REGIONAL INTEGRATION

AND

POVERTY

edited by

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Dr. Kweka has published several papers in the areas of Tourism economics, public finance, manufacturing and industrialization, trade and regional integration, and, economic reforms; and contributed to a published Book. His recent paper in refereed journal includes: 'Economic Potential of Tourism in Tanzania', *Journal of International Development*, 15, 335-351, 2003 (co-authored with O. Morrissey and A. Blake). He contributed a chapter in a book on '*The Form and Role of Industrial Innovativeness in Enhancing Firms' Productivity: The Case of Selected Manufacturing Firms in Tanzania'*; and reviewed several books in the *Journal of International Development* and the *Journal of Agricultural Economics*. Dr. Kweka has also worked on several consultancy project and presented papers in various workshops in and outside Tanzania. His recent assignments include the Investment Climate Assessment survey for Tanzania, for the World Bank, and ODI Contracted study on 'Identifying Linkages Between Trade and Poverty in Tanzania' as part of the DfID's Trade and Poverty Programme. In addition Dr. Kweka has consulted for the ILO, World Bank, ICTSD, UNIDO and UNDP.

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Present research concentrates on the economic impact of aid and capital flows; trade and non-policy barriers to export growth; and the political economy of policy reform. Books include *British Aid and International Trade* (with B. Smith and E. Horesh, Open University Press, 1992), *Evaluating Economic Liberalisation* (edited with M. McGillivray, Macmillan, 1999), *Globalisation and Trade: Implications for Exports from Marginalised Economies* (edited with I. Filatotchev, Frank Cass, 2001), *Economic Policy and Manufacturing Performance in Developing Countries* (edited with M. Tribe, Edward Elgar, 2001), Foreign Aid in the New Global Economy (edited with P. Burnell, Edward Elgar, 2004).

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Sheila Page has been a Research Fellow, Overseas Development Institute, London, since 1982. Previously she was at Queen Elizabeth House, Oxford, 1972, and the

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Dirk Willem te Velde (editor)

Dr Dirk Willem te Velde has been a Research Fellow at the Overseas Development Institute, London, since 2000 and specialises in trade and investment policy. He holds a PhD in Economics from the University of London. He has published around 30 journal articles and book chapters and recently completed an ODI book on *Foreign Direct Investment, income inequality and poverty*. He advises several international organisations and governments including DFID and the European Commission on trade and investment policy. Before joining ODI he was a research officer at the National Institute of Economic and Social Research in London.

List of abbreviations

ACP	African, Caribbean and Pacific countries
ACS	Association of Caribbean States
ADB	African Development Bank
AFTA	ASEAN Free Trade Agreement
AGOA	African Growth and Opportunity Act
AHSN	Animal Health Surveillance Network
AICO	ASEAN Industrial Cooperation
AIDS	Acquired Immune Deficiency Syndrome
AMU	Arab Maghreb Union
ANDEAN	Andean Community
APEC	Asia-Pacific Economic Cooperation
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ATPA	Andean Trade Preference Act
ATPDEA	Andean Trade Promotion and Drug Eradication Act
BIT	Bilateral Investment Treaty
CACM	Central American Common Market
CAN	Comunidad Andina de Naciones
CARICOM	Caribbean Community and Common Market
CBI	Confederation of British Industry
CBI	Cross Border Initiative
CCIA	COMESA Common Investment Area
CEMAC	Economic and Monetary Community of Central Africa
CEPGL	Economic Community of the Great Lakes Countries
CER	Closer Economic Relations
CET	Common External Tariff
CGE	computable General Equilibrium
CIF	Cost, Insurance, and Freight
COMESA	Common Market for Eastern and Southern Africa
CSME	Caricom Single Market and Economy
CTH	change in tariff heading
CUTS	Consumer Unit and Trust Society
DC	domestic content
DfID	Department for International Development
DFIs	Development Finance Institutions
DRC	Democratic Republic of Congo
EAC	East African Community
EAIDSNet	East African Integrated Disease Surveillance Network
EBA	Everything But Arms
EC	European community
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
EDB	Economic Development Board
EEC	European Economic Community
EEZ	Exclusive Economic Zone
EFTA	European Free Trade Association
EPA	Economic Partnership Agreement
ESIPP	EU/SADC Investment Promotion Programme

EU	European Union
FAO	Food and Agriculture Organisation
FDI	Foreign Direct Investment
FOB	Free On Board
FTA	Free Trade Area
FTAA	Free Trade Area of the Americas
FTZ	Free Trade Zone
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GSP	Generalized System of Preferences
GULFCOOP	Gulf Cooperation Council
HIV	Human Immunodeficiency Virus
IBRD	International Bank for Reconstruction and Development
ICD	Inter- Congolese Dialogue
ICM	Integrated Committee of Ministers
ICSID	International Centre for Settlement of Investment Disputes
IDA Ireland	Industrial Development Agency
ILO	International Labour Organisation
IMF	International Monetary Fund
IMMPA	Integrated Macroeconomic Model for Poverty Analysis
IMP	internal market programme
IOR-ARC	Indian Ocean Rim Association for Regional Co-operation
IPA	Investment Promotion Agency
IPS	Inter-Press Service
ISIC	International Standard Industrial Classification
IUU	Illegal Unregulated and Unreported fishing
LAFTA	Latin American Free Trade Association
LAIA	Latin American Integration Association
LT	long term
MC	import content
MERCOSUR	Southern Common Market Agreement
MFN	Most Favoured Nation
MIGA	Multilateral Investment Guarantee Agency
MNE	Multinational Enterprise
MOA	Market Opening Agreement
MRU	Mano River Union
MTS	Multilateral Trading Systems
NAFTA	North American Free Trade Agreement
NALDISA	The Tariff System of LAIA
NEP	New Economic Policy
NEPRU	Namibian Economic Research Unit
NT	National Treatment
NTB	non tariff barrier
OAS	Organisation of American States
ODI	Overseas Development Institute
OECD	Organisation for Economic Development Co-operation
OECS	Organisation of Eastern Caribbean States
PATCRA	Papua New Guinea Agreement on Trade and Commercial Relations
PNER	Primary School Net Enrolment Rate.

PRSP	Poverty Reduction Strategy Paper
PTA	Preferential Trade Area
R&D	Research and Development
RI	Regional Integration
RIA	Regional Integration Agreement
RoO	Rules of Origin
RTA	Regional Trade Agreement
RTP	Regional Trade Preference
SAARC	South Asian Association for Regional Cooperation
SACU	Southern African Customs Union
SADC	Southern African Development Community
SADCC	Southern African Development Co-ordination Conference
SAPTA	Agreement on SAARC Preferential Trading Arrangement
SDF	SADC Development Fund
SICA	Central American Integration System
SIDO	Small Industries Development Organisation
SIRESE	The Sector Regulatory System in Bolivia
SMEs	Small and Medium scale Enterprises
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
SPS	sanitary and phyto-sanitary
SSA	Sub Saharan Africa
TADs	Trans boundary Animal Diseases
TBT	Technical barriers to trade
TRIMS	Trade Related Investment Measures
UEMOA	West African Economic and Monetary Union
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Industry
UNECA	United Nations Economic Commission for Africa
URT	United Republic of Tanzania
US	United States of America
VAT	value-added tax
WB	World Bank
WTO	World Trade Organisation

Table of contents

Charts

Tables

Chapter 1 Regional Integration and poverty: Introduction

Dirk Willem te Velde

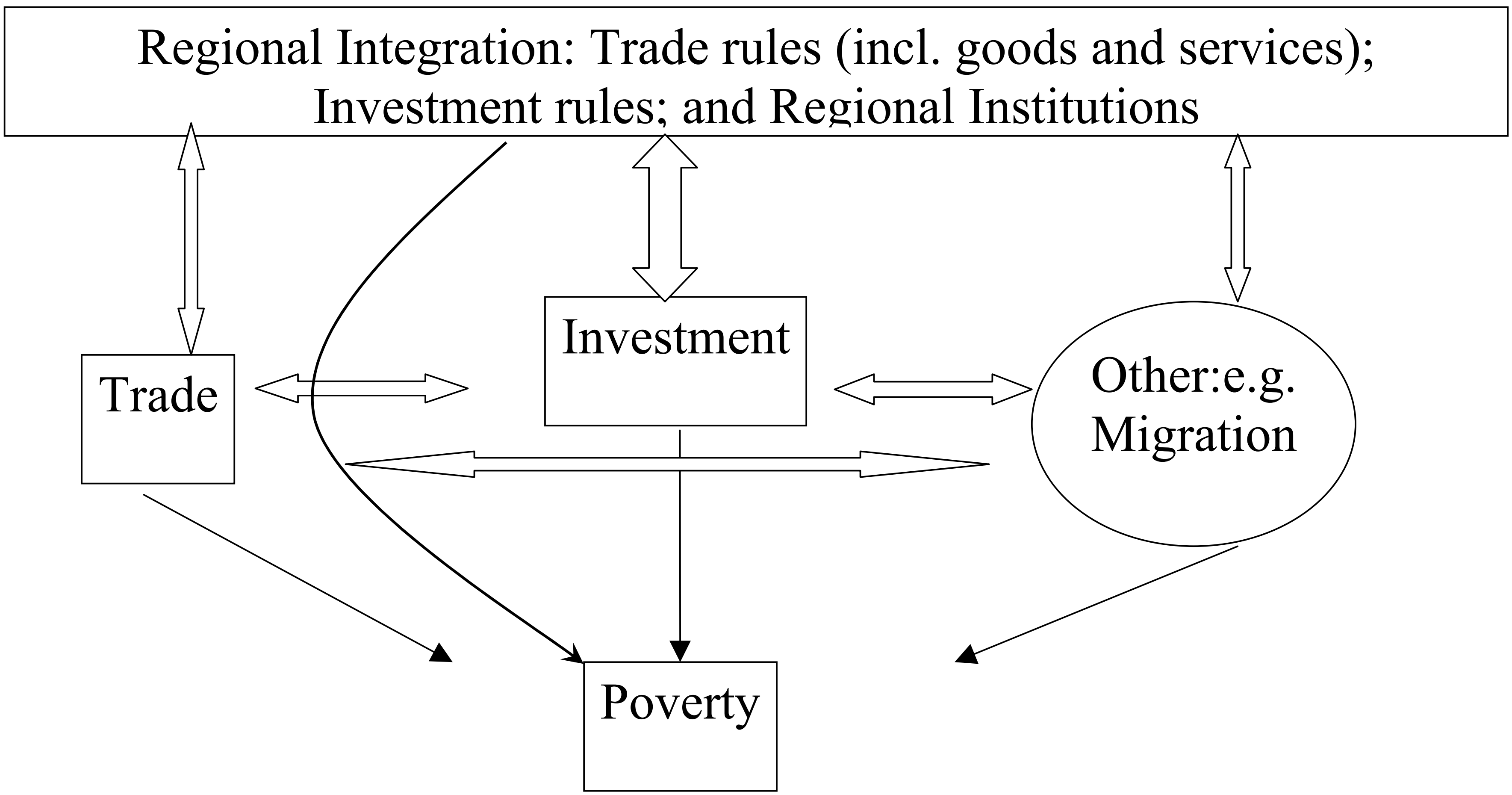
There is a renewed emphasis on fostering regional integration processes in the belief that this is good for development and poverty reduction. Unfortunately, a framework to map regional integration (RI) onto poverty does not exist, and so this premise is difficult to assess ex ante or even ex post. There is however a lot of research that is directly relevant. For some time now, there have been studies that examine the effect of RI on trade (at least as far back as Viner, 1950). More recently researchers have begun to extend this to RI and foreign direct investment. Ethier (1998) suggested that in the "new" regionalism countries seek to form regions in order to attract investment. Researchers have also begun to address the effects of trade and investment on poverty (see e.g. McCulloch *et al*, 2001; McKay *et al*, 2000; ODI, 2002). However, the evidence has never been put together into a single framework to address the links between RI and poverty. The purpose of this book is to provide such a framework. It is hoped that such a mapping exercise will inform those responsible for regional trade policy with respect to the presence of such links and where available with respect to the effects of available policy options on poverty. The resulting mapping should also be useful in identifying a checklist of areas relevant to assess the impact of RI on poverty in individual countries.

There are many ways in which a book on regional integration and poverty can be structured. We have chosen for a relatively simple approach (chart 1.1). Regional integration affects movement of products and factors of production across borders - trade in goods and services and movement of people and capital – which in turn affect poverty through various routes. Regional integration can also affect poverty directly though special initiatives and programmes (although strictly speaking some of this could be seen as movement of capital) and other functional co-operation. The movement of products and factors of production are related and there may be relevant relationships here. Finally, there may be feedback from economic variables back to the regional integration processes.

On this basis, we bring out three mappings describing how poverty in a country is affected by regional integration processes:

- RI can affect poverty through changes in volume and poverty focus of trade
- RI can affect poverty through changes in volume and poverty focus of investment
- RI can affect poverty through changes in volume and poverty focus of migration
- RI can affect poverty through other routes (including migration)

Chart 1.1 Mapping the Regional Integration Process onto Poverty



There are various reasons that further motivate to examine the subject of RI and poverty. First, the number of regional trade agreements notified under the WTO has increased rapidly in recent years (chart 1.2), with some regions much more advanced than other regions.[1] What effect does this have on development and poverty in developing countries? Secondly, (current) negotiations at the WTO are as usual slow and this has led some countries to focus on regional and bilateral trade negotiations. In the Americas, negotiations for a Free Trade Agreement of the Americas (FTAA) are well underway and were due to finish in 2005, and NAFTA, now ten years old, has inspired a range of other regions; in Asia, ASEAN has recently started discussion with other Asian countries.

The formation of a region may be seen as a tool for development but this is not always the only or even the main reason for countries to come together. The EU's development policy is based to a large extent on supporting the formation of regions amongst developing countries. The European Community is currently initiating negotiations on Economic Partnership Agreements with African Caribbean and Pacific regions under the Cotonou Partnership Agreement before 2008. The EU appears to assume that the question is not whether a region should be formed, but rather what type of region can help to achieve development objectives such as poverty reduction.

However, there remains a number of unanswered questions related to how regional integration effects poverty. For example, there is a lack of a suitable framework to analyse how regional integration affects poverty. There has also been insufficient attention to the detail of regional provisions on trade, investment and others. Finally, there has been very little analysis of the effects of regional integration on poverty in individual countries. This book will address these issues.

The book is in three parts. Part I deals with conceptual issues and evidence so far. The aim is to provide a theoretical structure or mapping of regional integration on poverty. There are three chapters in part I by Te Velde, Page and Morrissey. Chapter 2 discusses the top part in chart 1.1, how regional provisions affect trade, FDI and migration. Chapter 3 discusses how trade, FDI and migration affect poverty. Chapter 4 combines the main routes of chapters 2 and 3 and presents the building blocks for a mapping from regional integration onto poverty.

Part I argues that much evidence is based on multi-country or multi-region studies, deals with averages and fails to identify which provisions in which RTAs have what effect (on trade, FDI, poverty etc.) in which country. Studies that examine the effects of regional integration often use simple dummy variables to describe regions. This is problematic for those who want to negotiate the best possible type of region: in reality no region is the same and some guidance is required on best-practices in provisions in RTAs. For many other links we do not have evidence at all.

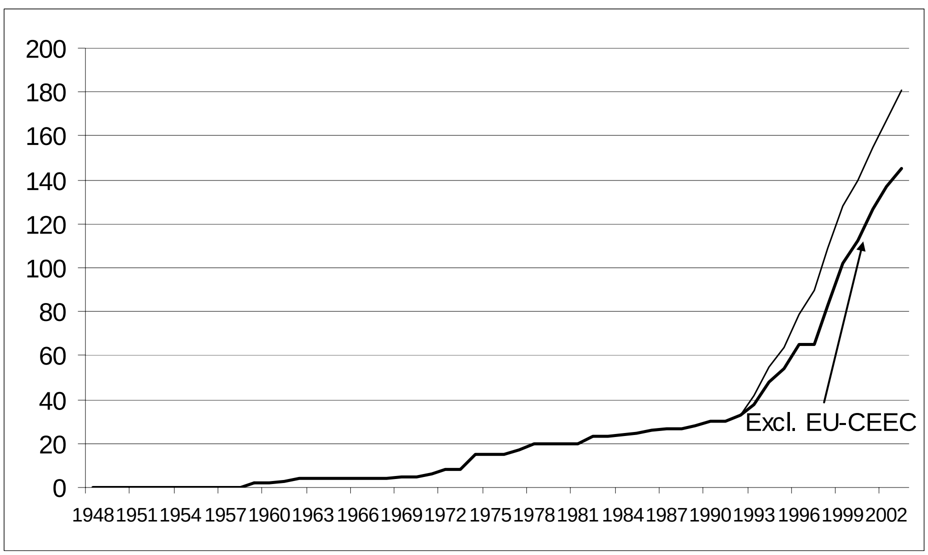
Therefore, in part II (chapter 5), Te Velde and Fahnbulleh measure trade and investment provisions in several key regions and discuss how these affect investment.

[1] The EU and CEECs account for a significant number of agreements, between them and amongst them.

The chapter confirms and describes that regional provisions differ markedly across RTAs and across time.

Most analyses of regions are at the regional level not at the country level. Part III addresses the effects of regional integration on poverty in two countries. This provides a good test of the mapping structure set out in part I. There are various countries that would be relevant for this and Part III will discuss the experience of two countries, Bolivia by Nina and Anderson in Chapter 6 and Tanzania by Kweka and Mboya in Chapter 7. Bolivia is part of ANDEAN, is an associate member of MERCOSUR and member of other regional groupings and has been included in the EU and US GSP systems. It has also one of worst poverty records in Latin America. Tanzania is a member of regions such as East African Community (old and new) and SADC and is also part of others such as GSP systems and the Cotonou Agreement, but withdrew from COMESA. While the implementation of regional trade provisions has been slow in Tanzania, it does not appear to have been much slower than comparable countries. Chapter 8 provides a brief conclusion.

Chart 1.2 The number of GATT/WTO notified RTAs in force



Source: WTO

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PART I REGIONAL INTEGRATION AND POVERTY: CONCEPTUAL ISSUES AND EVIDENCE SO FAR

Chapter 2 Regional integration, trade, foreign direct investment and migration

Dirk Willem te Velde, Sheila Page and Oliver Morrissey

As discussed in the introduction, there has been a remarkable proliferation of RTAs in the second half of the 20th Century, with more than 100 different agreements ratified. The first wave of regionalism in the 1950s to 1970s did not include many provisions beyond trade in goods. The second wave started in the 1990s (Ethier, 1998). The 1990s wave is often referred to as 'the new regionalism' as it has a number of distinctive characteristics. First, whilst the old regionalism of the 1950s/1960s typically involved RTAs that were 'North-North' or 'South-South', the new regionalism has been typified by several 'North-South' arrangements like NAFTA, Asia-Pacific Economic Cooperation (APEC) and EU with North African and Latin American countries. Second, many recent arrangements have been intercontinental. Third there are increasingly cases of multiple membership. Finally, many recent agreements have aspired to deep integration with commitments to harmonisation of regulatory measures, freeing up of factor movements with provisions for services and investment.

There are various ways in which RTAs or regional integration efforts affect national economies. We can distinguish between competition and scale effects, and trade and location effects. Competition and scale effects arise because national economies become more closely integrated, with a larger market permitting the economies of scale to be achieved and bringing producers in closer contact thus leading to efficiency gains. Trade and location effects arise when the RI changes the pattern of trade and location of production.

Most direct effects of RI work through trade on member and non-members (2.1), FDI (2.2) and migration (2.3) which we discuss below. Other effects of RI may be harder to capture, such as dynamic efficiency gains, and can be indirect. We return to these issues chapter 4.

2.1 Regional Integration and trade

The literature on Regional Integration and trade is an old one and dates back at least to Viner (1950). The theoretical literature was often concerned with whether regional integration was welfare enhancing. We do not attempt to discuss this theoretical literature in depth, but will provide a brief review, with an emphasis on empirics, is needed for the framework to analyse RI and poverty.

Viner (1950) suggested that the effects of regional integration on trade can be either *trade creating* when trade replaces domestic production, or *trade diverting* when partner country production replaces trade from the rest of the world. This implies that RI can lead to further trade, but this is not always welfare enhancing. Reflecting this, RI is not always revenue enhancing, and could in fact reduce national welfare in the case of trade diverting and loss of tax revenues.

2.1.1 Trade in goods

In the past decade there have been various attempts to address the relationship between RI and trade. Some studies distinguish between the effects on intra-regional and extra-regional trade. One example, Frankel (1997) found that the Regional Integration raised intra-regional trade by 65 per cent in the EC and 150% in Mercosur and Andean. Table 2.1 contains selected studies on the effect of RTAs on trade, in particular on intra-regional trade. Frankel and Rose (2001) show that RTAs have a big average effect on intra-regional trade. Soloaga and Winters (2001) show that the effects can differ amongst RTAs, with some positive and others negative effects. They show that the new wave of regionalism in the 1990s (new blocks and revamping of old blocks) has not led to further intra-regional trade. Further, they show that only the EU and EFTA may have led to trade diversion and the other blocks to trade creation.

Table 2.1 Regional trade agreements and merchandise trade: selected studies

Study	Type of equation		RTAs include	Effect RTA on trade
Frankel and Rose (2001)	Gravity equation explaining log of bilateral trade volumes using control variables such as distance, language, currency boards, income and others	Indirect using dummies	Dummy for the EEC/EC; the Canada-US FTA; EFTA; the Australia/New Zealand closer economic relationship; the Israeli/US FTA; ASEAN; CACM; PATCRA; CARICOM; SPARTECA; and the Cartagena Agreement	1.1 (Coefficient) (0.10) – standard error
Soloaga and Winters (2001)	Gravity equation explaining log of bilateral import values using control variables such as distance, language, income and others	Dummies for RTA trade amongst member states, region imports and region exports	EU EFTA ASEAN Mercosur CACM LAIA ANDEAN GULFCOOP	Negative and significant dummies for EU, EFTA, ASEAN . Positive and significant dummies for GULFCOOP, NAFTA, CACM, LAIA, ANDEAN, MERCOSUR. However, no significant difference in dummies before and after new wave of regionalism. Trade diversion in EU and EFTA.
Estevadordal and Robertson (2004)	Gravity equation explaining log of bilateral import values using control variables such as distance, language, income and others	Preferential Tariffs (one aspect of RTA)	LAIA NAFTA And US-Latin America and EU-Latin America under GSP	Tariff elasticity significant between -0.8 and -1.7

There are many ways in which an RTA can affect intra and extra regional trade. The previous studies account for this simply by including a dummy, but a more detailed account would examine how trade rules within RTAs, such as tariff liberalisation and rules of origin, would affect trade.

Regional Tariff Preferences

The key market access negotiations within RTAs focus on tariff reduction, particularly to what degree parties to RTAs grant each other regional trade preferences. Tariff preferences can be set at a fixed level or a percentage deviation from most-favoured nation (MFN) tariffs. Table 2.2 shows differences between MFN and regional tariffs. Unilateral and multilateral tariff reductions will erode the absolute level of regional trade preferences.

Table 2.2 MFN tariffs and regional preferential rates: selected examples.

	Average applied MFN	*Average applied regional*	*Absolute preferential tariff reduction (as percent of price)*
SAPTA (1996) / SAARC			
Bangladesh	17.5	15.8	1.4
India	33.5	24.1	7.0
Nepal	20.7	18.1	2.2
Pakistan	21.7	19	2.2
Sri Lanka	21.9	15.3	5.4
South Asia	26.4	20.3	4.8
AFTA (2001) / ASEAN			
Brunei	2.6	1.0	1.6
Indonesia	7.2 (2002)	4.4	2.6
Laos		5.0	
Malaysia	7.3	2.4	4.6
Myanmar	5.6 (1996)	3.3	2.2
Philippines	7.3	4.8	2.3
Singapore	0	0	0.0
Thailand	16.8 (1999)	7.4	8.0
Vietnam	16.0	3.0	11.2
ASEAN-region		3.5	
MERCOSUR (2001)			
Argentina	12.7	0.4 (1996)	10.9
Brazil	14.6	0.0 (1996)	12.7
Paraguay	13.2 (2000)	0.8 (1996)	11.0
Uruguay	13.8	0.9 (1996)	11.3
NAFTA			
Canada	7.7	1	6.2
Mexico	16.5	1	13.3
US	5.5	1	4.3
ANDEAN (2001) / CAN	13.6	0	12.0
Bolivia	9.6	0	8.8
Colombia	11.6	0	10.4
Ecuador	11.2	0	10.1
Peru	11.6	0	10.4
Venezuela	11.9	0	10.6

Sources: WTO, IPS (2000), own calculations.

Estevadeordal and Robertson (2004) review existing and provide new empirical work showing that preferential tariffs do have a large and significant effect on bilateral trade, see also table 2.1.

Rules of Origin

Rules of origin constitute another trade rule that can affect location decisions. Rules of origin differentiate trade regimes, to ensure that goods that enter a country receive the correct import treatment. Proof that the imported product was produced in a party to the regional agreement would be sufficient to obtain preferential treatment as applied in the region. However, this may become complicated if products are partly produced and processed in a member of the region and partly outside the region. Rules of origin provisions govern when such products can benefit from preferential treatment and when products will be treated as originating from outside the region.

There are three main methods that determine where a substantial transformation takes place (WTO official document WT/REG/W/45, 2002). First, the *change in tariff heading* (CTH) method origin is granted when a processed good falls under a different tariff classification (e.g. Harmonised system usually at 4-digit level) from the imported good used for processing. Secondly, the *percentage criterion method* determines that a substantial transformation has taken place on the basis of a minimum percentage of the total value that must have been added in the exporting country (domestic content or DC) or a maximum percentage of value due to imports (import content or MC). Thirdly, the *technical test method* stipulates certain production or sourcing requirements in processing operations. There are advantages and disadvantages for different parties to an agreement for all three rules, which is why regions often decide to adopt more than one rule, especially if there is a dominant country, as in NAFTA or SADC.

Rules of origin can include provisions for cumulation. Such provisions describe the conditions under which imported inputs can be regarded as domestic content in the exporting country s that final products will more often benefit from preferential tariffs. Some RTAs allow for bilateral cumulation, where inputs from importers and exporters are regarded as domestic content. Diagonal cumulation allows that inputs from non-parties are regarded as domestic under certain conditions. Full cumulation allows that all processing in the whole RTA area will be regarded as domestic. This would be more generous than bilateral cumulation when domestic content of the exporting county is low, but the regional content is high.

Other concepts discussed in more detail elsewhere include tolerance and absorption levels (see WTO official document WT/REG/W/45, 2002, and Estevadeordal and Suominen, 2003). The *tolerance* rule allows a certain percentage of inputs not originating in the exporting country to be used without affecting the origin of the final product. This can make it easier for products with non-originating inputs to qualify for preferences. The *absorption* rule allows parts or materials that under relevant rules of origin are regarded as not originating can be treated domestic in any further processing operation.

Empirical evidence on the effects of rules of origin on trade is scarce. The evidence that has attempted to address the issue shows that RoO can prevent growth in (intra-regional) trade flows and divert resources from their most efficient source, i.e. RoO can be so stringent that importers do not use tariff preferences which they would be due. Estevadeordal and Suominen (2003) summarise evidence that utilisation rates of preferential trade agreements can be low.

Non Tariff Barriers
There are non-tariff barriers to trade ranging from administrative requirements like customs control procedures to labour and environmental standards and these can have effects on investment. Technical barriers to trade (TBT) and sanitary and phyto-sanitary (SPS) measures can also affect trade. For instance, Barrell and Te Velde (2002) examined the Single Market Programme in the EU which began in 1986 with the removal of technical barriers to trade and the harmonisation of standards and showed that this has affected trade in varying degrees.

A barrier, which is not normally included in "NTBs", is the use of anti-dumping which is consistent with WTO provisions. Not only developed countries, but increasingly also developing countries use these provisions. Well known are the voluntary export restraints and (threats of) using quotas and anti-dumping by the EU in part motivating the Japanese to set up operations inside the EU.

2.1.2 Trade in Services

Little is known about the effects of RTAs on trade in services. At the multilateral level, the GATS governs liberalisation in trade in services. However, developing countries have also begun to design provisions in RTAs addressing trade in services. Some argue that the inclusion of such new provisions is part of the new regionalism (Dee and Gali, 2003). GATS Article V requires RTAs to be more liberalizing than the GATS. RTAs should have substantial sectoral coverage and provide for the "absence or elimination of substantially all discrimination" through elimination of existing discriminatory measures and/or through the prohibition of new or more discriminatory measures either at the entry into force of the agreement or on the basis of a reasonable time-frame. The substantial sectoral coverage in services refers to the number of sectors, volume of trade affected and modes of supply. No mode of supply should be excluded beforehand.[2]

Stephenson and Prieto (2002) define the components often found in regional (Western Hemispheric) service agreements on the basis of three elements: coverage, liberalising principles and depth of commitments.

- *Coverage* describes the four modes of supply (as in GATS: cross-border delivery, consumption abroad, commercial presence, and movement of people), and whether the agreements takes a negative list approach where all

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[2] There are four modes covering cross-border supply and returns to cross-border movement of factors in multilateral and regional agreements on services.

- Mode 1. Cross-border supply: when a service crosses a national border. An example is the purchase of insurance or software by a consumer from a producer abroad.
- Mode 2. Consumption abroad: when a consumer travels abroad to consume from the service supplier, such as in tourism, education, or health services.
- Mode 3. Commercial presence: when a foreign owned company sells services (e.g. foreign branches of banks).
- Mode 4. Temporary movement of natural persons: when independent service providers or employees of a multinational firm temporarily move to another country.

services sectors are included subject to exceptions (called non-conforming measures), or a positive list approach specifying the type of access offered to service suppliers in scheduled sectors.
- *Liberalising principles* include the fundamental principles of National Treatment (NT – no discrimination between foreign and domestic suppliers), Most Favoured Nation (MFN – no discriminations amongst source of foreign suppliers), Local presence requirement (is a local presence required to supply the service), quantitative non-discriminatory restrictions (e.g. on number of TV frequencies).
- *Depth of commitments* includes transparency (informing members of existing restrictions on services trade), ceiling binding, freeze or standstill on non-conforming measures (no return to less liberalisation), ratcheting, list or lose (non-conforming measures can be maintained only when they are listed in appendices) and future liberalisation.

Table 2.3 below compares RTAs in the area of services recently concluded by countries in the Western Hemisphere and ASEAN. The following points emerge

- Western Hemispheric RTAs are based on a negative list approach, except for MERCOSUR. ASEAN is based on a positive list approach.
- RTAs offer MFN, with the exception of CARICOM;
- ANDEAN, NAFTA and CARICOM require transparency, while ASEAN and MERCOSUR do not have such provisions. Transparency is required when changing measures related to trade in services.
- Many (NAFTA) of the above agreements have separate rules governing investment in services (mode 3 of services), though MERCOSUR regards investment in services as mode 3 of services supplies.
- ASEAN does not have a special chapter on monopoly practices, while ANDEAN, NAFTA and MERCOSUR do. CARICOM has a separate agreement on competition
- MERCOSUR and NAFTA (and CARICOM) *require* member states to encourage recognising titles of other member states, while in ASEAN tiles *may* be recognised.
- NAFTA includes provisions on government procurement of services. MERCOSUR has negotiations ongoing.
- Treatment of mode 4 (temporary movement of people) varies considerably. In MERCOSUR it depends on the scheduled commitments, and in NAFTA there are limited provisions related to business services providers only. CARICOM is in an advanced stage, allowing movement of people based on foreign establishments, and (when the protocol is ratified) allowing free movement of “skilled nationals”.
- ASEAN and MERCOSUR do not have rules regarding non-conforming measures, while ANDEAN, CARICOM and NAFTA are not allowed to schedule any new non-conforming measures.
- Most RTAs are quite ambitious, aiming to reduce all restrictions on trade in services within the coming two decades.

Table 2.3 Services components in selected RTAs

	ASEAN (Framework agreements on services, 1995)	ANDEAN (1998)	MERCOSUR (1994, to be ratified)	NAFTA (1994)	CARICOM (1997, to be ratified)
Sectoral coverage	According to schedules	Universal	According to schedules, all sectors by 2010	Universal	Not determined
Negotiating modality	Gradual, positive list	Negative list	Gradual, positive list	Negative list	Negative list
Most favoured nation	Subject to sectoral exemptions	Unconditional	Subject to sectoral exemptions	Unconditional	No
National Treatment	scheduled sectors subject to bound commitments	General obligation	scheduled sectors subject to bound commitments	General obligation	Yes
Transparency	Not included	Each Party will promptly publish all measures of general application	Each Party shall publish all measures	Procedures to be established to notify restrictions	No, but when ratified the protocol requires notification of existing restrictions and provisions on services providers
Treatment of investment	Commercial presence covered by specific sectoral commitments; separate investment disciplines	Right of establishment guaranteed for service providers; separate investment disciplines.	Commercial presence covered by specific sectoral commitments; separate investment disciplines	No local presence required, investment rules in separate chapter	While no national treatment is provided, it does establish that members shall not introduce in their territories any new restrictions relating to the right of establishment of nationals of other members states.
Safeguards	Provisions exist for Emergency Safeguard Measures and Restrictions to Safeguard the Balance of Payments	Provisions exist for Restrictions to Safeguard the Balance of Payments	Provisions exist for Emergency Safeguard Measures and Restrictions to Safeguard the Balance of Payments	No provision for safeguard action in services, but provisions in case of balance of payment difficulties (different for tare in financial services)	Provisions to safeguard the Balance of Payments
Monopoly practices	No	Disciplines to be developed for monopoly practices and exclusive service suppliers	Disciplines to be developed for monopoly practices and exclusive service suppliers	Yes, for monopolies and state enterprises	Monopolies not specified, but Agreement on competition
Recognition of titles	Each Member State may recognize the education or experience obtained, requirements met, or licenses or certifications granted in another Member State.	Each Party shall recognize the licenses, certifications, titles of professions, and diplomas, accorded by other Member Country, in which activity of services requires of such instruments, according to the established criteria in a Decision dealing with the matter.	Each state shall be encouraged its competent authorities to develop together with those of the other Parties mutually acceptable standards or criteria regarding the exercise of professional activities related to trade in services	Annex on professional services which requires members to encourage the relevant bodies in their respective territories to develop mutually acceptable standards and criteria for the licensing and certification of professional service providers, to provide recommendations on mutual recognition to the parties and to develop procedures for the temporary licensing of professional service providers of another party	Provision to establish common standards and measures for accreditation or, when necessary, for the mutual recognition of diplomas, certificates and other evidence of qualifications of nationals of CARICOM members
RoO	Benefits are denied to a service supplier who is a natural person of a non-Member State	Benefits of the protocol can be denied to a service provider from another member party, given notification and consultation, when this party demonstrates that the services provided by a person or country not part of Mercosur.	Benefits of the protocol can be denied to a service provider from another member party	Subject to prior notification a Party may deny the benefits to a service provider of another Party	It seems possible to deny benefits of the protocol to a service provider from member an non-member parties.
Government procurement	No	Government Procurement disciplines to be applied to services,	To be developed, but to be applied to services	Includes government procurement of services in separate chapter on government procurement	Not mentioned

		once developed			
Movement of natural persons	No	Freedom of Temporary movement guaranteed.	No, depends on scheduled commitments	Commitment regarding temporary movement of business services providers	Temporary movement of persons as services providers in connection with foreign establishment, incl. (family of) management, supervisions and technical staff; CARICOM skilled nationals act to be ratified before 2005 by all members.
Dispute settlement	A specific dispute settlement mechanism may be established	Provisions provide for procedures in the case of rules of origin dispute, including consultation	Disputes are to be settled according to the dispute mechanisms of MERCOSUR	Access to investor-state dispute mechanisms under chapter 11 on investment, see e.g. financial services chapter	No mentioning of this in the chapter on services
Exceptions	No	Yes	Yes	Yes	Yes
Restricting Non-conforming measures	No	No party will increase the number of existing non-conforming measures	No	Parties need to make reference to law when scheduling commitments.	Members will not introduce any new restrictions on the provision of services in the Community (standstill)
Special provisions	Financial services, basic telecommunication, maritime transport, movement of natural persons, and audio-visual	Financial services, basic telecommunications, and professional services will be elaborated in a near future	Financial services, basic telecommunications, maritime transport, movement of natural persons, and audio-visual	Financial services, air services, land transport, telecommunications, professional services, Temporary Entry for Business Persons	Professional services, air transport
Future liberalisation of trade in services	Gradual liberalisation through exchange of lists commitments.	Progressive liberalisation of a list of commitments through negotiations within a period of 5 years (by 2005).	Progressive liberalisation of a list of commitments through negotiations within a period of 10 years (by 2007).	To remove restrictions but allow for exceptions and reservations.	To achieve a complete elimination of the identified restrictions to the movement of people and capital throughout the region by 2005

Sources: OAS website and RTA chapters/protocol related to services

Nikomboriak and Stephenson (2001) discuss differences amongst RTAs. In particular they highlight the different approaches taken in ASEAN and those in the Western Hemisphere. The latter are based (mostly) on a negative list approach with commitments being "GATS-plus". ASEAN on the other hand is based on a positive list approach and so far with similar commitments as in GATS.

Table 2.4 Coverage of services in selected African RTAs

Region	*Coverage of services*
ECOWAS	Article 27 of 1975 Treaty on Community Citizenship Protocol on Free Movement of Persons and the Right of Residence and Establishment (1979) 1992 revised ECOWAS treaty affirmed right of entry, residence and settlement
SADC	Sectoral protocols (1996) on • Energy • Tourism • Transport, communications and meteorology SADC Draft Annex on Trade in services under discussion
EAC	Chapter 15 of 2001 EAC Treaty on co-operation in infrastructure and services
COMESA	Chapter 11 of 1993 COMESA Treaty on cooperation in the development of transport and communications Chapter 28, article 164, is on free movement of persons, labour, services, right of establishment and residence

RTAs clearly differ with respect to services agreements for various reasons. It appears that Latin American RTAs are most liberalised, followed by ASEAN in Asia while African RTAs have only just started to consider or implement provisions on services. The table below shows services provisions in African RTAs.

An important question is whether RTAs in services can provide a boost to (intra-regional) trade in services as has been the case for trade in goods, and if so, what strategies, or what elements, help to achieve this? The first part of the question depends on whether an RTA can provide a credible margin of preference for regional services providers on the one hand, and the extent of commitments on the other hand. The Latin American RTAs seem to have achieved a credible margin of preference over GATS, by including more transparency and stability for services providers through a negative list approach and a list of non-conforming measures, and has also included more liberal schedules. So in principle RTAs will be able to provide a credible margin. However not all regions actually do this. The second part of the above question in terms of optimal strategy is difficult to answer, as there is little evidence whether developing country RTAs (do not) boost trade in services, let alone on what type of RTAs are most effective.

2.2 Regional Integration and foreign direct investment

There are various ways through which RTAs can influence FDI and vice versa. We can distinguish between investment rules (3.2.1), trade rules (3.2.2) and other links (3.2.3).

2.2.1 Investment rules

Investment rules are rules governing cross-border investment in the region and usually consist of rules on treatment and protection of FDI contributing to the "investment climate". Investment rules do exist in a handful of RTAs[3] although they are not as common as trade rules, particularly amongst the poorer developing countries. Some regions include voluntary principles (e.g. APEC voluntary principles) while other regions include rules with effective dispute settlement procedures. We discuss a number of investment provisions in regional treaties (scope, standard of treatment, performance requirement, expropriation and dispute settlement mechanisms) and their expected effects on the volume of FDI.

Scope

The scope of investment treaties deals with the definition of investments and investors and the extent to which the treaty applies to member and non-members. Sometimes investment in general is included, while other agreements include FDI only. Provisions in some RTAs apply also to non-member states when they invest in the region from another location in the region (e.g. performance requirements in NAFTA). The scope also can also be used to determine whether investment rules apply to listed sectors only (positive approach) or to all sectors in principles with listed exceptions (negative approach).

[3] Investment rules also appear in bilateral trade arrangements (e.g. Singapore-Japan), but more often appear in bilateral investment treaties.

Standard of treatment

While many RTAs would include fair and equitable treatment, more contentious are whether investment rules provide national treatment or MFN treatment to post-establishment operations or to pre-establishment issues. Most liberal are those RTAs that include national treatment to members with respect to pre-establishment, subject to exceptions, as investors would have the right to establish a subsidiary anywhere within the region, and would be treated the same as national investors. The fewer the restrictions on establishment the easier it is to invest and so the more investment would be possible (though actual investment attraction depends on there being profitable economic opportunities). Such enhanced market access can be important and regional arrangement may include this and may thus be more liberal than is provided for in most multilateral and bilateral (except perhaps the US) investment treaties (see www.unctad.org for coverage and number of bilateral investment treaties. National treatment of foreign firms post-establishment usually refers to issues such as (abolition of) performance requirements.

Performance requirements

The more elaborate RTAs can include a section on performance requirements and the extent to which they cannot be applied to new and/or existing investment. Performance requirements are requirements imposed on the operations of MNEs and traditionally include export and domestic content (local sourcing) rules related to foreign goods producers. However, they can include more extensive requirements (e.g. employment) or deal with the service sectors in addition to the goods sector (e.g. NAFTA).

Performance requirements affect investment in a number of ways. First, by imposing requirements it may require foreign investors to use inefficient inputs or inefficient production processes. If this is severe this can lower the volume (and profitability) of investment. The potential benefit of performance requirements would be less costly for countries or regions that have built up a minimum supply capacity. It may be difficult to identify the effects of performance requirements on locational decisions in practice. Few sectors are covered by performance requirements. The automobile assembly sector is one sector that is often affected, and a sector where local content requirements can be effective because it depends on component parts. Sectors that are less dependent on inputs from outside the company would be affected less. Secondly, performance requirements may influence the type of investment, because performance requirements could affect quality of inputs used (and hence the profitability of investment).

Expropriation and nationalisation

Expropriation is a potential threat to interests of foreign investors if governments decide to nationalise subsidiaries of MNEs – though this seemed more likely to occur in the past in Latin America and Africa[4]. International law and regulations normally allow expropriation only when it is in the public interest, on a non-discriminatory

[4] Some cases take considerable time to resolve. For instance, in January 2003, Nestle settled an expropriation claim with the Ethiopian government dating back to the Ethiopian nationalisation programme of 1975.

basis and against adequate compensation. RTAs can contain such provisions that allow expropriation of property by the state on a non-discriminatory basis (national treatment and MFN). These provisions would add some comfort and diminish the non-commercial risks of an investment. Without other good reasons to invest, such provisions would not attract FDI on its own, but they could help to establish a favourable investment climate when offered as a package with other conditions.

Dispute settlements
Investment rules, including those on expropriation, are likely to be more effective when backed by some dispute settlement mechanism. There are various procedures, ranging from state-to-state to (foreign) investor-state dispute settlement procedures. In the event of an investment dispute, the more advanced regions allow for a consultation process leading to a panel review either between states or between investors and states. In some cases there are regional courts of justice, and in many cases disputes can be reviewed in the host-country or some independent arbitrator (when countries are a member) such as the Convention of the Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL). There is much debate about the ultimate effect of such settlements on development but it is likely that investors see some comfort in having them as they may reduce non-commercial risks. The presence of (access to) dispute settlement procedures may also form the basis for home countries offering investment guarantees against political risks in the context of bilateral treaties.

There is a heated discussion on how investment rules (bilateral, regional and multilateral) affect investment decisions. Generally a predictable investment climate can be in the interest of investors when they were previously disadvantaged. It is not clear whether this would lead to *additional* FDI or simply more comfort for the investor. It is however clear that surveys reveal that investors want a predictable investment climate (e.g. CBI position paper for WTO negotiations, EU survey of MNEs – EC, 2000), although not necessarily at the cost of other policy liberalisation (e.g. further trade liberalisation). The predictability of the investment climate may be enhanced when domestic policies are enshrined or locked into regional treaties. However, it remains unclear under what circumstances which investment rules would lead to additional FDI. Much will also depend on existing treatment. If treatment of existing investors in practice is already good or better than of domestic investors, new (regional) rules may add little to generating new investment or a better investment climate, other than offering a little more long-run security. There seems to be no empirical evidence that addresses the effects of individual investment provisions on FDI, so this is an area of further research.

2.2.2 Trade rules
There are three types of regional trade rules that may affect investment: regional tariff preferences, rules of origin and non-tariff barriers (which are not taken to include rules of origin). We discuss these with respect to the effects on intra and extra-regional FDI.

Regional Tariff Preferences
The elimination of intra-regional tariffs will affect trade vis-à-vis the level of sales by multinational subsidiaries depending on the importance of transport (incl. tariff) costs and plant-level and firm-level costs to set-up multinational subsidiaries (Markusen

and Venables, 1997, Brainard, 1997, Carr *et al*., 2001). Hence, the type and motive of investment plays an important role and to reflect this, the analysis will need to distinguish between intra-regional and extra-regional FDI and between horizontal (market-seeking: subsidiaries selling similar products) and vertical (efficiency and natural resource seeking: subsidiaries exploiting efficiencies or wanting control over input markets) FDI.[5]

Regional tariff preferences are likely to lower *horizontal* (tariff-jumping) intra-regional FDI because it may now become cheaper to serve the partner country by trade rather than to establish a subsidiary and incur plant-level costs more than once and firm-level costs only once. Of course when firm-level and plant-level fixed costs are zero, there would be no trade and no concentrated production facility or FDI – just national production. However, on the other hand, regional tariff preferences encourage *vertically-motivated* intra-regional FDI, because lower trade costs will provide incentives to establish international production networks and establish an efficiency seeking subsidiary in a partner country which can process imports for re-exports. An example includes the increase in US – owned production in Mexico partly as a response to NAFTA (nut not through "maquiladoras" which were in operation before NAFTA, see e.g. Gruben and Kiser, 2001), although domestic Mexican regulation has also played a role.

Extra-regional FDI can also be affected by declining regional tariff preferences in different ways. First, by lowering tariffs amongst parties to the RTA, it may become profitable for an extra-regional investor to avail of an effectively larger market (horizontal market seeking FDI) from one or more locations in the region (export platforms). If individual countries of a region were previously served by trade, this may then raise inward FDI (export platforms or beachhead locations, see also Ethier, 1998). However, if the member countries of a region were already served through sales of a multinational subsidiary, concentration of production may occur in one of a few countries in the region, with ambiguous or negative effects for the volume of extra-regional FDI in each country. The combination of lower internal tariffs and significant plant fixed costs would lead to a consolidation of several plants in several members of the region into one plant, which is being used by the parent to serve the region as a whole. This may also induce FDI inflows to the most cost-efficient location (usually nearest to the largest market), possibly at the cost of FDI to other

[5] In the past decades, trade economists have begun to broaden the trade theory and the 'new trade theory' now embraces increasing returns, imperfect competition and product differentiation in addition to the traditional comparative advantage paradigm. Recently, multinationals have been incorporated and made endogenous. The first attempts were by Helpman (1984) who integrated vertical multinationals and Markusen (1984) who integrated horizontal multinationals into the trade theory. Horizontal multinationals are multi-plant firms selling similar products in different locations. Vertical multinationals separate production geographically into different plants to intra-industry trade (in practice multinationals include both horizontal and vertical features). Markusen (1997) presents a unified approach to vertical and horizontal multinationals. Horizontal MNEs dominate if nations are similar in size and relative endowments and if transport costs are high. Vertical MNEs appear with headquarters in the skilled labour abundant country, provided that transport costs are high enough. National firms dominate if both trade costs are small and the home market is large enough: in this situation it makes sense to incur the fixed costs of setting up only one plant, from where to export. Within this framework it can be shown that trade and investment liberalisation are not substitutes and the two taken together may lead to a reversal in the direction of trade. Carr *et al*. (1998) provides a good empirical test of the framework, clearly showing the complexity and non-linearities affecting FDI and hence the relationship between trade and FDI.

members in the same region. This could be the case for market seeking multinationals. An example could be Unilever, which has traditionally invested in many developing countries including Bolivia, Argentina and Brazil. When confronted with lower trade (incl. tariffs) costs between Bolivia, Argentina and Brazil they may decide to rationalise production in fewer countries to exploit economies of scale or some other locational advantage (a process of rationalisation has recently taken place). The effects of regional trade preferences for extra-regional vertical (or efficiency-seeking) FDI is likely to be small, though lower regional preferences may lower costs and raise efficiency in the vertically motivated subsidiary when it uses inputs from more than one country in the region (e.g. possibility of regional enterprises in the ASEAN, ANDEAN or SAARC context).

There are various effects of regional tariff preferences on inward FDI. However, in the context of developing country regions, where most inward FDI is inter-regional even more so than in developed country regions[6], the market size argument would the most important, and apart from other factors regional tariff preferences would tend to raise inward FDI. It must be noted however that the strength of this argument depends on the difference between tariffs applied regionally and tariffs applied to others (MFN). With large regional markets, but low tariff preferences the effects is likely to be low. Table 2.2 provides data on this for selected countries.

Rules of Origin

Rules of origin constitute another trade rule that can affect location decisions. The effects of rules of origin (RoO) on investment can vary depending on the type of investment as well as the interaction with regional tariff preferences. The RoO can encourage the use of intra-regional inputs diverting away from extra-regional inputs even if these were more efficient. However, a stricter and more costly RoO would stifle intra-regional trade favouring extra-regional imports (which are likely to be levied the MFN tariff). The higher the difference between MFN tariffs and regional tariff, the higher the incentive to comply with the RoO by importing regionally using good certificates. This has effects for intra and extra regional FDI. For instance, it may encourage extra-regional FDI by setting up subsidiaries in the region to satisfy the RoO, possibly diverting investment made outside the region towards the RTA. Regional rules of origin applied to Mexico (NAFTA) would require many maquiladoras, such as Japanese and South Korean electronics manufacturers, to switch away from Asian sources of components and either need to find new suppliers in the US, Canada or Mexico, or encourage Asian suppliers to relocate to Mexico, creating a further extra regional inward FDI.

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[6] Intra regional inward FDI is 6 per cent of total FDI in ASEAN and 1 per cent in SAARC.

Table: Intra-regional FDI flows as per cent of total FDI

	EU (outward)	NAFTA (outward)	ASEAN (outward)	ASEAN (inward)	SAARC (inward)
1986	36	30			
1997	49	21		12	
1999	46	18	15	6 (2001)	1

Source: IPS (2000), ASEAN secretariat, UNCTAD, Rugman and Brain (2002)

According to Businessmap, even though South Africa is a major and growing investor in other SADC countries, this seems to count for only 25% of total FDI inflows. The FDI stock of non-SADC origin in South Africa is also greater than the stock of South African outward FDI.

We should distinguish between market-seeking and efficiency-seeking FDI (see Dunning, 1993) and extra and intra-regional FDI. MNEs based outside the region are more inclined to set up a subsidiary in the region to serve the regional market particularly when the difference MFN – regional tariffs is great, and when the RoO is strict. When the RoO are strict, the *extra-regional* investors need to set up all manufacturing and processing operations in one (or a few) country in the region to serve that market when it wants to satisfy strict RoO (see NAFTA example). This would not be worth it if either the difference between MFN and regional tariffs is low or when it is too costly / difficult to comply with strict RoO. Efficiency seeking extra-regional FDI would not be affected considerably, since such products produced in the RTA are likely to be (re-) exported to outside the region irrespective of RoO or regional tariff preferences in the RTA. Such re-exports to outside the region may often go to big developed country markets such as the EU, US and Japan, and for these exports preferential RoO are relevant (Cotonou, EBA, AGOA, GSP, etc.) not RTA RoO.[7] On the other hand some big developed countries have begun to form RTAs with developing countries (e.g. EU with individual East European and African countries) including RoO, but in this case we speak of *intra-regional* FDI.

The effect on intra-regional FDI can be complex, and would also depend on the type of operations. For instance high-fixed costs, market seeking operations would favour an establishment in one of the countries when tariffs are low as opposed to establishments in every member of the RTA. This is because the region can be served more cheaply through exports from a single (or a few) establishment in the region thereby realising economies of scale. Low-fixed costs operations could be expected to set up more efficiency seeking establishments in other members of the RTA when intra-regional tariffs are decreasing since it becomes cheaper to re-export regionally produced products. There is likely to lead to more intra-regional FDI in countries with few manufacturing capacities when RoOs are looser, e.g. allowing for diagonal or full cumulation so that others incl. non- members can supply the country that attract intra-regional FDI, than when RoO are stricter, when operations can use inputs only from one partner country.

Strict RoO can distort investment decisions when there is no CET (common external tariff) and MFN rates vary considerably, as in the case of NAFTA. Taking the example of NAFTA, strict RoO could prevent some extra-regional imports (or intra-regional production) into Mexico for processing and re-export to the US market, leaving investors to choose the US even though this may be an inefficient production location. A lower MFN tariff in the US compared to Mexico would only reinforce this trend. Another distortion can arise when using RoO provisions such as minimum domestic content, which can be easier satisfied when production costs are high (Estevadeordal and Suominen, 2003).

Non Tariff Barriers

As non-tariff barriers to trade have affected trade in varying degrees, they can also affect investment. NTBs include voluntary export restraints and the threat of imposing EU quotas and using anti-dumping against Japanese exports motivated the Japanese to

[7] Exception apply: e.g. Japanese efficiency seeking investors in Mexico producing for the NAFTA market.

set up operations inside the EU. Barrel and Pain (1999) found that after controlling for relative labour costs and market size, Japanese investment flows to EC countries over 1980-1991 were significantly influenced by anti-dumping activities taken in the EC.

Summary and further discussion

Table 2.5 provides a summary of possible links between trade rules and FDI. On balance it appears that RTAs should lead to increased extra-regional FDI, but more ambiguous results for intra-regional FDI. An important reason for the ambiguity of the effects of trade rules is that MNEs are motivated by exploiting firm-specific assets (e.g. firm specific fixed costs) and hence wants to enjoy economies of scale and scope, in addition jumping trade barriers.

It includes simple predictions as to how trade rules in RTAs affect FDI and compare well with the general literature on FDI and integration in developed countries, though some refinement is usually needed. For example, both Blomstrom and Kokko (1997) and Dunning (1997a) acknowledge that the effects of regional integration (trade rules) and FDI further depends on pre-existing rules in the region and the extent to which regional rules will actually change such rules. Countries and industries that are already integrated prior to regional integration due to geographical and historical reasons can expect to see more limited effects than other countries and sectors. A stronger actual change to the investment climate i.e. whether national policies are changed dramatically and locked into a regional framework, will reinforce these effects. On the other hand, this could also raise the risks of policy reversal and instable regions.

Table 2.5 Summary of possible links between trade rules and FDI

		Extra-regional FDI inflows			
		Market seeking	*Efficiency seeking*		
RoO loose	*Low intra/extra tariff difference*	negligible	Negligible		
	High intra/extra tariff difference	+	Negligible (6)		
RoO strict	*Low intra/extra tariff difference*	negligible	negligible		
	High intra/extra tariff difference	++ (2)	+ (1)		
		Intra-regional FDI flows			
		Market seeking		*Efficiency seeking (3)*	
		High fixed costs	*Low fixed costs*	*High fixed costs*	*Low fixed costs*
RoO loose	*Lower intra regional tariffs*	- (4)	?	? (5)	++
RoO strict	*Lower intra regional tariffs*	- (4)	?	? (5)	+

(1) It may be easier for investors to locate an efficiency seeking plant in one country of the region : cheaper imports processed for exports. This effect is more positive the more countries in a region supply the plant.
(2) Possibly Japanese in Mexico to serve US market (while for NAFTA it was market seeking, for Mexico it was efficiency seeking); the more stricter are ROO the higher the share of the production process in the market
(3) Relevant especically for mixed developed and developing regions
(4) Concentration of investment in one country: more trade and fewer individual plants
(5) Depends on trade-off between lower tariffs/transport costs and fixed costs
(6) This could be positive, e.g. in the case of Japanese efficiency seeking investors in Mexico that happen to service the rest of NAFTA.

Dunning (1997a) offers 4 hypotheses related to the impact of the single economic market (SEM) in the EU on EU inward FDI. First, the SEM will have a positive impact on intra-EC trade and an ambivalent effect on intra-EC FDI. Extra-EC defensive FDI could increase depending on the external tariff and efficiency seeking FDI may increase due to the competitive enhancing effects of integration, with possible investment diversion away from several investment locations towards the most suitable export platforms for the region. The SEM may diminish the importance of market size and growth and increase the importance of country specific strategic assets or location factors. Second, the SEM will have an ambivalent effect on the geographical distribution of FDI. There are however suggestions that economic integration will lead to a more concentrated geographical distribution of economic activity. Markusen (1995) argues that when countries become similar in size and wealthier, MNEs (reaping economies of scale) will come to dominate exports provided that transport costs are sufficiently high. The FDI/trade ratio will be higher in developed than in developing regions. Third, depending on both country and sector specific factors, the SEM will have an ambivalent effect on the ownership of production in the EC. MNEs are likely to dominate sectors where there are significant firm level economies relative to plant level economies and intra-firm co-ordination costs. Fourth, the consequences of the SEM will be sector specific and FDI will concentrate in those sectors that have characteristics conducive to MNEs, e.g. FDI intensive services, incl. banking and insurance and trade enhancing services.

When analysing hypotheses and empirical findings regarding the effects of the formation of the SEM in Europe, Dunning (1997b) makes several observations. First, the main dynamic impact of the FDI is through the effects on other determinants of FDI such as market size, income levels, structure of activity and agglomeration economies. SEM as an independent variable has raised extra and intra (less than extra) regional FDI not as much as other variables have increased FDI. Thirdly, the effects of the SEM are industry specific, with extra-EC FDI increasing more in FDI sensitive sector. Fourth, there was limited evidence that economic activity has become geographically concentrated as a result of the SEM, although high value added activities remained clustered and lower value activities became more dispersed. Finally, there is complementarity between trade and FDI.

There is no standard of a region, so it is obvious that regions differ. Chapter 5 documents that regions differ in two fundamental respects with respect to investment –related provisions:

- *Over time* when regions change or add investment related provisions
- *Across regions* when investment related provisions differ at one single point in time

The same chapter 5 shows that there are significant differences withy respect to investment related provisions in key regions differ significantly, including :

- Extent of regional tariff preferences
- Restrictiveness of Rules of Origin
- Investment rules, including national treatment for pre and post establishment and presence of effective dispute settlement mechanisms
- Regional co-ordination on investment

- Type of membership: North-North, South-South, North-South, South-South-North.

Regions (with an economic motive) that desire to formulate new or change existing investment related provisions might be helped by an analysis of their effects. The experience over the past three decades shows that regions can be subdivided into four categories with respect to investment provisions: 1) regions that do not have investment related provisions except for trade rules (most RTAs); 2) regions that impose a common policy toward investment (ANDEAN in the early 70s) that is more restrictive than individual member policies were; 3) regions that choose to develop a common approach gradually over time introducing provisions that stimulate regional investment co-operation and regional investment promotion and (begin to) grant national and MFN treatment (pre and post establishment) to foreign firms (ASEAN); and 4) regions that include comprehensive investment provisions from the beginning, including pre-establishment national treatment and effective investor-state dispute mechanisms (NAFTA).

In understanding the effects of RTAs on FDI, particularly in developing countries, the existing variation in investment related provisions across regions and over time has not yet been fully exploited. Existing empirical evidence has recently begun to address the links between RTAs and FDI. We will provide a more precise overview elsewhere, but table 2.6 provides a simple review of a few studies tentatively finding that RTAs in most cases boost extra-regional FDI and in some cases intra-regional FDI. Levy *et al* (2002) address the issue of regional integration and FDI at a basic level, using dummies for regions applying the analysis to the OECD databases thus excluding many developing countries. The market size effect is used but it is not a true market potential function as allowance for RoO and regional preferences have not been made. Other researchers have examined individual regions; Waldkirch (2003) and Monge-Naranjo (2002) for NAFTA, Chudnovsky and Lopez (2001) for MERCOSUR. UNCTAD (2003) includes a useful overview of several regions but does not provide new empirical research.

Only one recent study, Dee and Gali (2003), examines how “new” trade provisions in Preferential Trade agreements affect the patterns of trade and investment flows. They use gravity models of trade and investment between pairs of countries over 1988-1997. They include two type of indices: 1) covering “traditional” trade provisions regarding agriculture and 2) industrial products and “new age” provisions” covering services and other provisions such as investment rules. The indices are unweighted averages of scores on sub-categories. They also control for the usual control variables in gravity equations and include three dummies for each RTA provision to measure intra-regional effects, extra-regional effects on inward FDI and extra-regional effects on outward FDI.

Table 2.6 RTAs and FDI inflows, selected examples

Study	Research question; Region, countries and years; Methodology	Explanatory variables	Findings
Levy, Stein and Daude (2002)	How do RTAs affect the location of FDI? FDI from 20 OECD countries to 60 OECD/non-OECD countries, 1982–98	RTA membership, extended market host, extended. market source, capital/worker distance, market size, bilateral trade, inflation trade/GDP, privatisation capital/worker, investment environment, common border, common language	• RTA membership doubles FDI stocks on average FDI increases upon joining a FTA with: • more trade/GDP (openness) • more similar capital/worker • better investment environment • larger market
Srinivasan and Mody (1997)	Which factors determine US and Japanese FDI? 35 OECD and non-OECD countries, 1997–92, split out in groups of low-middle, high income countries; and EEC, Latin America, East Asia	Market size, labour costs capital costs,. previous FDI infrastructure (telephone, electricity), country risk openness	• When split by periods (1977–81; 1982–86; 1987–92), no evidence that IMP increased US and Japanese FDI (but we should bear in mind that IMP was complete only in 1993)
Brenton *et al.*, (1998)	Does European integration increase FDI? Does it divert FDI? Are trade and FDI substitutes or complements? FDI in and outflows, imports, exports for EU and CEEC countries	Population, distance, trade/FDI agreement dummies, host country economic freedom dummies, CEE dummies, host country EU membership dummy, FDI residual (in trade regression)	• Single European Act (1992) and Iberian enlargement : more FDI but no observed FDI diversion
Pain and Lansbury (1996)	How has intra- and extra EC FDI by UK and German forms in different sectors changed with the introduction of the Internal Market Programme (IMP)? UK and German outward FDI for seven sectors, 1980/81–92	Sector output, factor costs, currency volatility, corporate finance conditions, non-tariff barriers (1–3 scale), IMP dummy, sector dummies	• FDI determinants differ over sectors • IMP introduction boosted FDI • IMP redirected UK FDI from US to EC

The traditional trade provisions affected both intra regional inward FDI stocks and extra regional inward FDI stocks in SPARTECA (investment creation), but only extra regional outward FDI in the EU and US-Israel RTA (investment diversion). The new age provisions led to net investment creation in EFTA, EU, NAFTA, MERCOSUR, SPARTECA, CER, net investment diversion in AFTA, and no impact in ANDEAN and US-Israel (tables 4-7 in Dee and Gali, 2003).

While this study has gone someway in understanding the effects of different provisions in regions on trade and investment flows, many questions have remained unanswered. For instance, their study does not address all RTAs or any with African countries; they do not include a lot of developing countries, focusing their attention on RTAs relevant for Austalia; they do not compare provisions over time – while provisions can change over time (as e.g. in ASEAN); they lump all "new" trade provisions together; finally, it is not clear which type of countries within regions gain (most).

2.3 Regional Integration and migration

There are various ways in which RTAs deal with migration. OECD (2002) distinguishes between:

- RTAs that provide for full mobility for people. For instance, the EU covers free mobility of workers and non-workers. COMESA foresees free movement of labour by 2025. Such agreements provide for full access to labour markets (in the case of the EU there is a currently some controversy about the effects of enlargement on intra-regional migration, and most old members states have imposed temporary controls on migration from the new members).
- RTAs that provide for mobility of certain types of people. A prime example is CARICOM which has a separate agreement on the movement of skilled nationals. It allows allowing movement of natural persons based on foreign establishments, and (when the protocol is ratified) allows for free movement for 'skilled nationals' and access to labour markets.
- Other RTAs that use provisions under GATS (mode 4) with some elements. Table 2.3 on provisions on services includes a row which deals with temporary movement of people. Some agreements facilitate the temporary movement of people. In particular, APEC has introduced an APEC business travel card facilitating visa procedures.

There are marked differences in provisions on migration or temporary movement of people. There can thus be different effects on the movement of labour within a region, although the evidence tends to show minor effects. At one extreme when full mobility of labour is granted (Treaty of Rome, EU) this has not led to significant labour mobility (intra-labour mobility covers 0.2 per cent of the total EU population, World Bank 2003). At the other extreme, GATS type commitments in regions does allow for temporary movement of people and even in this situation movement is severely limited by qualification requirements, economic needs tests and residence requirements (and thus dependent on FDI regimes).

There are few studies that examine the effects of RTAs on labour mobility. Those that are available find that there is little effect (e.g. Fuchs and Straubhaar, 2003). Intra-regional mobility for the EU is estimated to be less than 1 per cent, despite large wealth gaps between Southern and Northern European members, and persistently high unemployment differentials across countries. There also appears to be no effect of the Nordic Common Labour Market (Denmark, Finland, Sweden and Norway).

2.4 Regional integration and cross-border investment: other links

There are various other links between RTAs and FDI. Provisions other than the trade and investment rules include free movement of people (CARICOM) and free transfers of profits which can all facilitate the establishment of intra-regional FDI. Many other provisions are region specific and cannot be easily categorised.

For instance, some regions (ANDEAN, ASEAN, MERCOSUR) have co-operation schemes which sometimes aim to establish regional enterprises by promoting joint ventures. The ASEAN region seems to be one of the most advanced in this area. The ASEAN Industrial Cooperation scheme (AICO Scheme) seeks to promote joint manufacturing industrial activities between ASEAN-based companies. More than 100 projects have been selected for special tax and tariff incentives. The initiation of these schemes may also help to foster the regional integration process as opposed to being the result of regional integration.

Some argue that the effects of RTAs on FDI are not so much about trade and investment rules, but about the increased predictability of the investment climate by locking-in general reforms (regulation, competition policies, property rights, contract enforcement, guaranteed access to members' markets and stable trade policies) in a wider context. The fact that national policies are "locked" in regional treaties should give investors additional security that policy reversals are less likely, reducing non-commercial risk. In practice this argument would depend on how strong the region is vis-à-vis individual members in practice. The argument is also related to signalling, that signing an RTA signals an intention which can be regarded as favourable to investors.

Many argue that important effect of RTAs on FDI are dynamic, with competition creating a more efficient industry and growth, which in turn can affect FDI . Neary (2001) includes dynamic effects in a theoretical model of describing MNEs. First, there is the tariff-jumping motive as discussed before: FDI is favoured over exporting the higher the external tariff and the lower the fixed costs of a new plant. Second, the export platform motive could affect FDI as lower intra regional tariffs would favour a single plant in the region. Finally, lower intra-regional tariffs would lead to increased competition from stronger domestic firms and hence fewer FDI. On the other hand, a more efficient private sector can also raise efficiency seeking investment by becoming efficient regional suppliers as well as raise strategic asset seeking investment.

Blomstrom and Kokko (1997) also argue that regional integration leads to efficiency gains and higher growth, and thus further FDI. FDI can actually be such a catalyst through spillovers in terms of technology transfer and other linkages with local firms. There can thus be long-lasting effects on growth and productivity as opposed to a one-off effect based on a more efficient allocation of resources.

While regional integration can lead to more extra regional investment for the region as a whole, this may not lead to more FDI in each individual member. As discussed briefly before, the extent to which polarisation or uneven distribution takes place depends on the level of external MFN tariffs, strictness of RoO, market size and agglomeration effects in individual member countries. If polarisation takes place this could lead to conflict of interest amongst member states in maintaining a region and facilitating regional efforts to address investment. While increased intra-regional FDI could be expected to enhance the integration process, competition for FDI between member states can do the opposite. The attempt to reduce such competition is thought to be one of the reasons why Mercosur has begun further talks on investment issues (Chudnovsky and Lopez, 2003) – and the EU and NAFTA have included provisions on capping incentives. UNECA's annual report on regional integration shows that there is an expectation that cross-border investment and trade could lead to closer integration. If regional integration leads to further FDI with equal benefits, this could start a virtuous circle. If, however, FDI benefits member states unequally this may actually put the region in jeopardy.

Despite competition amongst RTA member states for the same FDI, which Oman (2000) argues has increased over the 1990s, it is possible to think of co-operation when competition has become too fierce or costly, or when joint investment promotion may bring benefits shared across the region. ASEAN has organised ministerial-level joint investment promotion activities to major developed country markets, with the aim to convey a strong regional image. The ASEAN secretariat has also begun various activities in the area of investment facilitation, by providing information through portals, databases, publications and statistics. It can thus be said that a region can do much more to try to promote investment than design and implement trade and investment rules. They can put in place the regional infrastructures (legal, institutional etc.) to deal with investment issues at a regional level.

Apart from trade and investment rules and regional institutions, regions can also decide to harmonise fiscal and monetary policies. For instance the Euro area (within the EU), the UEMOA and 4 out of SACU members (within SADC) have common currencies. This reduces intra-regional exchange rate variability and may reduce cross-border transaction costs, which are amongst the factors contributing to investment. Because the EU and SADC and SCAU are incomplete currency areas, there should be implications for which parts of the region are influenced.

2.5 Conclusions

The chapter has shown that regional integration affects trade, FDI and migration in a number of different ways. We found that regional integration is associated with increased intra-regional trade (and in several cases trade creation), as well as with increased FDI from outside the region. The chapter emphasised that there are many different regional provisions which can have different effects. It is important to understand the peculiarities of each region.

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Chapter 3 Trade, foreign direct investment, migration and poverty

Dirk Willem te Velde, Sheila Page and Oliver Morrissey

3.1 Trade and poverty

Examination of the relationships among trade, trade policy and poverty shows (Page 2001, Bird 2003 for an extensive discussion and bibliography) that trade can have significant effects on total income and on its distribution, and therefore on poverty. Both the macro-economic and the sectoral and distributional effects are now well studied (and even sometimes exaggerated, Freeman, 2003). The direct impact on poverty of particular changes in trade can be traced, through price, employment, and fiscal effects to incomes, and then through household analysis, to the income and assets aspects of poverty. If policy such as a regional agreement or its ending (unlike normal trend changes in trade) creates abrupt changes (losses of a whole sector), the effects may be more severe. If opening to trade increases or decreases the vulnerability of an economy to large variance in income, this may have important impacts on poverty as the poor are less able to adjust to changes. More opportunities in trade (through imports or access for exports) are likely to increase national income and may increase efficiency sufficiently to increase growth. Any of these income effects may have direct effects on poverty (the evidence is that it is likely, but not inevitable), and clearly will have effects on the potential to reduce poverty. This, however, depends on government policy response.

If we assume that countries have the objective of reducing poverty and that they have the administrative skills and institutions to redistribute income, then we need look only at the first round effects of a change in trade: if this increases income, then poverty can be reduced. If we take the more reasonable approach in a development context, that countries face problems of skill and institutions in implementing policies, then we must look at where the initial benefits from trade come from: do they reduce the prices of the goods purchased by or produced by the poor? Are any negative changes impossible to reverse through policy? If we assume that even if governments do not have poverty reduction as an objective, other governments (donors or trading partners) have some internationally given ‘right’ to impose this target on them, then we can look only at the first round effects (and even this requires an assumption that governments cannot redistribute for administrative reasons).

Output and growth effects

In traditional terms, opening to trade (or to more trade) should raise a country’s income (its potential welfare) by permitting it to change the composition of its output to a more efficient structure, that is, permitting it to specialise according to comparative advantage. This produces a one-off increase in total national income, and may, through the effect of an increase in output on investment, cause some further increase in output.[8] This assumes that prices are operating as correct signals (or that they are altered to remove distortions as part of the opening of the economy) so that transmission effects work, and that there are no binding obstacles to growth. If instead the economy (or at least those elements which are opened to trade) is assumed to be operating with other constraints, of inefficiency for example, then greater integration will not necessarily increase output (but equally is unlikely to have a negative effect). The traditional efficiency gain is problematic faced with increasing evidence that external openness is not necessarily associated with reduced domestic price distortion, but at a minimum it can contribute to reduced price distortion and therefore to some increase in efficiency.

Transmission effects may not function as directly (or as smoothly and fast) as analysis suggests, because the country economy is not fully integrated or because of policy interventions, insulating individuals from either good or bad effects, or postponing or attenuating them.

Trade does not raise all incomes, and may lower some. One obvious example is if a trade policy change is from protecting some sector either through restricting imports or through subsidising exports, towards opening. Total income will normally rise, but it is clear that some in the protected sector will lose, unless there is immediate and perfect mobility out of it. And if some institutions depended on the subsidies, for example marketing arrangements (Winters, 1999 p. 4), then the losers may not be confined to the sector which is liberalised (all who used the marketing boards will lose a service). Normally, it is not the poorest (who are, probably, politically weakest) sectors which are protected, so normally a shift of income away from a protected sector to other sectors is more likely to improve poverty or income distribution, than to worsen them, but this is not certain.

Fields (2001 p. 101) notes that 'it has proved far easier to generate economic growth than to change the Gini Coefficient. In the developing world, GDP per capita grew by 26 percent between 1985 and 1995...while Gini coefficients in the world barely changed over the same period'. What is not clear from this observation is what 'easier' means in this context: growth has been the objective of most developing countries during this period, not inequality, so it may indicate no more than that countries have succeeded more in what they were trying to do than in something which was at most a secondary objective. A detailed analysis of projections of possible growth and/or inequality paths, in an attempt to determine whether the development targets for reducing poverty by 2015 are feasible, found that >except for the very poorest countries, policies which spread the gains from growth more evenly will lift people out of extreme poverty more effectively than plausible increases in the overall rate of growth (Hanmer and Wilmshurst 2000 p. 9). And, although the precise

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[8] While there a lot of evidence on trade, trade policy and growth regarding the goods sector, there comparatively less on trade in services. Surveys of recent work (OECD, 2003) also indicate that services trade liberalisation offers benefits. Three sectors offer strong benefits. Efficient financial services contribute to investment and growth, and foreign providers offer potential gains. Efficient transport services can reduce substantially the costs of trade. Telecom services are an important element in effective communications and dissemination of information. The problem is ensuring competitive provision in relatively small markets; there is a need for safeguards that protect consumers as well as foreign investors.

elasticities depend on the shape of the inequality curves, in general the more unequal a population, the smaller the effect of growth on poverty.[9]

Fields also (2001 p. 190) finds that examples where growth has led to all distinguishable income groups seeing an increase in income (and, for the reverse: all suffering from a fall) are quite common, looking across the experience of the Asian countries, but also some Latin American. But inequality has increased in many of the cases, so that if inequality as well as levels of income is part of the welfare function, the results are not unambiguously good or bad.

Distribution of trade effects

The most common area in which to look for explanations of how growth affects poverty or income is in composition effects: 'The composition of economic growth and the inequality of a society have a significant effect on the relationship between growth and poverty reduction' (Weiss, 2000), justifying the analysis of poverty in terms of sources of income. While the direction of effects from individual elements of trade or other international integration or from growth to the economic variables is normally clear, or subject to known influences, even if difficult to quantify in particular cases, the interaction of all the effects can only be analysed under strict assumptions about the general equilibrium of an economy, and assuming either no policy or very specific policy changes. As well as the obvious practical difficulties of modelling and analysing economies which are in the process of major structural change (from development, even if there is no change in their integration), the policies themselves will react to the changes, so the analysis becomes undetermined. Here, we will look at the direct, partial effects.

Increased specialisation makes the characteristics of the sectors in which the country has a comparative advantage a particularly important determinant of the direct impact of trade on the economy. In developing countries, this is often initially a primary product, either agricultural or mineral, but later it can become a specialised manufacture or service. If it is a product also consumed (or used as an input) in the country, growing specialisation in its production may lower consumption costs, and increase the return to output in the country, as well as the income from the exports; if it is not directly used in the country, and if the income from production is not distributed appropriately, there will be more pressure on the country's institutions to redistribute the income both to support other development and to increase the income of poor households. Thus the nature of the export helps to determine how important it is to have effective fiscal and social institutions in order to get the optimum effects on poverty.

Trade theory argues that increasing the openness of an economy improves the return to factors which are less scarce in the country than in those to which it opens (it

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[9] Because of differences in the degree of inequality, general conclusions that on average reductions in poverty are closely correlated to increased in average income are not helpful. Gallup, Radelet and Warner 1998, cited in McKay et al 2000 find 'that some cases show less than proportionate growth..., but argue that these are balanced by cases where the poor have done better than average' (p. 28). It is not clear in what sense the fact that the poor in some countries have done well 'balances' the fact that they have done badly in others: it seems more logical to rephrase this as that the effects depend on the policies and the existing distribution of income than to attempt to draw generalisations which do not answer the specific question (see also Dollar, Kraay 2000).

moves their price, and therefore their return, nearer to the other levels). For countries with abundant labour, this is likely to mean an improvement in the distribution towards wages, but for those where natural resources, whether agricultural, mineral, or scenic (in the case of tourism) are the principal advantage, it may instead shift the distribution towards returns to holders of these, that is towards profits and rents. Where the move is towards labour, it is likely (for a developing country) to be towards labour that is unskilled relative to world levels, so that there is 'mixed evidence on the effects of greater openness on relative skilled-unskilled wages' (McKay et al 2000 p. 19), made more uncertain by different countries' definitions of the boundary.

The labour which gains may not be the lowest skill level by national standards. Producing internationally competitive products requires some habituation of labour, if not what would be defined as training to 'skilled' level. It is, however, likely to increase total employment. This may increase the employment of the less skilled through substitution at various levels of untraded and already traded activities, as the more skilled move into the new traded sectors. Thus where labour is a country's main advantage in international trade, there is likely to be an improvement in the distribution of income at least to the less well off, and probably to some previously unemployed. This is likely to include some defined as poor. But, as discussed above, if a country had protected its manufacturing industry before liberalising and increasing its trade (McKay et al 2000), then removing this distortion may counterbalance some or all of the potential gains to labour income. The potential opening of trade in services would increase this bias of positive trade effects on labour intensive countries.

The greater specialisation encouraged by trade may make individual producers/households more vulnerable to shocks, and if neither the economic unit (because it is too small or lacks access to capital markets) nor the country (because it is poor or administratively lacking) has a suitable income-protection or insurance scheme, then small producers who decide to specialise may be more vulnerable to income shocks and poverty following an opening to trade. It could be argued that they have made a choice; to go for the more risky, but higher income path of specialisation rather than sticking to a still feasible joint production strategy, but they may also lack information about the nature of more specialised markets. The policy question is whether the implication of this is that there should be less openness to trade to encourage small producers or fewer small producers, to allow the country to have the advantages of greater trade. Providing income support may be particularly difficult and costly for a poor developing country. It may be better to shift to larger trading units (it is notable that in all developed countries most trade is by large companies).

But if mobility of labour among different types of work or different sectors is high, then any increase in income will come through more strongly and losses from any falls will be reduced, as people shift from losing to rising sectors. And in practice, especially in poorer households in informal or agricultural activities, many of these separate interests are actually the same people or companies. All are consumers. Many producers of exports use imports. Many people and companies may be involved in the production of a variety of products, including both import substitutes, which may lose, and exports and potential exports which may gain. Therefore it cannot be assumed that all losses correspond to or allow us to identify 'losers' from trade.

What poverty is to be measured?

There are differences in the concept, in the quantification, and in the approach to analysing poverty. The simplest economic definitions depend on income or capital, expressed and measured in money terms. Most quantification based on this measures income-type concepts, not capital The income may include imputed non-monetary income (subsistence, public services). But when the definition is modified to include either additional economic or new non-economic elements, these are normally expressed and measured as forms of asset or capital: health characteristics, education levels, access to financial capital, perhaps plus measures of non-economic assets like empowerment or exclusion. Although much empirical discussion of the impact of trade on poverty finds significant effects from wealth distribution factors, in particular land distribution, capital is not normally found in analysis of trade's effects on poverty.

Current research is emphasising the time dimension of poverty. Adjustments down (reductions in output, employment, and therefore income) can normally be very rapid. New activities, investing in the capital and labour resources, producing and marketing new products, require adjustment time. Fluctuations in income have more effect on those who are poor than on others. Researchers are now trying to distinguish between the chronically poor and the transitorily (perhaps in response to a shock) or even seasonally poor. Trade can increase the probability of some types of shock, but would normally be expected to reduce the size and frequency of shocks (by increasing the range of possible markets and sources of consumption goods).

Definitions which start from either analysis or surveys of what 'the poor' want are also based on income (if only to identify the 'poor' whose wants are to be measured). Such surveys suggest that the poor would add elements like health or education characteristics, but also other, apparently non-economic, needs: 'a sense of insecurity or vulnerability; lack of a sense of voice vis-à-vis other members of their household, community, or government' (Farrington et al 1999). These may be related to income or relative income, but cannot be directly 'purchased' by reallocation of spending as education or health can potentially be. They may suggest a need for institutions as well as income or market redistribution to equalise outcomes.

For both conventional income or capital and power/vulnerability measures, it would be desirable but is normally impossible, for the unit of analysis to be the individual. In most countries, this is the unit on which power and voice in government are based (subject to exclusions like children), and it is the normal base for welfare analysis in economics. The existence of different distributions of power in households is paralleled by different effective access to income (and capital). But there are rarely data on intra-household stocks or flows or relationships, and in practice most analysis of the impact of policy on poverty has tended to go in the opposite direction, of treating households as the unit, and assuming that households take a collective 'livelihood' approach to all the different types of income and expenditure found within the unit. Another approach would carry the emphasis on sources of income to the extreme, to look at 'classes' of those dependent (entirely or predominantly) on particularly types of income, and assume that these can be treated together as having the same interests (a definition of a Marxist approach, Cogneau, Robilliard, 2000, p. 7).[10]

Policy responses

While most effects of trade unambiguously lead (eventually) to an increase in national income, the direct consequences for the distribution of this among households (and within households) are not necessarily the most favourable for reducing poverty, and may have temporary or permanent effects that increase it for some people. Therefore, the principal determinant of the effect of trade on poverty is likely to be not any of the factors determining the initial distribution of effects, but the policies followed (or not followed) by the government to redistribute income or assets, through taxes, support for incomes, and provision of public goods, temporarily through safety nets or permanently. The increase in national income permits increased spending (whether public or through redistribution of income to households) on education and health, seen both as components of welfare in their own right and as contributing to future welfare by increasing productivity. It also permits increased investment, on infrastructure (water provision, transport, basic financial and marketing services) and directly productive activities, and any effects on growth (as discussed under the output effects) will also stimulate increased demand for investment. Over time, the increase in the size of the economy and the increased availability of specialised resources from abroad increase the efficiency of the structure of the economy, by providing the scale necessary for basic commercial and financial services to operate.

If this pattern of short-term losses and long-term gains holds, it raises a basic policy question: whether it is better to try reduce poverty in the short run by increasing or preserving production in the traditional sector (which may be difficult: the possibilities of production increase may be limited, so that productivity and income can only be increased by transferring labour out), and thus increasing or stabilising the income of the poorest in the short run, or to encourage the modern sector in order to accelerate the transfer. The decision requires choosing among different targets (poverty, distribution, total income).

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[10] The 'livelihood' approach is a mixture of capital and income measures (of assets and activities). It is an extended version of the income plus other economic elements approach, based on the total capital available: financial, human, natural, and social (Farrington et al 1999). Further additions, like 'clean water and other services which are required to prevent people from falling into poverty' (Farrington et al 1999) can be made, but to be consistent these would need to be based on an analysis of rigidities either in the economy or in public provision of services which would prevent individuals from obtaining these by using the 'income' or capital included in the basic measure, or on rigidities in utility functions. If each of 'a range of livelihood outcomes (health, income, reduced vulnerability, etc.)' is to be considered an end in itself, not a component of aggregate utility or welfare, this would not accept the trade-offs basic to normal utility analysis. It is not clear that they should be considered additional or merely a component of the minimum basket of goods on which poverty lines or other income measures can be based. To the extent that they are based on 'other streams of analysis, relating for instance to households, gender, governance and farming systems', this may imply findings of rigidities, and the emphasis on structures, processes, and institutions is a useful way of conceptualising the rigidities which may require looking at multiple impacts and objectives. As its proponents point out, 'it is essentially an integrating device, helping to form and bring together the perspectives which contribute to a people-centred...approach...[It] does not replace other approaches but builds on them'. It uses detailed quantified analysis for variables for which this is possible. By starting from the population on which effects are to be measured, it also avoids omission of negative indirect effects (if the impact of one effect is to alter that of another) (Ashley 2000 p. 19).

Whether governments can redistribute any addition to national income and whether they will do so will depend initially on the share of any increase going to the government in taxes or easily available to it in taxable sectors, and then fundamentally on its social objectives, political will, and administrative competence. Any increase in income can be captured by appropriate taxation, but for increases in trade there are also direct effects. For many poor countries, tariff revenue is a major source of revenue, and administratively one of the easiest and cheapest to collect. Trade taxes are particularly important for small countries (where trade is a high share of total income and output) and for many Least Developed countries (McKay et al 2000 cite an IMF result that for 36 it is 'nearly one third of total tax revenue or around 5% of GDP, p. 22). For this reason, tariff reform is normally assumed to require simultaneous increases (or introduction) of other taxes. The least market distorting practical tax is normally an indirect tax (VAT), but if the government wants to 'distort' incomes in favour of the poor, either an income tax or a discriminatory sales tax, combined with subsidised or free provision of desired social services, will be more appropriate. The important point to note is that unless specific action is taken to alter other taxes, lower tariffs may reduce the share of government revenue, at a time when the risk that the increase in national income may go, under some conditions, more to the high income than to the poor requires the share to increase.

3.2 FDI and poverty

FDI and development

There are many areas in which FDI affects development

- employment and incomes
- capital formation, market access,
- structure of markets,
- technology and skills,
- fiscal revenues, and
- political cultural and social issues.

We can distinguish between static and dynamic effects and FDI can have positive and negative dynamic effects on development in all of these areas. While FDI was traditionally seen as an additional source of capital, vital for the development of countries with insufficient economic capacity and infrastructure, and where domestic saving rates are low, the view that FDI can also bring new techniques and skills is also important. This can lead to growth and eventually to poverty reduction.

As FDI is associated with direct costs and benefits as well as indirect costs and benefits, a simple quantitative measure (FDI flows, direct employment, wage levels, etc.) is not sufficient as a means of assessing the impact of FDI on development. There are three alternatives

- detailed econometric studies assessing one aspect of the investment, for example, productivity spillover effects.
- cost-benefit analyses, valuing the costs and benefits of all aspects of an investment.
- qualitative accounts comparing outcomes in similar situations but with alternative policies in place.

While the first two approaches are criticised for not being able to construct a 'strategic counterfactual', the qualitative approach may not address cause and effect adequately. Outcomes of all approaches may further depend on the time framework and sector of analysis.

There is a heated discussion about the impact of FDI on development, and at least a significant part derives from the observation that (foreign) multinationals are different from local (non-multinationals) firms. Foreign multinationals tend to be larger, pay higher wages, are more capital and skill intensive and introduce more up-to-date technology (see e.g. Dunning, 1993 and Caves, 1996). Some characteristics of multinationals relate simply to the size of the firm, which itself is often related to higher pay, more training and usage of the latest technologies (Tan and Batra, 1997). However, controlling for factors such as size, foreign ownership is still related to better performance.

Output and growth effect

When discussing the econometric evidence of FDI on growth and productivity, there are different types of econometric studies. Macro and meso studies usually find positive and significant correlations between FDI and GDP per capita or productivity. This may come as no surprise as FDI tends to locate in higher value-added industries. It is often not clear whether productivity increases at the macro level are driven by spillovers to and learning effects in local firms, or only because of a composition effect. It is thus important to understand *whether* and *how* positive spillovers to local firms occur because FDI associated with positive spillovers has long-lasting effects for development whereas FDI without spillovers may have only one-off effects which may disappear when the foreign investors leaves the country.

Micro-econometric studies can account for the composition effect testing whether local firms can improve their productivity as a result of foreign presence. It must be noted, however, that spillover studies are usually confined to the manufacturing industry. A significant body of evidence (e.g. Haddad and Harrison, 1993; Aitken and Harrison, 1999; Djankov and Hoekman, 2000) finds that the productivity level of foreign firms is higher than in domestic firms (but there are some exceptions, see Matsuoka, 2001, for Thailand) but that the effects on productivity levels and growth in domestic firms are mixed. As a result of foreign firms, domestic firms in the same sector could be better off as (foreign) competition forces them to upgrade technologies (as in the case of Indonesia, see Blomström and Sjöholm, 1999). They could be worse off when foreign firms take the market of existing local firms (as in Venezuela, suggested by Aitken and Harrison, 1999). Or they could not learn at all as the productivity gap is too large to learn anything (as in Mexico, see Blomström, 1986). In Morocco, Venezuela and the Czech Republic, the presence of foreign firms lowers productivity *growth* in domestic firms.

While useful in themselves, the above econometric studies do not specify how spillovers occur (Mortimore, 2004). There are various authors that have tried to set the literature on FDI and development in the framework of learning by local firms. Lall and Narula (2004) argue that FDI *per se* does not provide growth opportunities unless a domestic industrial exists which has the technological capacity to profit from the externalities from MNE activity. Thus an understanding of how technological knowledge is acquired is relevant to how FDI affects development. There are widely varying experiences, with some countries having used FDI to upgrade domestic firms, while other countries have been less successful. Countries are most successful if the use policies to maximise the impact on learning in local firms. The long-run effect on growth will also be greater when the domestic sector benefits. One such effect works through linkages, and learning through linkages is greatest when domestic firms have built up an absorptive capacity.

Distribution of investment effects

The links between FDI and income inequality are complex. We may distinguish between the effects on wage inequality and on non-wage income inequality. The following general effects play a role:

- *Skill-specific technological change.* In addition to initial efficiency differences, FDI could induce faster productivity growth of labour in both foreign (technology transfer) and domestic firms (spill-over effects). If such productivity growth is skill-biased (for example, information technology), FDI may increase skill-biased technological change (Berman and Machin, 2000).
- *Skill-specific wage bargaining.* Skilled workers are usually in a stronger bargaining position than less-skilled workers because they posses key skills in relatively scarce supply and may have better negotiation skills to negotiate higher wages.
- *Composition effect.* Foreign firms tend to locate in skill-intensive sectors or skill-intensive segments within sectors. If FDI causes a relative expansion of skill-intensive sectors, this will improve the relative position of skilled workers and raise wage inequality (Feenstra and Hanson, 1995).
- *Training and education*. FDI may affect the supply of skills through firm-specific and general training and through contributions to general education. While foreign firms generally train more than their local counterparts, after controlling for other factors that are positively related to training such as size, much training benefits skilled workers.

The above points show that FDI can be expected to increase wage inequality in contrast to prediction by traditional trade theory (in the 2 by 2 skilled/unskilled labour variant of the Heckscher Ohlin model) that FDI reduces wage inequality in developing countries because FDI would allow developing countries to specialise in less-skilled intensive activities. However, because there are many possibly opposing effects, empirical testing is required.

In addition to the effects of FDI on wage inequality, there can be effects on non-wage income. For instance, FDI may increase profits and the return to capital, relative to other types of income such as that of the self- employed and employees. Real wages have decreased over the past two decades in many Latin American countries implying that capital owners have benefited more from the economic reforms. This could have helped increase income inequality. Other effects on income inequality could be indirect, for instance through the effects on fiscal revenues and expenditures. These could nonetheless be very significant or the main link to inequality for certain types of investment (e.g. natural resource based FDI).

ODI (2002) summaries recent evidence so far. Most evidence on the relationship between inward FDI and wage inequality at the macro level is for developed countries. Blonigen and Slaughter (2001) find that multinational activity was not significantly correlated with skill upgrading within US manufacturing sectors over the period 1977-1994, but Te Velde (2001) finds evidence for a sector bias towards using skilled workers. Figini and Gorg (1999) find that FDI was, up to a point, associated with skill upgrading and increased wage dispersion in Irish manufacturing over the period 1979-1995, while Taylor and Driffield (2000) find significant effects of FDI on wage dispersion in UK manufacturing.

With regards to the evidence for developing countries and Latin America in particular, Feenstra and Hanson (1995) find that inward FDI increased the relative demand for skilled labour in Mexican manufacturing over the period 1975-1998. In some localised regions, FDI can account for over 50% of the increase in the labour wage share in the late 1980s.

Studies that include a wide range of countries tend to find little systematic effect of FDI on inequality. Freeman et al. (2001) find no evidence for a consistent relationship between FDI and wage inequality in a large sample of developing countries. Vivarelli (2004) find a neutral impact for 45 developing countries in the 1990s, but their analysis is based on the more general Gini measures of inequality (which include wage and other inequality).

But this does not mean that FDI has no effect on (wage) inequality in all individual countries. Te Velde and Morrissey (2004) provide macro evidence for the effects of FDI on wages and wage inequality in five East Asian countries (Korea, Singapore, Hong Kong, Thailand and Philippines). Wage inequality has been low and decreasing in some but not all East Asian countries. Using ILO data for wages and employment by occupation, they did not find strong evidence that FDI reduced wage inequality in five East Asian countries over the period 1985-1998. Controlling for domestic influences (wage setting, supply of skills) they found that FDI has raised wage inequality in Thailand. They also found that FDI raises the wages for both skilled and low-skilled workers. Te Velde (2003) provides further evidence for Latin America arguing that FDI raised wage inequality in Bolivia and Chile, while having no to very small effect in most other Latin American countries. The macro evidence thus shows that FDI does not tend to reduce wage inequality but may increase it in some cases.

The empirical evidence on foreign ownership and wages at the micro level shows that:

- foreign-owned firms pay more to their workers than local firms. Wage differentials can be up to 60%, but are often more modest;
- studies that do not control fully for other effects (size, location, industry, etc.) overstate the effect of foreign ownership on wages; and
- studies that distinguish between average wages in two separate skill categories find that wage differentials are greater for non-production (relatively skilled) workers than for production (less skilled) workers.

An issue of current interest is whether FDI can contribute to the objective of reducing poverty, ODI (2002). This will depend on how the gains from FDI are distributed, among sectors, workers and households. Systematic evidence on the effects of FDI on income distribution and poverty in developing countries was discussed before. In principle, there is no direct link between FDI and poverty reduction – this does not include 'socially responsible' investment which may directly benefit the poor– but there are three possible indirect links.

- If FDI contributes to export growth, productivity growth and finance for the balance of payments, it supports increases in national income that offer the potential to benefit the poor. In this case FDI does not reduce poverty directly, but it helps to create an enabling economic environment.
- If FDI increases employment it may help some to move out of poverty. With the exception of FDI in textiles, a lot of FDI in manufacturing is likely to employ labour that is relatively skilled (in terms of the local market), and would not directly benefit the poor. Well-developed linkages with local suppliers may increase employment of various skill groups.
- Foreign firms may pay higher wages than local firms for workers with similar qualifications. Because of the skill bias of FDI this will not directly affect the poor and is likely to increase inequality of wage incomes, increasing the skilled/unskilled wage differential, and to increase urban/rural income differentials. However, by establishing a higher paid labour force and developing a better skilled effects depend on the country, sector and time framework of interest.

Lee and Vivarelli (2004) edited a book about globalisation, education and poverty. In it Lall argued that the effects of globalisation on employment are content specific and depend on specific circumstances as well active policy interventions. Indeed, generally little is known about the impact of FDI on employment. Most authors tend to examine the effects on income distribution rather than on employment generation or income growth. Spiezia argues that FDI has more positive employment effects in richer developing countries than in poorer developing countries. So while the FDI-employment link is potentially important in reducing poverty, the relationship is not always positive or negative, and it is not the only route to poverty reduction.

Policy responses

Most econometric work on the effects of FDI on development tends to ignore economic and policy factors affecting the link between FDI and development. It is often shown that FDI is correlated with growth and productivity, but this masks the fact that different countries with different policies and economic factors tend to derive different benefits and costs of FDI. Whether the positive effects of FDI outweigh the negative effects will depend on the economic and policy factors in the host country as well as the sector and the strategies of multinational affiliates. Recently, researchers have begun to stress the importance of local capabilities (educated and trainable workforce, see, e.g., Borensztein et al. (1998), investment in R&D see e.g. te Velde (2001), the ability to conduct an outward oriented trade policy, see e.g. Balasubramanyam et al., 1996) in deriving benefits to the local economy. One implication could be that countries with relatively few local capabilities are less able to derive benefits from FDI. On the other hand, however, researchers have also suggested that countries have more to gain the further they have to catch-up.

With respect to the effects of policy on the distribution of investment effects, there are potentially ways in which government and business can co-ordinate their actions or form partnerships in order to improve the impact of MNEs on the development of the poorest workers. Such opportunities are most likely to arise when government and business actions interact. The following areas, where the business and development cases are linked, deserve further attention (Te Velde, 2003).

- **Education and Training**. MNEs will train their workers more when workers have a good and appropriate basic education. Governments could therefore consider whether the quantity and quality of basic education is sufficiently geared towards areas of economic expansion and the needs of MNEs. Governments may also consider providing incentives (public-private partnerships in training, subsidies, taxes, standardisation) for more training of less-skilled workers, particularly in larger firms.

- **Health.** A healthy workforce is in the (business) interest of the MNE and a healthy population is a government priority. In the case of epidemics, MNEs and less-wealthy governments may join to fight the disease as witnessed in Southern Africa. Neither partner could fight the epidemic on its own. The government may have limited funds, while the provision of health care for (future) employees can make economic sense.

- **Supplier development.** MNEs will source locally when local quality suppliers are present. There may be a role for the government to provide an enabling environment for private sector development and to actively support linkages between MNEs and local firms in a market-led way. This would involve matching local suppliers with MNEs and upgrading the basic capabilities of local firms. Well-developed Investment Promotion Agencies (IDA Ireland and Singapore EDB) already perform such tasks through national linkage-support programmes. MNEs may then develop their suppliers further. An example of supplier development in Latin America related to the Intel plant which has more than 100 suppliers. The Costa Rican government is helping local suppliers to become more competitive (see Larrain *et al*, 2000).

- **Infrastructure.** It may be in the interest of both the MNE and local communities to provide local infrastructure. A combination of MNE activities and government funds may maximise the benefits to the development of infrastructure in host countries.

3.3 Migration and poverty

Output and growth effects
The literature on migration is emerging and this chapter will only briefly deal with migration. The static gains of migration can be shown on the basis of a variation of the 2 by 2 Heckscher Ohlin model. If both trade in goods and capital flows are not permitted, labour flows would also achieve factor price equalisation in a situation where labour is optimally allocated. Simulations using general equilibrium models, based on many assumptions, provide estimates of the static gains of migration. If developed countries permitted movement of labour up to 3 percent of the total labour force, world incomes would rise by $156 billion (Winters, 2002). Developing countries would be the main gainers and the net welfare for the home region Africa would be $14 billion. While clearly most of such gains are related to developed – developing migration there may also be some (but obviously lower) benefits for developing country regions.

But there are static and dynamic effects. It is useful to distinguish between effects on labour sending countries and labour receiving countries (World Bank, 2003). The benefits of the sending country are threefold. Labour emigration reduces unemployment and raises wages. Once emigrated workers send remittances back home which are an important source of external capital flows for developing countries. Table 3.1 shows that remittances to developing countries amount to $80 billion, about half more than aid flows. For Sub Saharan Africa remittances are about a third of FDI flows. The emigrated worker can acquire skills abroad, which can be useful once the worker returns. Obviously, the emigrated work will initially translate into a loss of human capital in the sending country, or a brain drain cost. The receiving country will initially gain by importing labour that can be put to work in areas of labour shortages.

Table 3.1 Worker remittances to developing world (2002)

	$ bn	% GDP
Total	80	1.3
East Asia and Pacific	11	0.6
Europe and Central Asia	10	1.0
Latin America and Caribbean	25	1.5
Middle East and North Africa	14	2.2
South Asia	16	2.5
Sub-Saharan Africa	4	1.3

Source: World Bank (2003)

Distribution of migration effects

North-South migration is usually done by skilled workers, while there appears to be some evidence that the poor migrate less (e.g. a poverty constraint, see Clark *et al*., 2003, and Hatton and Williamson, 2001). This may relate to the migration of medium to high skilled workers in education, IT and health to developed countries. However, this may be less so for South-South migration, see e.g. migration to the South African mines. Thus (North-South) migration is likely to benefit the relatively skilled workers directly. However, indirectly remittances may also benefit poorest countries and workers. The type of migration may also affect income inequality. If migration is in those skill groups that are relatively unskilled for the receiving country, this may increase inequality, but if immigration is in skilled categories this may lead to an increased supply of relative skills and hence reduced inequality.

Policy responses

There are various types of responses to migration. There are different appropriate responses depending on whether it relates to temporary or long-term migration. The sending country may want to limit permanent emigration in favour of temporary emigration and maximise the productive use of remittances. The receiving country may also want to react to the labour market consequences, especially when income inequality is increasing.

3.4 Conclusions

This chapter has provided a number of important building blocks relevant for the book as a whole. Whilst regional integration may affect trade, FDI and migration each of these variables will affect poverty differently. The main message is that the impact of trade, FDI and migration depends on the complementary conditions in place, many of which can be influenced by appropriate policies.

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Chapter 4 Regional Integration and Poverty: towards a conceptual framework

Dirk Willem te Velde, Sheila Page and Oliver Morrissey

In this chapter we develop a framework to identify and assess the various ways in which RTAs can affect poverty, especially the effects that operate through the volume of trade and investment. Whereas Chapter 3 discussed the circumstances under which RTAs lead to more trade (investment and/or migration), and Chapter 2 discussed how such increases in trade (investment and/or migration) can affect poverty, this chapter aims to provide the links from RTAs to poverty impacts.

Section 4.1 outlines the three basic ways in which RTAs can have effects on poverty – through the level of activity (volume), prices and the share of the poor in economic activity ('slice' effects). We then consider if features of integration can alter the poverty focus (or impact) of RTAs through differences with respect to the regional versus global composition of trade, investment and migration in sections 4.2, 4.3 and 4.4 respectively. Is it possible for two identical countries with the same volume of trade, investment and migration have different poverty reduction profiles because of features of regional integration? Section 4.5 considers a variety of ways that RTA can affect poverty other than through trade, investment and migration. Section 4.6 then presents a conceptual framework for mapping the effects of RTAs on the poor and poverty reduction, while Section 4.7 concludes with some implications for future research.

4.1 RTAs and poverty: volume, price and slice effects

As it supports increased trade and investment, at least in principle, integration would be expected to expand the level of economic activity. Given the prevailing pattern of distribution, the poor can expect to benefit from this level or volume effect. The "volume" effects on poverty reduction are greatest when RTAs are trade (and investment) creating because the poor are better off if they can get the same share of a larger trade (and thus income) cake. On the other hand, when RTAs are trade diverting through lower internal tariffs, the reduction in tax revenues can offset any positive "volume" effects. Volume effects are likely to be greatest if integration involves relatively large and rich countries with diversified and complementary patterns of production and trade. Where integration is between low-income and structurally similar countries, it is likely that volume effects and hence poverty reduction impacts will be relatively small.

Another important link to poverty are the "price" effects of an RTA. Trade policy liberalisation (e.g. tariff reductions) can lead to lower prices, which will benefit consumers (although there is a cost in terms of lost tax revenue). To the extent that tariffs are reduced on products that are consumed proportionally more by the poor, e.g. staple foods, and the tariff reduction are passed through to consumers, this will benefit the poor proportionally more. This effect is relevant even in the absence of changes in volumes. However, if the poor tend not to consume imported goods then the poor are least affected by import liberalisation. Furthermore, if the propensity to consume imports is lowest for the poor, the poor will derive the least proportional benefit from lower import prices.

There are also more general price effects in addition to those on imports, as the level effect on domestic and export production can generate price effects. In terms of the poverty impact, the important issue is the effect on the prices of goods that matter most to the poor, whether because they are a large share of the consumption basket or the poor are engaged in their production (perhaps as employees). Integration would have the greatest benefit to the poor if it can be shown to reduce the price of the goods they consume (necessities and basic foods) and increase the price of the goods they produce, or at least increase demand for what they produce. As the volume effect can increase the demand for informal sector services, this can benefit the poor.

There are ways in which RTAs can affect poverty by altering distribution or the share of economic activity involving the poor. The pro-poor price effects outlined above are one example, another is where the RTA has a particular benefit for a sector especially important to the poor. There can be a "slice" effect if the slice of the same cake would be bigger for the poor as a result of signing an RTAs, for example if RTAs change the poverty focus of trade, investment and migration (compared to multilateral integration). We discuss this in section 4.2. Another type of slice effect could arise if government spending is targeted at the poor, or is at least redistributive. In this case, the effect of integration on tax revenue may be very important, and is likely to have negative impacts on the poor (as a fall in tax revenue is likely).

4.2 Does Regional Integration change the poverty focus of trade

Trade policy reforms have economic effects on (a) prices of traded products (b) output, wages and employment opportunities in affected sectors, and (c) the government's fiscal position (see e.g. McCulloch *et al*, 2001; McKay *et al*, 2000). Research could focus on import prices and consumers to address (a), and export performance to address (b), although one should also consider if any sectors have evidently suffered from competition from cheaper imports. Most of the literature is in the context of international trade at a global level. RI is a policy reform that affects trade at the relevant regional level. Against each of the three issues, we consider how RI may affect trade and poverty in a manner that is different from how global trade affects poverty.

a) Prices of traded goods. Open international trade implies domestic prices of traded goods should tend (downwards in nearly all cases) towards world prices. In the case of RI, there is only convergence of regional prices, which will tend to be above world prices. If there is a common external tariff lower than pre-RI tariffs, then regional (domestic) prices will decline. Thus, the principal effect of RI will be to reduce prices of goods traded within the region. This will benefit consumers, and would be expected to benefit producers in some countries in the region (those able to expand exports) at the expense of others (those with relatively high initial protection who face increased competition from regional imports). The overall effect on poverty will depend on which products are traded regionally and how prices are affected, but consumers gain. In this context, it would be worth asking whether poor people consume relatively more products traded intra-regionally than products traded extra-regionally. There is another issue related to the pattern of tariff liberalisation. In RTAs, tariff liberalisation will be uniform across all products eventually reducing all tariffs to zero (possibly with some exceptions). However, due to pressure groups, multilateral negotiations may reduce tariffs in a way that disproportionately benefits the non-poor.

b) Static and dynamic output effects. In principle countries should raise their output as they specialise on the basis of comparative advantage (static effect). But not all countries may benefit to the same extent. Often, the bigger members of the developing country RTA will have a competitive advantage (typically in basic manufactures) and will benefit the most. The smaller members are likely to face increased competition from imports so production will not increase as much. *Ceteris paribus*, the poverty impact is beneficial in large countries and adverse in small countries. The small countries may benefit if they can export food within the region, and growth in agriculture typically benefits the poor.

   RTAs can affect poverty through dynamic output and productivity effects such as through competition and scale. Many argue that important effects of RTAs are dynamic, with competition creating a more efficient industry and growth. Lower intra-regional tariffs would lead to increased competition (Neary, 2001). The new trade theory emphasises long-run productivity effects of trade (Grossman and Helpman, 1991). Productivity spillovers can occur via importing and exporting (Coe and Helpman, 1995; Coe, Helpman and Hoffmeister, 1997). Not only does a country's efficiency increase due to allocation effects, trade helps actors to learn from each other and appropriate R&D spillovers. These learning effects can be translated into long-run efficiency gains. Unfortunately, there is little evidence for these dynamic effects. Schiff and Wang (2003) find no empirical evidence of dynamic effects of RIAs based on technology diffusion. They then go on to show that NAFTA imports has raised productivity (between 5.5-7.5%) in Mexico through imported foreign knowledge stocks, while extra-regional imports had no effects (but this may be due to the specifics of NAFTA). These are long-lasting effects that can in the long-run benefit the poor. There can also be long-lasting effects on productivity through learning by exporting, and such effects may be appropriated particularly when dealing with more developed partners and these tend to be extra-regional.

c) The effect on tax revenue depends on the pre- and post-RI pattern of trade and tariffs. Import liberalisation might be expected to reduce government revenue, as tariffs are typically an important source of tax revenues. This effect is reinforced when RI leads to trade diversion (Viner, 1950). There are a number of reasons why import liberalisation may not be associated with lower tariff revenues. First, the lower tariff rates discourage evasion and avoidance so collection efficiency increases. Second, quantitative restrictions may be converted into tariffs. Third, the tariffs may apply to an increasing value of imports. This may arise either because demand is elastic or because there was also devaluation (which increases the domestic price of imports). If tariff revenue declines, as it typically does, the revenue can in principle be compensated by increased revenue from other taxes (mostly domestic sales). In practice, however, tax revenues have tended to decline.

The presence of import barriers or restrictions creates an anti-export bias by raising the price of importable goods relative to exportable goods. Removal of this anti-export bias through trade liberalisation would induce a shift of resources from the production of import substitutes to the production of exports. The factors used intensively in the production of exports, land and rural and/or unskilled labour in poor countries, should benefit most. On the other hand, factors employed in the production of import-competing goods, mostly urban capital and labour, may suffer losses. Typically, import supply from the rest of the world responds more rapidly than domestic export supply, so liberalisation imposes adjustment costs (losses tend to be immediate whereas export gains can take time). As RI does not involve exposure to imports from all the rest of the world, only from the region, adjustment costs (hence adverse poverty effects) are lower, but so are the possible gains.

There is another effect of trade on poverty in RTAs, but this is based on the distribution of the benefits. The benefits of regional integration may not be evenly spread amongst members of a region. Venables (1999) argued that South-South agreements will tend to lead to divergence of income levels of members states, while North-North agreements may lead to convergence of income levels. The explanation of this is based on the position of countries in a region compared to those outside the region. Countries with a comparative advantage (e.g. in manufacturing) closer to the world average do better in a region than do countries that are at the extreme position as the latter are more likely to switch import suppliers (of manufactures) and face trade diversion costs. This explanation is based on manufacturing, but it is less clear when other sectors are also included. Nevertheless, possible divergence due to relocation effects may actually put RIAs under strain, as may have been the case in the EAC. While peripheral countries to the EU such as Ireland have caught up in terms of productivity levels with other members of the EU apparently through trade and FDI spillovers, there was a degree of divergence and agglomeration in developing regions such as East African Community and the Central American Common Market both dating back to the '50s and '60s. This also brings home the fact that the distribution of gains among member states may affect further regional integration processes.

In general, as intra-regional trade among low-income countries tends to be lower than for high-income countries (e.g. Page, 2000, table 7.1 for 1996, ranging from more than 50% of total trade in EU15, less in NAFTA, MERCOSUR, ASEAN, 13% in ANDEAN and CACM, 12% in SADC to just 4% in SAARC) and limited to fairly simple products (basic manufactures and perhaps food), the overall trade impact may not be great. However, the level and the share of intra-regional trade appear to be on the increase, although this may not be happening in all regions in all years with several regions (MERCOSUR, EU) experiencing a decline in the intra-regional share of trade over the last 5 years. Furthermore, we should realise that trade is probably more under-recorded in low-income countries than in high-income countries.

Table 4.1 Share of intra-regional trade in total exports and imports

RTA	*Exports*			*Imports*		
	1990	1995	2002	1990	1995	2002
EU (15)		64.0	61.6		65.2	61.9
NAFTA (3)	42.6	46.0	56.5		37.7	38.1
ASEAN FTA (10)	20.1	25.5	24.0	16.2	18.8	23.6
MERCOSUR	8.9	20.5	11.5	14.5	18.1	17.0
ANDEAN	4.3	12.3	10.2	7.7	12.9	13.9
CARICOM	9.5	9.8		12.3	16.4	

Source: WTO (2003), *International Trade Statistics*

In some regions, there will be one large member (measured in terms of economic market size[11]) that is likely to derive the most benefit because it has a comparative advantage in regional manufactures (e.g. Kenya in EAC, Nigeria in ECOWAS). The smaller countries are only likely to benefit if they produce niche products, e.g. if they are able to expand food exports to the large member. This distributional effect implies that the large member may have to compensate smaller members (a similar argument applies to distributing revenue from a common external tariff). Failure to agree compensation is one reason why RTAs among low-income countries have often failed in the past, or why achieving deep integration has been such a slow process.

Because integration among developing countries typically affects only a small share of their total trade, the volume effects are likely to be small, hence the revenue effects are also likely to be small. In the case of developed-developing country integration, where trade diversion is more likely, revenue effects will be greater, highlighting the need for policy measures to offset any adverse effects on income distribution.

We briefly consider whether *services* liberalisation at the regional level provides better outcomes than liberalisation at the world level, and whether RTAs could affect the poverty focus of trade in services. Stephenson (2002) defines four different categories of services:

1. Infrastructure-type services: financial, telecom, energy and transport
2. Business-type services: distribution, professional services, other business services, tourism, construction and engineering services, and environmental services
3. Social services: educational and health services
4. Other services: recreational, cultural

In order to attract the most efficient service provider in the capital intensive category 1, it would make sense to liberalise beyond the region. Global service providers are likely to have better access to capital than service providers whose market is a Southern region (the global provider may of course by from a developing country). For the less capital intensive category 2, tourism is a relatively liberalised sector

[11] Small does not imply necessarily poor. For instance, Singapore is very rich compared to other ASEAN members. That is why we refer to small in economic size.

(although GATS often includes qualified commitments such as subject to national approval); construction and engineering services and professional services on the other hand depend on qualifications and national standards, so that RTAs may play a useful role in order to facilitate recognition across borders (within the region first). The third category is sensitive to national concerns and it could be easier to liberalise these sectors among countries with similar levels of development, language, culture, etc. RTAs could act as a catalyst. The fourth category is mixed. Hence, for some sectors RTAs could be an appropriate starting level. However, it is premature to fully analyse differences in services liberalisation now as many regional protocols have not been ratified by all parties and, those that have, have been in force for a short period.

4.3 Does Regional Integration change the poverty focus of FDI?

Various factors determine whether RI changes the poverty focus of FDI. Table 4.2 uses the FDI and development framework set out in Chapter 1 to examine whether global MNEs could be expected to have a distinctive impact on development and hence poverty than regional MNEs. It shows that regional MNEs (in a typical developing country region) have both advantages and disadvantages over global MNEs While there is by now quite a lot of evidence on differences between foreign and local firms (see section 2.2), there is not much on the effect of the source country on FDI. Some evidence for developed countries suggests that US firms pay higher wages and are more productive than other MNEs, including from the EU, that have set up in the UK (Te Velde, 2002). Generally it seems that the potential benefits of global liberalisation are greater than of regional integration, but that the potential losses will also be greater. This implies that active public policies (as we discussed in section 2) increase in importance with global versus regional integration.

Table 4.2 Foreign Direct Investment and host-country development

Impact Area		
	Indicators	**Regional vs Global Integration**
Employment and Income	• Employment generation inside foreign firms • Wage levels for staff with given characteristics	• Global MNEs from the EU and US may pay higher wages than regional developing country MNEs. • Global MNES may be more productive and hence create more employment in the long-run, but their superior productivity may also crowd-out more domestic employment.
Physical capital	• Fixed capital formation • Financial transfers	• Global MNEs will have better access to finance than regional MNEs
Market access	• Share of inputs imported • Share of output exported	• Global MNEs may export more than regional MNEs • Regional MNEs will source more regionally (because they may have regional networks); but this is not the case when global MNEs invest in order to source locally
Structure of factor and product markets	• Concentration in product and factor markets • Profit margins	• Profits of regional MNEs are more likely to stay within region, while global MNEs may send profits to their headquarters. But the effect for the host-country may still be the same.
Technology, skills and management techniques	• Skill level of employees • Training budgets • Output per employee • R&D budgets • Types of technologies used	• Global MNEs will have more access to skills, technology and management techniques, compared to regional MNEs
Fiscal revenues	• Fiscal payments • Grants to foreign firms	• Many fiscal grants have been wasted to attract global MNEs; there may be regional competition but this often for global start MNEs such as Intel and General Motors
Political, social and cultural issues		• Regional MNEs are more likely to be culturally and politically acceptable

It is usually often the dynamic effects that are emphasised. Blomstrom and Kokko (1997) argue that regional integration leads to efficiency gains and higher growth. FDI can actually be such a catalyst through spillovers in terms of technology transfer and other linkages with local firms. There can thus be long-lasting effects on growth and productivity in addition to a one-off effect based on a more efficient allocation of resources. Not surprisingly, many studies examining the wealth effects of regional trade arrangements find large wealth effects. Wealth (or GDP) effects can ultimately benefit the poor depending on the distribution of the gains.

In practice, integration among developing countries affects only a small share of total FDI, i.e. intra-regional FDI is low as a percent of total FDI for low-income regions for SAARC, ASEAN, and even for SADC. One could infer from this that regions do not have an important role to play with respect to the overall poverty focus and impact of FDI. However, this would be wrong. Crucially, while trade rules in regions aim to, at best, create trade amongst members, trade and investment rules aim to raise investment from both members and non-members.

The possible divergence amongst members of developing country regions as a result of an uneven spread of benefits, can be further enhanced by agglomeration effects (Venables, 1999). Agglomeration effects refer to a spatial clustering of economic activities and are another way through which investment affects poverty. Agglomeration can occur within a county (e.g. cities) or across countries. Clusters of economic activities can lead to efficiency gains for instance because a pool of specialised support services is feasible due to economies of scale (e.g. Porter, 1998). If relocation effects occur within a region, this may lead to efficiency gains which may reinforce further relocation effects. This would lead to further divergence or convergence, which could affect the distribution of gains from and ultimately the motives for regional integration processes. On the other hand, as argued in Ethier (1998) smaller (and possibly poorer – though this is obviously not the case in regions such as ASEAN) countries may actually have incentives to form a region in order to attract investment away from other members, particularly extra-regional FDI. This may be the case when regional tariff preferences allow foreign investors to set up beachhead locations in a small (or poor) country to serve the entire regional market.

Agglomeration effects occur through local and foreign investment. It would thus be important to ask how (intra and extra) foreign direct investment would affect regional integration processes in addition to other factors (parallel national reforms, country size, political and security issues, etc.). Competition for FDI may lead to the introduction of more efficient and organised regional policy and institutions, but there is also a possibility that such competition undermines regional integration efforts. Similarly, if not all countries can benefit from an increased amount of FDI or do not have the capabilities to benefit from it, this may also undermine regional integration efforts. FDI may affect the establishment of regional institutions relevant to FDI. For instance, competition for FDI between member states is thought to be one of the reasons why Mercosur is beginning to have talks on investment incentive issues (Chudnovsky and Lopez, 2003).

4.4 Does Regional Integration change the poverty focus of migration

Table 4.3 Intra-regional migration

	Intra-regional migration as % of population	Total migration as % of population	Intra-regional as ratio of total immigration
Immigration			
Argentina	1.28%	4.92%	0.26
Brazil	0.05%	0.52%	0.10
Uruguay	1.31%	2.92%	0.45
Paraguay	3.81%	4.51%	0.84
MERCOSUR	0.37%	1.42%	0.26
Bolivia	0.11%	0.93%	0.12
Colombia	0.17%	0.32%	0.53
Ecuador	0.44%	0.76%	0.58
Peru	0.04%	0.24%	0.17
Venezuela	3.21%	5.66%	0.57
ANDEAN	0.78%	1.47%	0.53
CARICOM (early 90s)	1%		
EU (2000)	0.80%	Ranges from 2.2 in Spain to 4% in UK and Netherlands to 5.6% in France and 8.9% in Germany and 37% in Luxembourg	< 0.20 for most EU member states (except 0.33 in Spain)
Emigration			
Philippines contract workers			0.08 (to ASEAN)

Sources: Fuchs and Straubhaar (2003), World Bank (2003) and Thomas-Hope (2002), World Development Indicators, Wickramasekera (2002)

The first notable issue is that intra-regional migration is low in developed and developing country regions, see table 4.3, as a percentage of total population. Obviously this can differ in other regions, e.g. in SADC where South Africa is experiencing significant immigration. On the other hand the intra-regional share of immigration is a quarter for MERCOSUR and a half for ANDEAN. This is higher than the intra-regional shares of FDI and trade, and this may indicate that that migration is likely to take place amongst neighbours. For the EU, the intra-regional share of immigration seems lower than that of trade and FDI. Also, the Filipino contract workers seem to prefer the Middle East over their own region ASEAN (8%). This can also be said for Indonesian labour flows. Overall the numbers are of limited significance, certainly compared the importance of FDI as per cent of total investment (www.unctad.org), or trade as per cent of GDP.

Secondly, the main source of remittances and most of the skills gained are both more likely to be associated with South-North migration rather than South-South. We can thus offer the preliminary conclusion that RTAs have a limited impact on poverty through migration (compared to say trade or investment), although we should emphasise that further research is required. Also, this does not deal with temporary movement of people, which can also be important in delivering services, and has in essence become a trade issue under GATS.

4.5 Regional Integration and poverty: non-trade and non-FDI routes

Various processes usually coincide with regional integration in various degrees depending on the region. Besides direct effects such as improved market access for trade in goods, investment, and more recently trade in services, there can be increased functional co-operation in regional infrastructure, security and protection of democracy, increases in market size and income levels, convergence and divergence amongst members of RTAs, co-operation in terms of movement of natural persons and regional investment funds and social programmes.

Regional social programmes and investment funds
Some regions specifically include regional investment banks or structural funds (e.g. ANDEAN, EU) often to finance development of the least developed parts (countries, provinces) of the region. For example, within the EU, Ireland received some six per cent of GDP in structural funds in the 1990s to finance infrastructure projects. Most recently, the FTAA has attempted to include a regional fund to support the adjustment effects for small and vulnerable states in the region.

Trade - Investment – Migration Linkages
While this chapter considers the effects of RI on trade, investment and migration, there could also be effects on the connections between trade, investment and migration, which may ultimately affect poverty. There are various papers that discuss links between FDI and trade (e.g. Barrell and Te Velde, 2002), which can be substitutes or complements, between trade and migration (Schiff, 1997), and between FDI and migration (there is likely to be an association given the fact that there is significant capital flight and brain drain from several developing countries). However, it is not clear how RI processes affect these interactions. Such interactions may also be important when examining the effects of RI on poverty via the effects on trade, FDI and migration.

Stepping stone or stumbling blocks
There are a number of explanations for the increase in popularity of RTAs. One view is based on frustrations with the speed of multilateral liberalisation such as in the GATT and WTO. For example, Krugman (1993) argues that RTAs are easier to negotiate and implement than multilateral agreements as they typically involve fewer negotiating parties endeavouring to reach agreement on a narrower range of issues (though this may now not be the case anymore). Bhagwati (1993) advances a related argument in putting the new regionalism down to US interests in a greater regional focus to trade negotiations through NAFTA and more recently the FTAA. The same issues can be raised with the current Doha round of WTO negotiations.

An alternative explanation is the ‘domino theory’ that exploits the fact that RTA’s may result in trade and investment diversion. The greater the number of nations included, the greater the pressures on non-parties. Thus, a single initial agreement, if it is important enough, stimulates expansion of that agreement and/or proliferation of others.

Researchers disagree on whether RTAs are stepping stones or stumbling blocks to further liberalisation. Would an easier to negotiate RTA imply a slower level of multilateral integration (which would theoretically be more efficient) or would such a RTA decrease the interest in and ability of further multilateral integration? For instance, negotiating RTAs would attract scarce institutional resources away from other applications, possibly from effectively negotiating at the multilateral level. On the other hand, negotiating experience gained at regional level might be relevant for negotiations at multilateral level.

There are others reasons why RTAs might be stumbling blocks (or stepping stones). First, regions can lead to trade creation. Secondly, regional agreements could be less secure than other types of integration (see Page, 2000). This can have consequences for policy responses and benefits to the poor. If the benefits to the poor depend on the long term effects of trade, such long term effects may be less forthcoming within unstable regional agreements. Hence, if poor people would like to capture benefits from regions, the immediate effects become more important, and will alter the choice of policy as identified in section 2.1 on trade and poverty. If there are negative effects from trade diversion, then the benefits will be reduced.

Voices of the poor in RTAs

In sections 4.2 and 4.3 we posed the questions whether regional integration could alter the poverty focus of trade and FDI. In part this may depend on the economic conditions of the members of a RTA compared to non-members. This may also depend on whether certain interest groups are able to negotiate certain outcomes. For instance, would vulnerable groups within countries be better represented in a region than at multilateral levels? There does not seem to be a lot of direct evidence for this, but it is nevertheless a question worth asking, because better representation at the negotiating table may lead to more desirable outcomes (i.e. a more desirable poverty focus).

4.6 Towards a framework for analysing regional integration and poverty

The aim of this chapter was to set out linkages between regional integration and poverty. This section outlines the routes from RI to poverty on the basis of a simple mapping of four sets of links describing how poverty in a country is affected by RI processes.

The first set of links between RI and poverty is through <u>trade</u>. Chart 4.1 covers a number of building blocks. Regional Trade Agreements (RTAs) include certain provisions that may affect the volume, price and "poverty focus" of trade. This may in turn affect different characteristics of poverty intermediated through complementary conditions including public policies. For a country member of a particular RTA we should be asking a number of questions to unravel the effects of RTAs on poverty through trade (the same could be done for regions to which the country is not a member to detect possible trade diversion effects).

- **Regional Trade Agreement (**to which the country under examination is a member or not a member**)**:
    - What are the goods trade provisions (tariffs, rules of origin, NTB)
    - What are the services provisions
    - What are investment provisions
    - Other provisions

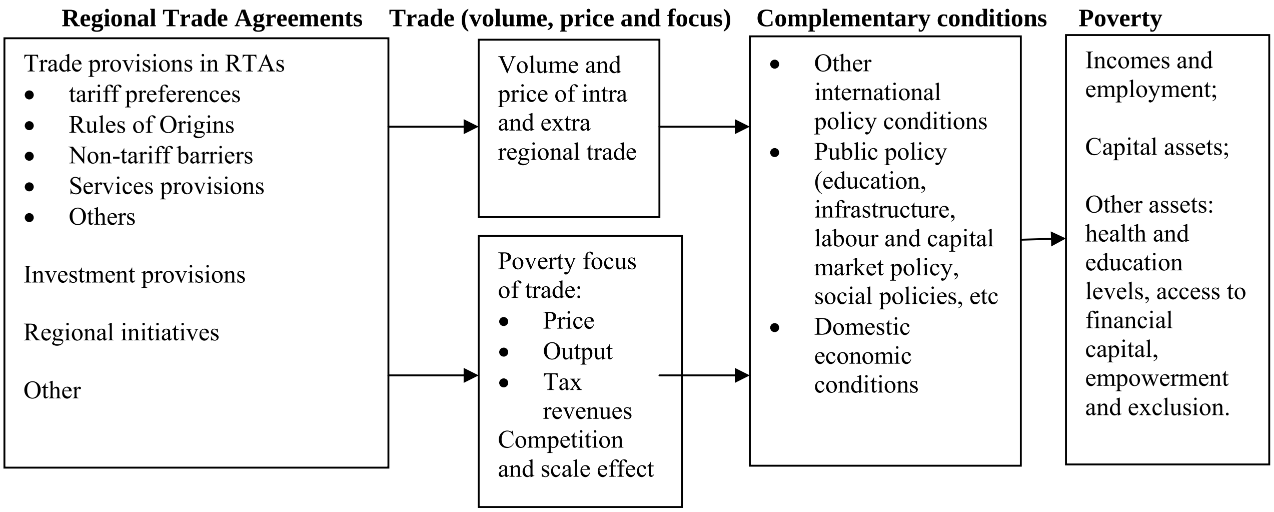
- **Trade (volume, price and focus)**
    - How have provisions in the RTAs affected the volume and price of intra and extra regional exports and imports (and the trade balance) of goods ands services
    - How has the RTA affected the poverty focus of trade
        - Does regional liberalisation lower import and domestic prices of products (goods and services) consumed directly by the poor or used in production processes that benefit the poor indirectly.
        - Has the RTA resulted in increased output in each country or have certain countries gained more than others.
        - Does the RTA lead to trade creation or trade diversion, and what are the effects of this on fiscal receipts.

- **Complementary conditions**
    - Does the RTA include provisions that are different from other international policies and agreements such as the WTO.
    - Does the country have the capabilities to withstand competition with imports or exports in sectors with comparative advantage in the region.
    - Are public policies (labour, infrastructure, trade facilitation, education) geared towards enhancing import competition and export capabilities.
    - Does the government redistribute income or assets, through taxes, support for incomes, and provision of public goods, temporarily through safety nets or permanently to compensate (relative) losers from RTAs.

- **Poverty - How does trade affect**:

- Iincomes and employment of the poor
- Capital assets (equipment, land)
- Other assets: health characteristics, education levels, access to financial capital, empowerment and exclusion.

Chart 4.1 Regional integration and poverty via trade



The second set of links between RI and poverty is through foreign direct investment. Chart 4.2 covers a number of building blocks. RTAs include certain provisions that may affect the volume, and “poverty focus” of investment. This may in turn affect different characteristics of poverty intermediated through complementary conditions including public policies. For a member of a particular RTA we should be asking a number of questions to unravel the effects of RTAs on poverty through investment.

- **Regional Trade Agreement (**to which the country is member**)**:
    - What are the goods trade provisions (tariffs, rules of origin, NTB)
    - What are the services provisions
    - What are investment provisions
    - Other provisions

- **Foreign Direct Investment (volume and focus)**
    - How have provisions in the RTAs affected the volume of intra and extra regional investment
    - How has the RTA affected the poverty focus of investment, i.e. what are differences between global MNEs, regional MNEs and domestic firms with respect to:
        - Wages, jobs,
        - Capital
        - Trade
        - Structure of markets
        - Tax revenues
        - Technology, skills

- **Complementary conditions**

- Does RTA include provisions that are different from other international policies and agreements such as the WTO (e.g. GATS, TRIMS) or bilateral investment treaties.
  - Does the domestic private sector have the capabilities to withstand competition with foreign firms to capture productivity spillovers.
  - Are public policies (labour, infrastructure, trade and investment facilitation, education, MNE-local firms linkage stimulation) geared towards capturing the productivity spillovers.
  - Does the government redistribute income or assets, through taxes, support for incomes, and provision of public goods, temporarily through safety nets or permanently
  -
- **Poverty - How does investment affect:**
  - incomes and employment of the poor
  - Capital assets (equipment, land)
  - Other assets: health characteristics, education levels, access to financial capital, empowerment and exclusion.

Chart 4.2 Regional integration and poverty via investment

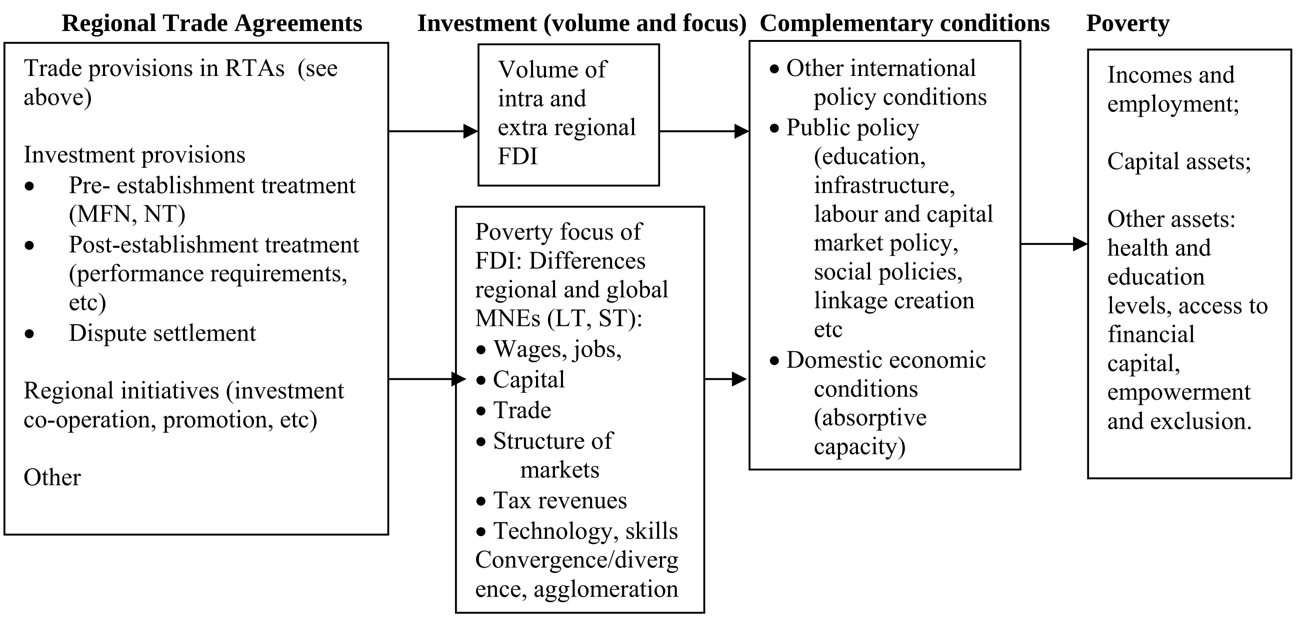
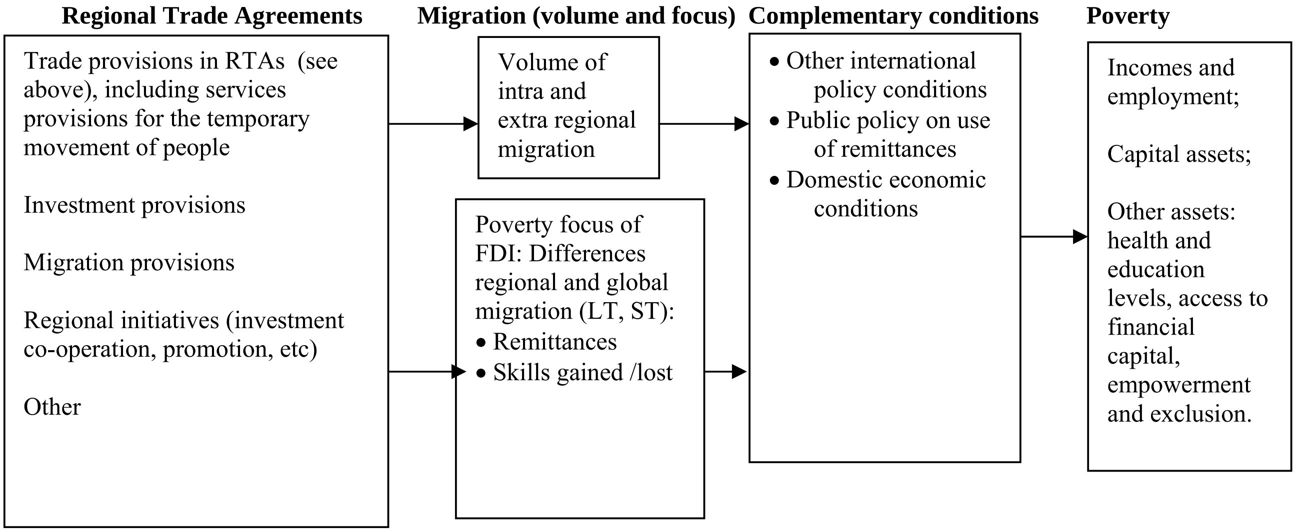


Chart 4.3 Regional integration and poverty via migration



The third set of links between RI and poverty is through migration. Chart 4.3 covers a number of building blocks. RTAs include certain provisions that may affect the volume, and "poverty focus" of migration. This may in turn affect different characteristics of poverty intermediated through complementary conditions including public policies that facilitate the use of remittances. For a member of a particular RTA we should be asking a number of questions to unravel the effects of RTAs on poverty through investment.

- **Regional Trade Agreement (**to which the country is member or not a member**)**:
    - What are the goods trade provisions (tariffs, rules of origin, NTB)
    - What are the services provisions (incl. related to temporary movement of natural persons)
    - What are investment provisions
    - Other provisions

- **Migration**
    - How have provisions in the RTAs affected the volume of intra and extra regional migration.
    - How has the RTA affected the poverty focus of migration, i.e. what is the difference between global and regional MNEs migration with respect to:
        - Skills gained/lost
        - Remittances

- **Complementary conditions**
    - Does RTA include provisions that are different from other international policies and agreements such as the WTO (e.g. GATS) or bilateral treaties.

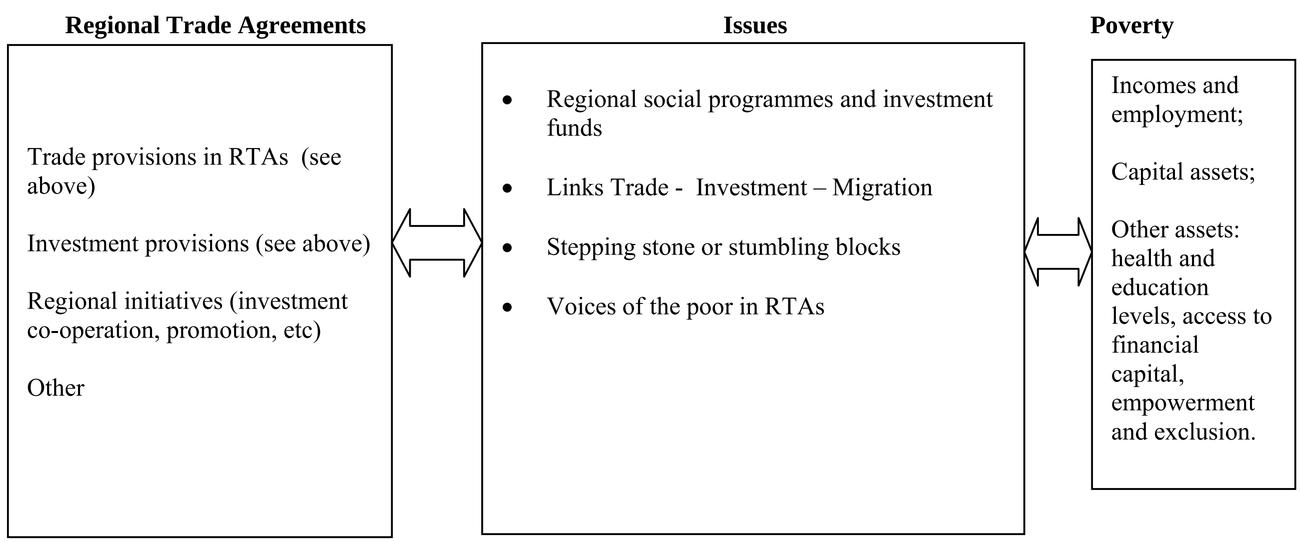
- o Does the domestic private and public sector have the capabilities to withstand the temporary loss of skills and can they absorb the skills gained in return migrants.
- o Are public policies geared towards channelling remittances towards the poor.
- o Does the government redistribute income or assets, through taxes, support for incomes, and provision of public goods, temporarily through safety nets or permanently.

- **Poverty - How does migration affect:**
  - o incomes and employment of the poor.
  - o Capital assets (equipment, land).
  - o Other assets: health characteristics, education levels, access to financial capital, empowerment and exclusion.

The fourth set of links can be termed "other" links and relate to non trade and non-FDI issues in RTAs that may affect poverty or trade and FDI issues that affect regional integration processes. These issues include:

- Is the RTA associated with long-run or dynamic effects through competition and scale effects.
- Is the RTA associated with convergence or divergence of income levels and how has this affected the regional integration processes.
- Does the RTA include regional social programmes and investment funds.
- Are there any significant links between an RTA and poverty through migration.
- What are the links among Trade effects- Investment effects – Migration effects of RTAs.
- Can the RTA be seen as a stepping stone or stumbling blocks towards further (multilateral) integration.
- Have negotiations on the RTA included effective representation of poor people.

Chart 4.4 Regional integration and poverty: non-trade and non-investment routes



4.7 Conclusions and Further Research

This chapter indicated for a number of potential links what the expected (and sometimes actual) effects are for regional integration on poverty. Awareness of such linkages should make it possible to gain a better understanding of how regional integration affects poverty. For instance, some general empirical findings in the literature include:

- RTAs boost intra-regional trade through tariff reduction; very strict rules of origin may dampen intra-regional trade or tariff preference take-up.
- Effects can interact: RoO are more relevant if preferential tariff rates are substantially lower than extra-regional tariffs.
- RTAs are likely to lead to increased extra-regional FDI; various RTAs have led to net investment creation. Trade and investment provisions in RTAs can both affect investment, but the precise effects will depend on a range of factors.
- Increased trade and investment is likely to lead to faster economic growth and poverty reduction particularly when economic conditions and appropriate public policies are in place. Investment has a tendency to raise income inequalities if not counteracted by public policies.
- The intra-regional share of trade and investment is lower for developing regions than for developed regions, so regional integration covers a smaller share of trade and investment. While trade provisions are important for increasing intra-regional trade and hence the intra-regional share (without aiming to divert trade), trade and investment provisions in regions are also likely to raise extra-regional FDI and hence the effect on the intra-regional share of investment is ambiguous.
- The intra-regional share of migration is low as a per cent of total population (e.g. compared to the importance of FDI as per cent of total investment, or trade as per cent of GDP), and while South-South agreements may help to spur migration, it does not deal with South-North migration associated with remittances.

Much evidence is based on multi-country or multi-region studies, deals with averages and fails to identify which provisions in which RTAs have what effect (on trade, FDI, poverty etc.) in which country. While we have documented that trade and investment provisions differ markedly across RTAs and across time, (econometric) studies that examine the effects of regional integration often use simple dummy variables to describe regions. This is problematic for those who want to negotiate the best possible type of region: in reality no region is the same and some guidance is required on best-practices in provisions in RTAs. For many other links we do not have evidence at all.

This overview suggests two ways in which we can contribute to an improved understanding of the effects of regional integration on poverty (but there are many other ways). The first is to conduct a more detailed study on the effects of specific trade and investment provisions on trade and investment. For this we need a detailed overview of investment provisions in key regions, this is the subject of chapter 5 in part II. This can be used to examine the links between investment related provisions and FDI.

Secondly, we will aim to test the mapping structure set out in part I of this book and as summarised above on the basis of two case studies. There are various countries that would be relevant for this. Part III discussed the experience of two countries. Bolivia, part of LAIA and ANDEAN (and FTAA due to start in 2005), associate member of MERCOSUR and featuring in the EU and US GSP systems, coupled with having one of worst poverty records in Latin America, has been chosen for the first case study to examine the effects of RTAs. The second case study is Tanzania to provide an African example. Tanzania is a member of the CBI, EAC (old and new) and SADC and is also part of others such as GSP systems and the Cotonou Agreement, but withdrew from COMESA. While the methodology of the case studies on regional integration has been fixed (e.g. via trade and FDI), the methods varied. The Bolivia case study is able to use quite a detailed database linking trade and FDI in regional settings with incomes and employment. The Tanzania case study on the other hand has used in depth interviews to obtain much relevant information.

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PART II DESCRIBING AND MONITORING REGIONAL INTEGRATION

Chapter 5 Investment related provisions in Regional Trade Agreements

by

Dirk Willem te Velde and Miatta Fahnbulleh

5.1 Introduction

There is a renewed interest in how regional trade agreements (RTAs) can foster foreign direct investment (FDI) to developing countries. Under WTO rules members can enter into a regional integration arrangement through which it grants more favourable conditions to its trade with other parties to that arrangement than to others, thereby departing from the guiding principle of non-discrimination, under specific conditions spelled out in three sets of rules: Paragraphs 4 to 10 of Article XXIV of GATT providing for the formation and operation of customs unions and free-trade areas covering trade in goods; the Enabling Clause which refers to preferential trade arrangements in trade in goods between developing country Members; and Article V of GATS which governs the conclusion of RTAs in the area of trade in services. Other non-generalized preferential schemes, for example non-reciprocal preferential agreements involving developing and developed countries (such as the EC-ACP Partnership Agreement), require a waiver from WTO rules. The number of RTAs notified to the WTO was 265 by May 2003, and the number of RTAs in force has increased especially since the early 1990s (see chart 1.2)

The coverage and depth of preferential treatment differs from one RTA to another. There is however a large number of RTAs that goes beyond tariff-cutting and provide for complex regulations on intra-regional trade in goods (standards, safeguard provisions, customs administration, etc.) and preferential treatment for intra-regional trade in services. A select group of RTAs go beyond traditional trade rules and provide rules on investment, competition, environment and labour.

Countries decide to form a RTA for various reasons. One reason might be to enhance economic development and co-operation through increased trade and investment. This can in turn affect poverty through various routes as we identified in part I. The purpose of this paper is to examine how RTAs can affect investment, in particular listing investment related provisions that (aim to) promote intra and extra-regional FDI. The structure is as follows. Section 5.2 describes investment related provisions by key region while section 5.3 does this by key provision. Section 5.4 provides a summary of new evidence on the effects of RTAs on FDI. Section 5.5 concludes.

5.2 An overview of investment related provisions in key regions

This section discusses what provisions have been implemented in the context of RTAs. While all RTAs have implemented or are planning to implement at least some rules that can affect investment, we will focus on those regions that 1) are relatively large in terms of market size or number of members and 2) have gone some way in implementing investment provisions. For these regions, we will discuss investment provisions and trade provisions by main region A detailed description can be found in appendix 5.2.

5.2.1 *What are the key regions?*

Appendix 5.1 provides a list of developing country regions notified to the WTO before May 2003, with a list of members, including when the regions was established or when members joined. We have narrowed down all regions notified under XXIV of GATT to developing country regions (African, Asian and Latin American), or joint developing and developed country regions. For instance, the many RTAs that the EU has negotiated with Eastern and Central European countries are not included, but those with North African countries are. The resulting list is still quite extensive.

Note too that regions are overlapping, i.e. that one country can be in more than one region, leading some to argue that the web of regional groupings is becoming a spaghetti bowl. For two example countries which we will follow more closely elsewhere, Bolivia is part of LAIA and ANDEAN (and FTAA in the future) and also features in GSP systems from the e.g. EU and the US, while Tanzania is member of EAC and SADC and is part of others such as GSP systems and the Cotonou Agreement.

We narrowed down the list of regions further by selecting those regions which 1) are relatively large in terms of market size or number of members and 2) have gone some way in implementing investment provisions. This leaves us with the following regions: ASEAN (AFTA, or ASEAN Free Trade Area), NAFTA, MERCOSUR, CARICOM, ANDEAN, COMESA and SADC. We do not include APEC because investment provisions are explicitly non-binding, or Cotonou because it is not an RTA (its investment provisions are also essentially voluntary) but gained a waiver at the WTO and is discussed in further detail in Te Velde and Bilal (2003). We have not included FTAA (Free Trade Agreement of the America) as this is due to finish at the beginning of 2005. The resulting list contains mainly South-South regions, though NAFTA is an example of a North-South region. In a different part we will look at differences between North-South and South-South regions at a basic level.

5.2.2 *Description by region*

For each region we discuss investment rules, trade rules and others significant initiatives. We discuss investment rules in more detail, while we deal with trade rules more quickly because information on this is available in a number of secondary sources. We have not addressed information on TBT/SPS or anti-dumping, though this would be possible in a more elaborate study, so the discussion on trade rules will simply report MFN tariffs, tariffs applicable regionally and the nature of RoO. For a detailed empirical analysis, we may need to collect more information on TBT etc.

NAFTA

The North American Free Trade Agreement (NAFTA), negotiated by the United States, Canada and Mexico, came into force in 1994. It represented the first north-south regional integration agreement of its kind in the Western hemisphere. NAFTA has taken significant strides in the area of regional economic cooperation. In particular, it encompasses one of the most comprehensive frameworks of regional investment provisions.

The investment provisions for NAFTA are laid out in Chapter 11 of the Agreement. NAFTA assumes a broader definition of investment than is usually applied to investment provisions. These rules are applicable to investors and investment of investors of a NAFTA state but some also extend to non-NAFTA investors with investments in one NAFTA country who decide to expand their operations into other NAFTA countries. This is however predicated on the condition that the investors have "substantial business activities in the territory of the Party" where they were originally established. Although NAFTA's investment provisions are applicable to all sectors in principle, each country has identified key sectors that are exempted from the agreement. Mexico excludes its petroleum sector, and all state owned sectors. Canada excludes cultural industries, health and social service and aboriginal affairs. The United States excludes health and social services in addition to all maritime activities being highly restrictive.

Chapter 11 grants national treatment for the establishment (market access), acquisition, expansion, management, conduct, operation and sale or other disposition of investments. This is complemented and strengthened by the provision of Most Favored Nation (MFN) treatment. In addition to this, it prohibits restrictions on ownership rules and the use of performance requirements on all investments by its members. The latter covers a broader range of performance requirements which go beyond those prohibited by the World Trade Organisation TRIMs Agreement and includes trade balancing, technology transfer and 'exclusive supplier' requirements. Finally, Chapter 11 guarantees investors free transfer of funds across borders and protection from expropriation and nationalisation.

NAFTA also established a comprehensive dispute settlement mechanism for both state-state disputes and investor-state disputes. With respect to the latter, it represented one of the first regional agreements to encompass a distinct mechanism for the arbitration of state-investor disputes. Both the mechanism for state-state disputes and that for investor-state disputes have been used a number of times. It also provides access to international arbitration bodies through the ICSID and UNCITRAL.

The first decade saw 9 investor-state cases against Canada, 9 against the US and 10 against Mexico. Of these Canada lost two cases and awarded $27 million Cdn and Mexico lost also 2 awarding $18.2 million, the US has lost no cases so far. Some cases have been settled out of court, dismissed or are still pending. Measures challenged include environmental protection, industrial policy, softwood lumber, property development and others and relate mostly to articles on national and MFN treatment.

There have also been important developments in the trade regime in the region. Most merchandise were liberalised between 1994 and 1998. Intra-regional trade faces average applied tariffs of between 0-2%. In contrast, applied MFN tariff rates averaged 16.5% (2001) for Mexico; 5.5% (2000) for the United States and 7.7% (1998) for Canada. Rules of origin exist and are based on a value content criterion that allows a 50-60% regional value content.

MERCOSUR

The Southern Common Market (Mercosur) was established in 1991 by the Treaty of Asuncion. It is comprised of Argentina, Brazil, Uruguay and Paraguay. Since its inception, Mercosur has achieved important developments in both regional trade and investment co-operation.

The investment provisions created for Mercosur members were established under the Colonia Protocol for the Promotion and Protection of Investment in 1994. It grants national treatment for the establishment, acquisition, expansion, management, operation and disposition of investment to Mercosur members. This is complemented and strengthened by the provision of MFN treatment. The Colonia Protocol also guarantees Mercosur investors free transfer of funds across borders and protection against expropriation and nationalisation. Although the protocol prohibits the use of performance requirements, Argentina and Brazil have reserved the right to maintain performance requirements in the automobile sector. A number of sectors were temporarily exempted from the wider agreements. These include border real estate, energy sectors, mineral extraction and exploitation sectors and telecommunications.

A less extensive range of provisions were established for non-Mercosur investors under the Buenos Aires Protocol in 1994. In principle, it grants MFN treatment to non-members. However, the application of MFN treatment is left to the discretion of each Mercosur country. In addition to this, it guarantees investors free transfer of funds across borders.

The Brasilia Protocol for the Settlement of Disputes in 1991 established the initial framework which was then expanded by the Ouro Preto Protocol in 1994. This provides a dispute settlement mechanism for both state-state disputes and investor-state disputes in addition to access to a number of international arbitration bodies.

Mercosur has taken important steps in enhancing regional trade integration. The implementation of the Common External Tariff in 1995, has facilitated the gradual harmonisation of the trade regime in the region. Full implementation of the Common External Tariff is expected by 2006. Applied average MFN rates in 2001 were 12.7 for Argentina, 14.6 Brazil and 13.8 for Uruguay, and averaged 13.2 for Paraguay in 2000. With respect to intra-regional trade, a gradual phase out of intra-regional tariffs has taken place since 1991. As early as 1995, 85% of intra-regional trade was duty free in 1995. Currently most intra-regional trade is duty free with the exception of capital goods, informatics and telecommunications products. Rules of origin exits and are based on a value content criteria that allows a 40% import content and 60% domestic/regional value content.

CARICOM

The Caribbean Community and Common Market was established in 1973. The original members were Antigua & Barbuda, Barbados, Belize, Dominica, Granada, Guyana, Jamaica, Montserrat, St Kitts & St Nevis, St Lucia, St Vincent & the Grenadines and Trinidad and Tobago. Bahamas entered Caricom in 1983 but opted not to become a member of the common market. Suriname became the fourteenth members of Caricom in 1995, followed by Haiti in 2002.

Since its inception, Caricom has made greater progress in the area of trade co-operation than investment co-operation. The Eighth Heads of Government Meeting in

1987, however, signaled one of the most comprehensive attempts to promote greater economic integration in the region. Significantly, plans were made to replace the Common Market with the Caricom Single Market and Economy (CSME). Preparations for the establishment of the CSME included the negotiation of nine Protocols which effectively amended the Treaty of Chaguaramas. Amongst these, the Protocols relating to investment and the free movement of people across borders have been most relevant for facilitating investment co-operation.

Few investment provisions were included in the Treaty of Chaguaramas which established Caricom in 1973. The 1980s and 1990s however witnessed the introduction of more investment provisions. Some initial provisions were laid out in the Principles and Guidelines on Foreign Investment approved by the Caricom Heads of State of Government Conference in 1982. These were later developed and consolidated by Protocol II in 1997. However, some members have yet to enact protocol II.

Although Caricom's protocol II does not include a national treatment provisions per se, it does establish that members shall not introduce in their territories any new restrictions relating to the right of establishment of nationals of other members states except as otherwise provided in the agreement. It allows each country to give preferential treatment to the investments of its nationals. It stipulates that regional agreements on foreign investment should accord preferential treatment to investors in the following order: nationals of the host Caricom country, nationals of other Caricom countries, nationals of the source country and finally other countries. In terms of performance requirements, the Principles and Guidelines on Foreign Investment permitted the use of performance requirements. Although no further provisions were defined in Protocol II on the subject, Caricom does conform to the World Trade Organisation's TRIMs. Protocol II establishes provisions for the free transfer of funds across borders and protection from expropriation and nationalisation. It also creates a dispute settlement mechanism for state-state disputes, and under certain circumstances investment-state arbitration. In addition, it provides access to international arbitration through the ICSID.

Caricom has however achieved important development in its regional trade regime. A common external tariff, ranging from 20-35%, has been in place since 1991. The common external tariff is being implemented through four stages of tariff reductions. There is currently a wide variation in the level of implementation obtained by different members. Intra-regional trade is duty free. The few exceptions include some agricultural produce and highly revenue sensitive sectors such as alcoholic beverages, tobacco and oil products.

Andean Community

The origins of the Andean Community date from 1969, and the signing of the Andean Pact (Cartagena Agreement). The original members included Bolivia, Chile, Colombia, Ecuador, and Peru. Venezuela joined in 1973 and Chile left the Pact in 1976. The Andean Group was established in 1988. Its members are Bolivia, Colombia, Ecuador, Peru and Venezuela. Peru suspended its membership in 1992 but resumed it in 1997. The Andean Group became the Andean Community in 1997 following the adoption of the Protocol of Trujillo. Over the past decade and a half, Andean has achieved a greater level of regional trade co-operation than it has investment co-operation, although the reverse seemed to apply back in the 70s.

Investment has been on the agenda from the start. The first regional approach to investment dates back to 1970 and established a system of common treatment of foreign investment. Decision 24 of the Andean Commission aimed to create international legal obligations (Commission of the Cartagena Agreement, "Common Regime of Treatment of Foreign Capital and of Trademarks, Patents, Licenses and Royalties".) with respect to investment. This decision created several new restrictions on investment, including a disinvestment scheme for foreign investors to become semi-nationally-owned companies after some time, a limitation on the repatriation of profits, a reservation of certain sectors for domestic enterprises, an investment screening mechanism setting high standards of entry for foreign investors and the establishment of a sub-regional office on industrial property and transfer of technology. The decision was silent on matters of expropriation. Chile withdrew from the Cartagena Agreement partly because of the controversial and tight restrictions on investment. Other member states also began to distance themselves from the regional treaty (which was mandatory), and by 1987, Decision 220 allowed each member state greater autonomy in setting investment policy as well as granting greater freedom to investors (e.g. lengthening the time period for companies to become semi-public). Decisions 24 and 220 were replaced by Decision 291 in 1991.

The main investment provisions currently applicable to investment were defined under Decisions 291 and Decisions 292 in 1991. The former is applicable to both members and non-members. Its provisions are however subject to national stipulation on the subject. This effectively abandons any common policy on investment. Andean grants national treatment to investors, but Decision 291 stipulates that national treatment can be regulated according to the national laws of each country. It also guarantees the free transfer of funds (and profits) across borders and protection against expropriation and nationalisation. With respect to performance requirements, it only establishes provisions for technological contracts and technical assistance. Finally, it provides a disputes settlement mechanism for state-state disputes through the Andean Court of Justice and access to an international arbitration body through the ICSID.

Decision 292 allows for the formation of Andean Multinational Enterprises. The establishment of such enterprises is however predicated on the condition that capital contributions by national investors of two or more member countries must make up more than 60% of the capital of the enterprise. Among the privileges granted to such enterprises are national treatment with respect to government procurements, export incentives and taxation, the right to participate in economic sectors reserved for national companies and the right to open branches in any member country, and free transfer of funds related to investment. Other institutions that seek to facilitate investment include the Andean Development Corporation which raises funds to provide to a range of financial services and the Andean Business Advisory Council.

Andean has made huge advancements in liberalising the trade regime in the region. The Andean Free Trade Area was formed in February 1993, when Bolivia, Colombia, Ecuador, and Venezuela finished eliminating their customs tariffs and opened their markets to each other. Intra-regional trade is currently duty free with all of the products in its tariff universe deregulated. Since Peru became a member in 1997 it has been gradually deregulating its trade with its Andean partners. Thus far, it has advanced more than 90% in this undertaking. The Andean Customs Union has been in operation since 1995, when the Common External Tariff (CET) approved by Colombia, Ecuador and Venezuela at the basic levels of 5, 10, 15 and 20 percent came into effect. The Customs Union is however incomplete. Bolivia enjoys preferential treatment and only applies levels of 5 and 10 percent, whilst Peru did not sign the agreement. Average applied MFN rates were 9.1% for Bolivia, 12.2% for Colombia and 12.4% for Venezuela in 2001. It averaged 11.2% for Ecuador in 2000 and 13.4% for Peru in 1998. Rules of origin exist and are based on a value content criterion that allows a 50% import content.

COMESA

The Common Market for Eastern and Southern Africa (COMESA) was established in 1994 to replace the Preferential Trade Area for Eastern and Southern Africa which had been in existence since 1981. It members include Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles (may leave SADC), Sudan, Swaziland, Uganda, Zambia, Zimbabwe.

COMESA currently grants few investment provisions. The Treaty of COMESA provides fair and equitable treatment to COMESA investors. It also guarantees the free transfer of funds across borders and protection from expropriation and nationalisation. In addition, it provides a settlement dispute mechanism for state-state disputes and access to an international arbitration body through the ICSID. Although the Treaty only encompasses the most basic of investment provisions, recent plans to develop a more comprehensive regional investment framework through a Common Investment Area, are indicative of COMESA's desire to enhance regional economic co-operation.

COMESA has however made some significant achievements in terms of trade liberalisation. A free-trade area (FTA) was established in November 2000. Nine countries are currently part of the FTA. Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Sudan, Zambia and Zimbabwe eliminated their tariffs on COMESA originating products. Burundi, Comoros Eritrea, Rwanda and Uganda have obtained a rate of tariff reduction between 80-90 %. The rest have yet to make decisive steps to enter the FTA. A Customs Union is expected to come into effect in November 2004, with a common external tariff (CET) comprising four rates: 0, 5, 15, and 30 per cent. Rules of origin exits and are based on a value content criterion that allows a 60% import content and 35% domestic/regional value content.

SADC

The Southern African Development Community (SADC), formerly known as the Southern African Development Co-ordination Conference (SADCC), was established in 1992. Its member states are Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. The membership has remained the same with the exception of South Africa, which was not a member under SADCC.

There are currently very few investment provisions guaranteed by SADC. However plans to establish more comprehensive provisions under the Protocol on Finance and Investment indicate an increasing awareness of the need for greater regional investment co-operation. Although the most basic of investment provisions are lacking, SADC does provide a disputes settlement mechanism for state-state disputes and access to international arbitration through the ICSID.

There has only recently been some progress towards greater trade liberalisation. The SADC Trade Protocol commenced operation in January 2001. A number of countries have begun to implement their commitments under this agreement and grant duty-free access, on a reciprocal basis, to imports of category A products (mostly capital goods and equipment) from other members that have also adopted the Protocol. These include Malawi, Mauritius and Zambia. Contrastively, those members that are also members of SACU, such as South Africa, Botswana and Lesotho apply SACU's common external tariff. Rules of origin exist and are based on a value content criterion that allows 70-35% import content.

ASEAN
The Association of South East Asian Nations (ASEAN) was established in 1967. The original members were Indonesia, Malaysia, Philippines, Singapore and Thailand. Brunei Darussalam later joined in 1984, followed by Vietnam in 1995 and Laos and Myanmar in 1997. Cambodia became the tenth member of ASEAN, acceding to all agreements in 1998. Since its inception, ASEAN has made significant developments in the attainments of greater regional trade and investment cooperation.

The first major attempt to enhance regional investment cooperation was the 1987 ASEAN Agreement on the Promotion and Protection of Investment. The provisions established under this agreement were improved under the 1996 Protocol to Amend the 1987 Agreement. These achievements were further developed and consolidated with the signing of the Framework Agreement on the ASEAN Investment Area in 1998 (AIA). The AIA endeavours to establish a regional investment area incorporating all ten members. It thus represents a significant step towards greater regional investment cooperation. Other programmes that have been developed to facilitate investment in the region include the ASEAN Industrial Cooperation scheme (AICO Scheme) which seeks to promote joint manufacturing industrial activities between ASEAN-based companies.

The Agreement on the Promotion and Protection of Investment guaranteed ASEAN investors free transfer of funds across borders and protection from expropriation and nationalisation. It also established a dispute settlement mechanism for state-state disputes and access to a number of international arbitration bodies, most notably the International Centre for the Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL). ASEAN's dispute settlement mechanism has been effective with at least on case put forward for arbitration.

The AIA enhanced this framework with the establishment of a more comprehensive range of provision. It grants national treatment for the establishment, acquisition, expansion, management, operation, and disposition of investment to ASEAN members immediately. Sectors exempted either under the Exclusion List or Sensitive

List are to be progressively liberalised by 2010, later reduced to 2003. National treatment has also been extended to non-ASEAN investors by 2020, later shortened to 2010. In addition, most favoured nation treatment was also granted to ASEAN investors. Finally, laws restricting foreign shareholders in national companies have been deregulated. A short term measure has been implemented which suspended laws regulating equity joint ventures between foreign and local enterprises and 100% foreign equity. ASEAN has also launched a series of joint outward investment promotion events to promote investment opportunities in the region and has various other activities to promote investment co-operation, including high-level meetings for relevant ministers to discuss investment related issues.

There have also been important developments in the trade regime in the region. Although a Common External Tariff does not exit, the signing of the ASEAN Free Trade Area (AFTA) in 1992 has witnessed significant steps towards regional trade liberalisation. Intra-regional tariffs have been gradually reduced from the 1992 average of 12% to less than 5% now. AFTA was expected to reduce tariffs to between 0 - 5% for all trade between member nations by 2008. This was brought forward to 2002 for the six original founding members. The Common Effective Preferential Tariff scheme is the main trade instrument of AFTA, which covers on average 90% of the tariff lines of all ASEAN member nations. The intraregional tariff rates range from 7% (Cambodia) to 0% (Singapore). Rules of origin exist and are based on a value content criterion that allows a 60% import content.

The experience over the past three decades shows that regions can be subdivided into four categories with respect to investment provisions: 1) Regions that do not have investment related provisions except for trade rules; 2) Regions that impose a common policy toward investment (ANDEAN in the early 70s) more restrictive than initial individual member policies; 3) Regions that choose to develop a common approach gradually over time introducing provisions that stimulate regional investment co-operation and regional investment promotion and (beginning to) grant national and MFN treatment (pre and post establishment) to foreign firms (ASEAN); and 4) regions that include comprehensive investment provisions from the start, including pre-establishment national treatment and effective investor-state dispute mechanisms (NAFTA).

5.3 An overview of regional provisions by investment provision

We now discuss investment related provisions by provision for the key regions identified above. The aim is to find variation in key provisions (as discussed under trade and investment rules in chapter 2) and quantify these, and this provides a cross-section element to investment provisions in regions. This can help to prepare an index of integration relevant for investment. We discuss investment rules, trade rules and others.

Scope and coverage
Even though RTAs is normally a preferential agreements for its members, in some cases the provisions are wider and apply to non-members. Under certain conditions, this is the case in NAFTA and MERCOSUR and planned for in ASEAN / AFTA (AIA). Other regions are more discriminatory in favour of intra-regional FDI such as CARICOM.

National Treatment and MFN
Some regions are now offering national treatment to regional investors pre and post establishments, e.g. in NAFTA and recently in ASEAN . However, for others free movement of capital remains an aspiration (e.g. COMESA).

Performance requirements, transfer of funds and expropriation
Some regions are quite strict on performance requirements and would not allow any (NAFTA), while other regions maintain the possibility contain a list of preferences and requirements applied to existing investment (CARICOM) though not new investment.

Dispute Settlements Mechanisms
While most regions have some state-state dispute settlement mechanisms, few have effective investor-state dispute mechanisms. NAFTA is the best example of an effective investor-state dispute mechanism, while ASEAN has also had at least one dispute – allegedly between a Singaporean investor and Myanmar - referred to arbitration under the ASEAN Investment Agreement. But less is known about the effectiveness of the investor-state provision in MERCOSUR or state-state provisions in SADC and COMESA.

Table 5.1 Summary of WTO Survey of Rules of Origin; selected regions

A. **General Criteria of the Rules of Origin**

RTAs	Criterion			Tolerance Rule	
	CTH	**Percentage**	**Technical test**	**Limitation (% of value)**	**Exceptions**
NAFTA	√	√	√	7%	Textiles: 7% Agricultural, few industrial prod.
ASEAN		√	√	No	
CARICOM	√				
COMESA	√	√		No	
MERCOSUR	√	√		No	
SADC	√	√	√	10%	Textiles and others
ANDEAN		√			

B. Rules of Origin based on the Percentage Criterion

RTAs	General criterion and Limitations			Basis for calculation			
	Import content	Domestic content	Value of parts	c.i.f.	f.o.b.	Ex-works	Cost prod.
NAFTA		√ 60%-50%			√ 60%		√ 50%
ASEAN	√ 60%				√		
CARICOM	n.av.						
COMESA	√ 60%	√ 35%		√			
MERCOSUR	√ 40%	√ 60%			√		
ANDEAN	√ 50%				√		
SADC	√ 70-35%					√	

C. Exceptions to the General Criteria of the Rules of Origin

RTAs	Criterion for exceptions			Sector-specific
	CTH	Percentage	Technical Test	
NAFTA		√		Yes (auto)
ASEAN			√	Yes (textiles)
CARICOM	n.av.			
COMESA		√ (DC, 25%)		
MERCOSUR		√ (DC, 33%-60% for certain automotive)	√	Yes (dairy, chemicals, steel, auto)

D. Drawback provisions

RTAs	Allow for drawback	No-drawback		Drawback not mentioned
		Rule	Derogation	
NAFTA		√	2 y. (Canada, US), 7 y. (Mex.)	
ASEAN	√			
CARICOM	√			
COMESA	√			
MERCOSUR	√	√		

Sources: WTO (2002), Estevadeordal and Suominen (2003)

Rules of Origin

Several publications have highlighted RoO as affecting locational decisions (Estevadeordal and Suominen, 2003). The rules of origin differ amongst regions, and the table below contains a summary on the basis of existing surveys of rules of origin in RTAs. While it very difficult to calculate overall restrictiveness as much is sector, chapter, heading or product specific, it is possible to have some simple ordering of RoOs in RTAs by following chart 5.1 in Estevadeordal and Suominen (2003) documenting the mean restrictiveness. Note that certain sectors have stricter rules of origin than others: for instance, the textiles and clothing sector faces higher than average restrictiveness in NAFTA, SADC and the Pan-Euro system.

We can also use a simple measure using the percentage criterion for maximum import value or domestic content (panel B). On the latter measure NAFTA and MERCOSUR have stricter RoO than the other regions.

Tariff structures

An important element for extra-regional investors is how intra-regional tariffs compare with MFN tariffs, because it determines the "market size effect" of an RTA. It depends on the regional preferences and the level of initial tariffs. In some cases regional preferences are set at a fixed percentage of MFN tariffs, or at a certain level fixed below the MFN (which may have to be revised if and when the MFN is revised), while in other regions there is a schedule for the phase-out of intra-regional tariffs altogether.

As Table 2.2 showed, there are quite big variations in preferences granted as a percent of the total import prices. For the regions shown they are low for SAARC because it grants very low regional preferences, low for AFTA because it already has low tariffs but high for the Latin American regions, partly because their intra-regional tariffs are very low, of course with exception on some products.

Others

No region is the same. The regions under discussion have designed various schemes to foster regional enterprises (ANDEAN), investment co-operation and promotion (ASEAN), and movement of people in CARICOM. These are likely to affect mainly intra-regional FDI.

Conclusions

The above sections 5.2 and 5.3 show that there is a wide variation in regional provisions across regions (this is summarised in table 5.2). On the basis of the above information it is possible to design some basic integration index with respect to investment related provisions (trade rules and investment rules) which varies across regions. This is shown at the bottom of the table. It basically reflects whether trade rules or investment rules in regions can be expected to increase FDI. Because regions have implemented different provisions, the expected effects on FDI would be different, indicated by a different index. For example, granting pre-establishment national treatment is one if the reason why the investment rule index scores high for NAFTA. On the other hand, there seems to be only limited progress in the implementation of the SADC trade protocol so that is why the trade rule index scores low for SADC. It is possible to design different indices weighing individual rules differently and we will experiment with these in more detail in a forthcoming empirical part. Note too that this integration index is cross-section and it is possible to design integration indices that vary over time – e.g. to reflect changes in investment provisions in ASEAN or ANDEAN. The main conclusion is that apart from changing over time regions can also be very different depending on which provisions it has implemented. This has clear implications for the expected effects of regions on extra and regional FDI.

Table 5.2Summary table of investment related provisions in RTAs.

	NAFTA	*MERCOSUR*	*CARICOM*	*ANDEAN*	*ASEAN*	*SADC*	*COMESA*
INVESTMENT RULES							
What year did investment provisions come into force at regional level	1994	1994	1982 & 1997	1991	1987 & 1998	Few provisions	1994
1 Scope and coverage							
a Applicable to non-parties (when or when not)	Yes	Yes	No	Yes	AIA National Treatment		No
b Positive or negative list approach	Negative	Colonia – Negative Buenos Aires - positive	Positive	Positive	1987 – positive AIA- negative		Positive
c Main exceptions (safeguards, sectors etc.)							
2 National Treatment							
a Pre-establishment (all sectors?)	Yes	Yes	No	Not specified	Yes	No	No
b Are there restrictions on ownership rules? (e.g. min equity share)	Yes	No	No	No	Yes	No	No
c Operations by MNEs in the country	Yes	Yes	No	Not specified	Yes	No	No
3 Most Favoured Nation and fair and equitable treatment							
a granted to parties	Yes	Yes	No	No	Yes	No	Yes – fair & equitable
b non-parties	Yes	Yes	No	No	No	No	No
4 Performance requirements							
a Are they banned for new and existing investment?	Yes	Yes	No	Yes	No	No	No
b Do they go beyond TRIMs?	Yes	Yes		No			
5 Transfers of funds							
a Are transfer of funds across borders allowed	Yes	Yes	Yes	Yes	Yes	No	Yes
6 Do provisions with respect to expropriation exist (nationalisation ,etc.)	Yes	Yes	Yes	Yes	Yes	No	Yes
7 Settlement of Disputes							
a State-to-state	Yes	Yes	Yes	Yes	Yes	Yes	Yes
b Investor-state	Yes	Yes	Yes under certain conditions	No	Yes	No	No
c Access to International Dispute Settlement (ICSID, UNCITRAL)	Yes	Yes	Yes	Yes	Yes	Yes	Yes
TRADE RULES							
9 Rules of Origin							
a Do rules or origin exist	Yes	Yes	Yes	Yes	Yes	Yes	Yes
b Value Content Criterion: Domestic/Regional Value Content (RVC)	RVC 50-60%	MC40% RVC60%	N/A	MC: 50%	MC: 60%	MC: 70-35%	MC:60% RVC:35%
c Are there roll-up arrangements?	Yes	Yes	-			Yes	Yes
d Are drawback allowed?	No	Yes	-		Yes		Not after 10 years
e Mean/median value of restrictiveness	4	3			4	4	3
10 Tariff structures							
a Does a Common External Tariff exist.	No MFN varies from 5.5% - 16.5%	Yes since 1995	Yes since 1991	Yes since 1993	No	No	No. Plans for CET
b Level of intra-regional tariffs and plans	0-2%	Duty free	Duty free	Duty free	0-7%	Mixture of duty free and SACU CET	Different levels of tariff elimination
c Exceptions	Yes	Yes	Yes				
11 Other relevant provisions (regional enterprise schemes, regional investment funds, etc.)			Free movement of people	Andean Multinational Enterprises Andean development Cooperation Andean Business Advisory Council	Asean Industrial Co-operation Regional Investment Promotion Events Asean Investment Portals		
Investment relevant integration index (1= no; 2=middle;3=integrated) INV	3	2	2	2	2/3	1	1
Investment relevant integration index (1= no; 2=middle;3=integrated) TRADE	2	3	3	2	1	1	1

Sources: tables in appendix 5.1. Note that cells represent a likely outcome, but will in reality depend on specific circumstances.

5.4 New evidence on the effects of regional integration on FDI

The effects of investment related provisions in regions can be treated more formally. Extending the review by Dunning (1997b) there are basically two ways in which this can be done. First, we can take a standard FDI model with standard explanatory variables such as costs, market size, risk, etc. and include an additional variable measuring the degree of implementation of the investment provisions. In this way we can isolate a separate RTA (provision) effect

$$FDI_{ijt} = f(FDI_{ijt-1}, HOME_{ijt}, HOST_{ijt}, OTHER_{ijt}, RTA_{kjt})$$

where FDI is the real stock of FDI, i is the home country, j is the host country, t time. *HOST* country factors can include amongst others market size, relative labour costs, human capital, indicators for natural resource availability and privatisation efforts and risk measures. *HOME* country factors from country i provided in country j. *OTHER* include such variables as distance or shared language. *RTA* denote measures of (the sum of) investment related provisions k in an RTA applicable in host country j at time t. Rules that are expected to raise FDI (extra, and/or intra regional FDI) would show in the regression with a significant and positive regression coefficient.

A second way to assess the effects of regional investment related provisions on FDI is by considering the impact of provisions on individual determinants of FDI (host market size, regional market size, efficiency or costs, risk, etc.) in addition to an effect independent from the other determinants. For instance, the following simple equation tries to account for this

$$FDI_{ijt} = f(FDI_{ijt-1}, Y_{jt}, RY_{jt}, RELCOST_{jt}, RISK_{jt}, OTHER_{ijt}, RTA_{kjt})$$

where *RELCOST* is a measure of relative investment costs such as relative unit labour costs, *RISK* is a measure of risk factors, *Y* is the market size of the host economy, and *RY* is the “regional market size” that countries of a region by lower intra-regional tariffs to the members of the region. Investment related provisions in RTAs can potentially affect (sign of provision above the variable) most of these explanatory variables, see panel below.

Dunning (1997b) argues that the main effects of RTAs work through the explanatory variables and are dynamic. We can control for the regional market size effect, by including it as an explanatory variable in the regression. However, this is not as straightforward for the other effects on explanatory variables, so the variable RTA in the above equations will pick up such effects.

Table 5.3 Investment related provisions and explanatory variables of FDI

Investment provision	**Relationship with determinant of FDI**	**Relationship explanatory variable and FDI**
Tariffs	$Y = f(\overset{-}{T}, OTHER)$, as lower tariffs, T, (regionally or MFN) foster growth	More growth, more FDI
Tariffs, Rules of Origin	$RY = f(\overset{+}{\sum_{members=l}} Tpref_l Y_l, \overset{+}{RoO})$, as larger regional preferences through lower intra-regional tariffs provide for a "larger" or more accessible regional market; similarly, the stricter the rules of origin the more important is the regional market.	A larger regional market, may lead to more (extra-regional) FDI
Tariffs	$RELCOST = f(\overset{+}{T}, OTHER)$, as lower tariffs (regionally or MFN) foster competition and more efficiency and this lower costs relative to outside the region	More efficiency leads to more FDI in the longer-term
Investment provisions	$RISK = f(\overset{-}{RTAinv}, OTHER)$, as more investment provisions safeguarding the interest of investors vis-à-vis governments would mean lower (political) risks	Lower risk fosters more FDI when the economic fundamentals are right
All RTA provisions	RTA measures all other aspects, e.g. a signalling or locking-in effect	

Te Velde and Bezemer (2004) estimated a model explaining the real stock of UK and US FDI in developing countries identified the effects of specific regional investment-related provisions, in the 7 key regions identified in table 5.2, on FDI controlling for key factors behind investment decisions such as education, infrastructure and market size. The provisions in regions with substantial provisions were measured not just across regions but also over time, as is shown in table 5.4. A higher value of the index is associated with more FDI (from outside the region). Implementation will vary by country, but for trade provisions such as tariff preferences, for example, we have used averages for the region.

It was found (table 5.5) for seven RTAs that i) membership of a region leads to further FDI inflows from outside (stock of UK and US FDI), but the type of regional provisions matters, i.e. whether or not regions include certain trade and investment provisions (column 1); and ii) that the position of countries within a region matters, i.e. that smaller countries and countries located further away from the largest country in the region benefit less from being part of a region than larger countries and those closer to the core of the region (column 2). The final column of table 5.5 shows that total inward FDI is higher in regions with provisions pointing to investment creation effects (column 3).

Table 5.4 Regional Integration Index for key regions

RTA (date of establishment)	Investment provisions 1970s	Investment provisions 1980s	Investment provisions 1990s	Trade provisions 1970s	Trade provisions 1980s	Trade provisions 1990s
NAFTA (1994)	0	0	3 (1994)	0	0	2 (1994)
MERCOSUR (1991)	0	0	2 (1994)	0	0	3 (1991)
CARICOM (1973)	0	1 (1982)	2 (1997)	1 (1973)	2	3 (1997)
ANDEAN (1969)	-1(1970)	1 (1987)	2 (1991)	1	1	2 (1993)
ASEAN	0	1 (1987)	2 (1996), 3 (1998)	1	1	1
SADC (1992)	0	0	1 (1992)	0	0	1 (1992)
COMESA (1994)	0	0	1 (1994)	0	0	1 (1994)

Notes: years between parentheses indicate when certain provisions were announced.

Investment Index
= 0 if not member of group
= 1 if some investment provisions in region (as in COMESA, SADC),
= 2 if advanced investment provisions in region (e.g. improved investor protection in ASEAN)
= 3 if complete investment provisions in region (e.g. Chapter XI of NAFTA)
= -1 if more restrictive provisions (restrictions on foreign investors in ANDEAN in 70s)

Trade Index
= 0 if not member of group
= 1 if some trade provisions (e.g. tariff preferences),
= 2 if low MFN, (close to) zero intra-reg tariffs
= 3 if high MFN, (close to) zero intra-reg tariffs

Table 5.5 Regional Integration and FDI in developing countries

	UK and US FDI (log of real stock) (1981-2000)		Total FDI (flows) (1981-2000)
GDP in host country (log)	0.68**	0.67**	0.79**
GDP growth			0.035**
Education (average primary, secondary and tertiary)	0.004**	0.004**	0.006**
Inflation	0.00	0.00	-0.00
Phone lines per 1000 inhabitants	0.003**	0.003**	0.0007*
Roads (% paved)	0.17**	0.11*	0.01
Regional Investment Provisions (index table 5.4) – for key regions only	0.41**	0.17*	0.38*
Regional Investment Provisions * ratio of host country to largest GDP in the region		0.80**	
No of observations	1521	1521	2230
No of countries	68 for UK 97 for US	68 for UK 97 for US	
R-squared	0.44	0.45	0.61

Notes: robust standard errors within parentheses, Constant, US fixed effect and time dummies omitted from tables, ** (*) denotes 5% (10%) significance level

5.5 Conclusions

This chapter has discussed the expected effects of investment related provisions in RTA and has assessed the way in which they have been implemented for a number of key regions. Important in all RTAs are trade rules. Trade liberalisation is likely to foster extra regional FDI, particularly in those sectors with high MFN tariffs (e.g. car components in Mercosur) and tight rules of origin, but is more ambiguous with regard to intra-regional FDI, as there is a trade-off between the importance of transport costs, firm level specific and plant level fixed costs. Investment rules when offered in package of other locational specific factors including basic fundamentals should provide a more welcoming investment climate. However, in reality there will be many specific factors that play a role when determining the effects of RTAs on FDI:

- Extent of regional tariff preferences (and other trade barriers)
- Restrictiveness of rules of origin
- Differences with actual regional investment rules
- Initial situation, including the structure of investment and existing liberalisation
- Plant level and firm level fixed costs
- Existing economic factors

We have shown that regions differ in two fundamental respects:

- *Over time* when one region can change or add investment related provisions
- *Across regions* when investment related provisions differ at one single point in time

A comparison of regions also showed that investment related provisions in key regions differ significantly, including differences in

- Extent of regional tariff preferences
- Restrictiveness of Rules of Origin
- Investment rules, including national treatment for pre and post establishment and presence of effective dispute settlement mechanisms
- Regional co-ordination on investment
- Type of membership: North-North, South-South, North-South, South-South-North.

A summary of the effects of RTAs on FDT shows that regional integration raises investment (from outside the region), but the benefits are likely to be distributed unequally across the region.

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CARICOM

Treaty of Chaguaramas (1973)
Agreement for the Establishment of a Regime for Caricom Enterprises (1987)
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ASEAN
ASEAN Agreement for the Protection and Promotion of Investment (1987)
Revised Basic Agreement on ASEAN Industrial Joint Ventures (1987)
Framework Agreement on the ASEAN Investment Area (1998)
Protocol to Amend the Framework Agreement on the ASEAN Investment Area (2001)

SADC
Treaty establishing Southern African Development Community (1992)

COMESA
The COMESA Treaty (1994)

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CARICOM Secretariat. www.caricom.org
COMESA. www.comesa.org.
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Foreign Trade Information Systems. www.sice.org
Mercosur Red Academica Uruguaya. www.rau.edu.uy/mercosur
Organisation of American States. www.oas.org
OECD. www.oecd.org
SADC. www.sadc.int
UNCTAD. www.unctad.org
World Trade Organisation. www.wto.org

APPENDIX 5.1 Membership of regional trade agreements involving developing countries.

Asia Pacific Economic Co-operation Forum 1989
Australia
Brunei Darussalam
Canada
Chile (entered November 1994)
China (entered November 1991)
Hong Kong (entered November 1991)
Indonesia
Japan
Korea
Malaysia
Mexico (entered November 1993)
New Zealand
Papua New Guinea (entered November 1993)
Peru (entered November 1998)
Philippines
Russia (entered November 1998)
Singapore
Chinese Taipei (entered November 1991)
Thailand
United States
Vietnam (entered November 1998)

Association of South East Asian Nations 08/08/1967
Brunei Darussalam entered 8/1/1984)
Cambodia (entered 30/4/1999)
Indonesia
Malaysia
Myanmar (entered 23/7/1997)
Laos (entered 23/7/1997)
Philippines
Singapore
Thailand
Vietnam (entered 28/7/1995)

Bangkok Agreement 17/06/1976
Bangladesh
China (formally became a member in 2000)
India
Republic of Korea
Laos
Sri Lanka

Economic Cooperation Organisation 1985,
Afghanistan (entered1992)
Azerbaijan (entered 1992)
Iran
Kazakhstan (entered 1992)
Kyrgyz Republic (entered 1992)
Pakistan
Tajikistan (entered 1992)
Turkey
Turkmenistan (entered 1992)
Uzbekistan (entered 1992)

Indian Ocean Rim Association for Regional Co-operation 1997 (March)
Australia
Bangladesh

India
Indonesia
Iran
Kenya
Madagascar
Malaysia
Mauritius
Mozambique
Oman
Seychelles
Singapore
South Africa
Sri Lanka
Tanzania
Thailand
United Arab Emirates
Yemen

South Asian Association for Regional Cooperation 08/12/1985
Bangladesh
Bhutan
India
Maldives
Nepal
Pakistan
Sri Lanka

ACS Association of Caribbean States 24/07/1994
Antigua & Barbuda
Bahamas
Barbados
Belize
Colombia
Costa Rica
Cuba
Dominica
Dominican Republic
El Salvador
Granada
Guatemala
Guyana
Haiti
Honduras
Jamaica
Mexico
Nicaragua
Panama
St Kitts & Nevis
St Lucia
St Vincent & the Grenadines
Surinam
Trinidad & Tobago
Venezuela

CACM Central American Common Market 12/10/1961
Costa Rica
El Salvador
Guatemala

Honduras
Nicaragua

CAN Andean Community 25/05/1988
Bolivia
Colombia
Ecuador
Peru
Venezuela

CARICOM Caribbean Community and Common Market 01/08/1973
Antigua & Barbuda
Bahamas (entered 4/7/1983 - not a member of the common market)
Barbados
Belize
Dominica
Granada
Guyana
Haiti (entered July 2002)
Jamaica
Montserrat
St. Kitts & St Nevis
St Lucia
St Vincent & the Grenadines
Surinam
Trinidad & Tobago

G3 Group of Three 1995
Colombia
Mexico
Venezuela

LAIA Latin American Integration Association 18/03/1981
Argentina
Bolivia
Brazil
Chile
Colombia
Cuba (entered 6/11/1998)
Ecuador
Mexico
Paraguay
Peru
Uruguay
Venezuela

MERCOSUR Southern Common Market 29/11/1991
Argentina
Brazil
Paraguay
Uruguay

NAFTA North American Free Trade Agreement 01/01/1994
Canada
Mexico
United States

OECS Organisation of Eastern Caribbean States 18/06/1981
Antigua & Barbuda
Dominica

Grenada
Montserrat
St Kitts & Nevis
St Lucia
St Vincent & the Grenadines

SICA Central American Integration System 1993 (February)
Belize
Costa Rica
El Salvador
Guatemala
Honduras
Nicaragua
Panama

AMU Arab Maghreb Union 17/02/1989
Algeria
Libya
Mauritania
Morocco
Tunisia

CBI Cross Border Initiative 1993 (August)
Burundi
Comoros
Kenya
Madagascar
Malawi
Mauritius
Namibia
Rwanda
Seychelles
Swaziland
Tanzania
Uganda
Zambia
Zimbabwe

CEMAC Economic and Monetary Community of Central Africa 24/06/1999
Cameroon
Central African Republic
Chad
Congo
Equatorial Guinea
Gabon

CEPGL Economic Community of the Great Lakes Countries 20/09/1976
Burundi
Democratic Republic of Congo
Rwanda

COMESA Common Market for Eastern and Southern Africa 08/12/1994
Angola
Burundi
Comoros

Democratic Republic of Congo
Djibouti
Egypt
Eritrea
Ethiopia
Kenya
Madagascar
Malawi
Mauritius
Namibia
Rwanda
Seychelles
Sudan
Swaziland
Uganda
Zambia
Zimbabwe

EAC East African Community 07/07/2000
Kenya
Tanzania
Uganda

ECCAS Economic Community of Central African States 18/10/1983
Angola (entered in 1999)
Burundi
Cameroon
Central African Republic
Chad
Democratic Republic of Congo
Republic of Congo
Equatorial Guinea
Sao Tome & Principe

ECOWAS Economic Community of West African States 28/05/1975
Benin
Burkina-Faso
Cape Verde
Cote d'Ivoire
Gambia
Ghana
Guinea
Guinea-Bissau
Liberia
Mali
Mauritania
Niger
Nigeria
Senegal
Sierra Leone
Togo

IOR-ARC Indian Ocean Rim Association for Regional Co-operation 1997 (March)
Australia
Bangladesh
India
Indonesia
Iran
Kenya
Madagascar
Malaysia
Mauritius
Mozambique
Oman
Seychelles
Singapore
South Africa
Sri Lanka
Tanzania
Thailand
United Arab Emirates
Yemen

MRU Mano River Union 03/10/1973
Guinea (entered 25/10/1980)
Liberia
Sierra Leone

SACU Southern African Customs Union 01/03/1970
Botswana
Lesotho
Namibia
South Africa
Swaziland

SADC Southern African Development Community17/08/1992
Angola
Botswana
Democratic Republic of Congo
Lesotho
Malawi
Mauritius
Mozambique
Seychelles (may leave SADC)
South Africa
Swaziland
Tanzania
Zambia
Zimbabwe

TRIPARTITE Tripartite Agreement 01/04/1968
Egypt
India
Yugoslavia

UEMOA West African Economic and Monetary Union 01/08/1994
Benin
Burkina Faso
Cote d'Ivoire
Guinea Bissau (entered 2/5/1997)
Mali
Niger
Senegal
Togo

Other regions involving developing countries

EC – Chile 2003

EC - South Africa Free Trade Agreement 01/01/2000

EC - Morocco Free Trade Agreement 01/03/2000

EC - Mexico Free Trade Agreement 01/07/2000

EC - Mexico Services Agreement 01/03/2001

EC - Tunisia Free Trade Agreement 01/03/1998

EC - Egypt Free Trade Agreement 01/07/1977

EC- Algeria Free Trade Agreement 01/07/1976

Cotonou Agreement Signed 23/6/2000 EU - ACP group of countries

US-Vietnam Free Trade Agreement 10/12/2000

US-Singapore Free Trade AgreementSigned 5/6/2003

US-Chile Free Trade AgreementSigned 6/6/2003

APPENDIX 5.2 Investment related provisions in key regions

NAFTA

Members (late membership between parentheses)	Canada Mexico United States	Established 1/1/1994
INVESTMENT RULES		
What year did investment provisions come into force (variable?)	01/01/1994	
1 Scope and coverage	Investors of a NAFTA state and investment of investors of a NAFTA state	Article 1101
a Applicable to non-parties (when or when not)	Non-NAFTA investors with investments in one NAFTA country are assured the benefits of Chapter 11 if they decide to expand their operations into the other NAFTA countries as long as they have "substantial business activities in the territory of the Party" where they were originally established. Particular disciplines re: performance requirements and environmental measures apply to all investment (inc domestic investment and investment from non-NAFTA parties)	Article 1106 (Performance requirements) Article 1114 (Environmental measures)
b Positive or negative list approach	negative list	
c Main exceptions (safeguards, sectors etc.)		
Mexico	Excludes: petroleum sector; electricity; nuclear power and treatment of other radio-active materials; telecommunications and media - all state owned sectors. Health and social services. Control of air and maritime ports.	Annex III, Chapter 11
Canada	Excludes: Cultural Industries; health and social services; aboriginal affairs; large scale water exports	Article 2106/ Annex 2106
United States	Excludes: health and social services. All maritime activities are highly restrictive.	
2 National Treatment	Yes with respect to the establishment, acquisition, expansion, management, conduct, operation and sale	Article 1102

a Pre-establishment (all sectors?)	Yes - covers all sectors unless exempted. Exemptions: Canada: Aboriginal affairs, some communications sectors, social services, some transportation. Mexico: Media, some communications and transport, energy and social services. US: Communications, social services, some media and transportation.	
b Are there restrictions on ownership rules? (e.g. min equity share)	Yes - No Party may impose a requirement that a minimum level of equity in an enterprise be held by its nationals, other than nominal qualifying shares for directors etc or require an investor of another Party, by reason of its nationality, to sell or dispose of an investment in the territory of the party	
c Operations by MNEs in the country	Yes	
3 Most Favoured Nation and fair and equitable treatment	Yes	Article 1103/ Article 1104
a granted to parties	Yes - No less favourable treatment than that granted to non-parties and that provided by international law.:	Exceptions: Article 1113
non-parties	Yes - Applies to 'third party' investors and their investments.	
4 Performance requirements	Yes - Outright prohibition on the use of certain performance requirements by NAFTA states. Exceptions: environmental standards; standards for employee training are permitted; no ban on requirements for R&D	Article 1106 Article 1106.2 & 1114 (Environmental Standards) Article 1106.4 (Employee training/ R&D)
	NB. Applies to requirements placed on any investment (inc non-NAFTA)	Article 1106
a Are they banned for new and existing investment?	Yes	
b Do they go beyond TRIMs?	Yes - no party may impose the following requirements: export requirements; minimum domestic content; domestic sourcing requirements; trade balancing; technology transfer; 'exclusive supplier' requirements	
5 Transfers of funds		
a Are transfer of funds across borders allowed	Yes - all transfers relating to an investment can be made freely without delay.	Article 1109
6 Do provisions with respect to expropriation exist (nationalisation, etc.)	Yes - no party may directly or indirectly nationalise/expropriate an investment of an investor of another party in its territory. Except: for public purposes; on a non-discriminatory basis; in accordance with due process of law and fair and equitable treatment; on payment of compensation	Article 1110

7 Settlement of Disputes		Article 1115
a State-to-state	Yes	Chapter 20
b Investor-state	Yes	Article 1116 - Article 1120
c Access to International Dispute Settlement (ICSID, UNCITRAL)	Yes - Arbitration under World Bank ICSID/ UNCITRAL. A Tribunal is established that is empowered to order interim measures to protect the rights of disputing investor	
8 Provisions for incentives and subsidies		
TRADE RULES		
9 Rules of Origin		
a Do rules or origin exist	Yes	
b Value Content Criterion: Domestic/Regional Value Content (RVC)	RVC: 60-50%	
c Are there roll-up arrangements?	Yes except automotive	
d Are drawback allowed?	No after 7 years for Mexico	
e Mean/median value of restrictiveness	4	
10 Tariff structures		
a Does a Common External Tariff exist. If so what is it and will it be? If not, give indication of country dispersion	No.	
	Applied MFN was 16.5 in 2001 for Mexico; 5.5 in 2000 in US; ad valorem MFN is 7.7 in Canada in 1998	
b Level of intra-regional tariffs and plans	Most merchandise liberalised between 1994 and 1998; Intra-regional trade face 0-2% average applied tariffs	
c Exceptions	High applied MFN for food, animal, footwear textile and clothing products in Mexico, Canada and US and textile and clothing in US and Canada; expected phase out of sensitive products until 2019 of motor vehicles, maize, milk and beans	
11 Other relevant provisions (regional enterprise schemes, regional investment funds, etc.)		

<u>MERCOSUR</u>

Members (late membership between parentheses)		Established 29/11/1991
	Argentina	

	Brazil Paraguay Uruguay	
INVESTMENT RULES		
What year did investment provisions come into force (variable?)	The Colonia Protocol for the Promotion and Protection of Investments in Mercosur was approved by the Decision No. 11/93 of the Common Market Council of January 17, 1994. The Buenos Aires Protocol for the Promotion and Protection of Investments in Mercosur from Non-Member Countries was approved by Decision No. 11/94 August 5, 1994.	
1 Scope and coverage	Any natural person who is a national of, permanently resides, or is domiciled in a Contracting Party in accordance with its laws. The Protocol does not apply to investments made in the territory of one Contracting Party by natural persons who are nationals of the other Contracting Party if they, by the date the investment is made, permanently reside or are domiciled in the host country, unless it is proved that the investment was admitted from abroad. Any legal person constituted under the laws and regulations of a Contracting Party, and having its seat in the territory of said Party; and, any legal person constituted under the laws of the host country but effectively controlled, directly or indirectly, by a natural or legal person as defined above.	Article 1 (2) Colonia Protocol
a Applicable to non-parties (when or when not)	Yes - The Buenos Aires Protocol creates provisions for Non-parties with respect to MFN and transfer of funds	(Article 2(C)(3) of the Buenos Aires Protocol).
b Positive or negative list approach	Colonia Protocol: negative. Buenos Aires Protocol: Positive	
c Main exceptions (safeguards, sectors etc.)	A number of transitory exceptions were agreed	
Argentina	Border real estate; air transportation; shipbuilding; nuclear power generation; uranium mining; insurance and fisheries	
Brazil	Exploration and exploitation of minerals; hydroelectric power; health care, telecommunications; rural property; banking and insurance services; construction and shipping	
Paraguay	Real property in the frontier zones; communication/media; air land or maritime transportation; electricity; water and telephones; exploitation of hydrocarbons and strategic minerals; importation and refining petroleum products and postal service	

Uruguay	Electricity; hydrocarbons; petrochemicals and plastic industries; nuclear energy; strategic mineral extraction and exploitation; financial industries; rail transportation; telecommunications; radio and television and journalism	
2 National Treatment	Yes - Parties must accord to investment of investors of member parties treatment which is no less favourable than accorded to investment of its own investors or investors of third states	Article 3 Protocol of Colonia
a Pre-establishment (all sectors?)	Yes	
b Are there restrictions on ownership rules? (e.g. min equity share)	No	
c Operations by MNEs in the country	Yes	
3 Most Favoured Nation and fair and equitable treatment	Yes	Article 3 Protocol of Colonia
a granted to parties	Yes	Article 3 Colonia Protocol
non-parties	Yes - But the application of MFN treatment is left to the discretion of each Mercosur country: Each Member Party **may** accord to investments of investors of third States treatment no less favourable than that accorded to investments of investors of other States.	Article 2 Buenos Aires Protocol
4 Performance requirements	Yes - Brazil and Argentina have reserved the right to maintain performance requirements in the automobile sector	Article 3 Protocol of Colonia
a Are they banned for new and existing investment?	Yes - No party shall impose performance requirements as a condition for establishment, expansion or maintenance of investments	
b Do they go beyond TRIMs?	Yes	
5 Transfers of funds		
a Are transfer of funds across borders allowed	Yes - Free transfer of investment and returns	Article 5 Protocol of Colonia; Article 2E of Protocol of Buenos Aires
6 Do provisions with respect to expropriation exist (nationalisation ,etc.)	Yes - Except on public interest grounds; on a non-discriminatory basis with respect to due process and prompt and fair compensation	Article 4 Protocol of Colonia

7 Settlement of Disputes		Initially established under Brasilia Protocol for the Settlement of Disputes in 1991 (in force as of 1993) were expanded by the Ouro Preto Protocol in 1994
a State-to-state	Yes - Disputes between states will be settled according to the terms and conditions set out in the protocol of Brasilia	Colonia Protocol Article 8
b Investor-state	Yes - In the first instance amicable negotiations. If the dispute is not settled in six months, an investor may seek resolution via national legal means, international arbitration or by a system of permanent dispute settlements that will be established under the framework of the Treaty of Asuncion	Colonia Protocol Article 9
c Access to International Dispute Settlement (ICSID, UNCITRAL)	Yes - Investor may choose CIADI or United Nations system for the settlement of disputes	
8 Provisions for incentives and subsidies		
TRADE RULES		
9 Rules of Origin		
a Do rules or origin exist	Yes	
b Value Content Criterion: Domestic/Regional Value Content (RVC) or Import Content (MC)	MC:40% RVC: 60%	
c Are there roll-up arrangements?	Yes except automotive	
d Are drawback allowed?	Yes except automotive imports from Argentina and Brazil	
e Mean/median value of restrictiveness	3 (Based on MERC-Bol/Chi)	
10 Tariff structures		
a Does a Common External Tariff exist. If so what is and will be average? If not, give indication of country dispersion	Yes since 1995; full implementation by 2006.	
b Level of intra-regional tariffs and plans	Phase out of intra-regional tariffs has proceeded since 1991 (85% of intra-regional trade became duty free in 1995)	
	Intra-regional trade is duty free	
c Main exceptions	General: Capital goods, informatics and telecommunications products	

Argentina: Automobiles, sugar and footwear have high CET or MFN (up to 30%)

11 Other relevant provisions (regional enterprise schemes, regional investment funds, etc.)

<u>CARICOM</u>

Members (late membership between parentheses)		Established 1/8/1973
	Antigua & Barbuda	
	Bahamas (entered 4/7/1983 - not a member of the common market)	The Single Market and Economy was launched 1/1/1991
	Barbados	
	Belize	
	Dominica	
	Granada	
	Guyana	
	Haiti (entered July 2002)	
	Jamaica	
	Montserrat	
	St. Kitts & St Nevis	
	St Lucia	
	St Vincent & the Grenadines	
	Surinam (1995)	
	Trinidad & Tobago	

INVESTMENT RULES

What year did investment provisions come into force (variable?)	Treaty of Chaguaramas establishing the Caribbean Community and the Caribbean Common Market, July 4, 1973. Protocol II which concerns the right of establishment, provisions for services and the movement of capital was signed in 1997. Not all members have enacted Protocol II. Some provisions were laid out in the Principles and Guidelines on Foreign Investment approved by the Caricom Heads of States of Government Conference 1982.

1 Scope and coverage

a Applicable to non-parties (when or when not)	No

b Positive or negative list approach	positive	
c Main exceptions (safeguards, sectors etc.)	In general foreign investment shall not be allowed in a sector/activity where there is need to; protect small entrepreneurs; insulate areas of the economy where investment is already adequate and where the effect of new overseas investment would be to drive out present investment; avoid threats to national security; create economic opportunities for nationals and nationally-controlled enterprises which need protection from more efficient foreign enterprises until, in the long run, they can develop the necessary entrepreneurial managerial and technological; capabilities to adequately service the sector/activity; curtail increased investment in service activities, thus giving preference to the goods-producing sector.	
2 National Treatment	No - recognises preferential treatment with regards to investments of its nationals. However it does establish that members shall not introduce in their territories any new restrictions relating to the right of establishment of nationals of other member states except as otherwise provided in the agreement.	Treaty of Chaguaramas, Caribbean Common Market Annex Article 35 .1; Protocol II
a Pre-establishment (all sectors?)		
b Are there restrictions on ownership rules? (e.g. min equity share)	No	
c Operations by MNEs in the country		
3 Most Favoured Nation and fair and equitable treatment	No - Cooperation agreements on foreign investments shall tend to accord preferential treatment to the following groups of entities, ranked as follows: 1 nationals of the host Caricom country, 2 nationals of other Caricom member countries, 3 Nationals of the sources countries - both developed and developing, 4 Other Countries	Head of Government Conference
a granted to parties		
non-parties		

4 Performance requirements	No - All foreign investments shall be required to meet performance criteria on a case by case basis as determined by Caricom host governments. Five criteria that will be required to be met; removal or reduction of restrictions under licensing agreements on production for both national and extra -regional markets; employment priority to be given first to nations of the host country, second to Carcim nationals and nationals of source country; and policies instituted to ensure that nations of the host country receive the necessary training and achieve the required experience to equip them top assume senior management positions; the use, where appropriate of local and regional; raw materials, other mineral inputs and services; the provision of externally generated financial resources to meet a reasonable proportion of long term and working capital needs of foreign enterprises; where there are joint venture enterprises, 'fade out, arrangements over time to enable ultimate local or regional control However Caricom does conform to WTO TRIMs	Heads of Government Conference 1982.
a Are they banned for new and existing investment?	No	
b Do they go beyond TRIMs?		
5 Transfers of funds		
a Are transfer of funds across borders allowed	Yes	Revised Treaty of Chaguaramas establishing the Caribbean community including the Caribbean Single Market and Economy, Article 40
6 Do provisions with respect to expropriation exist (nationalisation ,etc.)	Yes	
7 Settlement of Disputes	Yes	Chapter 9, Revised Treaty
a State-to-state	Yes	
b Investor-state	Under certain circumstances - persons of a contracting party, with the special leave of the court, may be allowed to appear as parties in proceedings	Article 222, Revised Treaty
c Access to International Dispute Settlement (ICSID, UNCITRAL)	Yes - most members have acceded to ICSID	
8 Provisions for incentives and subsidies	No	
9 Rules of Origin		
a Do rules or origin exist	Yes	
b Value Content Criterion: Domestic/Regional Value Content (RVC)	N/A	

c Are there roll-up arrangements?	Not mentioned	
d Are drawback allowed?	possibly	
e Mean/median value of restrictiveness		
10 Tariff structures		
a Does a Common External Tariff exist. If so what is it and will it be? If not, give indication of country dispersion	Yes since 1991. CET rates range from 20-35%. 4 stage schedule of CET tariff reductions, starting in 1993. The final Phase 4 of full implementation, with a tariff ceiling of 20% for non-exempt industrial goods and 40% for non-exempt agricultural goods was to be reached by 1998.	
b Level of intra-regional tariffs and plans	Intra-regional trade is duty free	
c Exceptions	Agricultural; highly revenue sensitive sectors, mainly alcoholic beverages, tobacco, oil products, jewelry, electrical appliances and motor vehicles.; some electrical appliances	
11 Other relevant provisions (regional enterprise schemes, regional investment funds, etc.)	Free movement of people	Article 45/46, Revised Treaty

ANDEAN

Members (late membership between parentheses)	Bolivia Colombia Ecuador Peru Venezuela	25/05/1988 Andean Group became the Andean Community in 1997 with the adoption of the Trujillo protocol
INVESTMENT RULES		
What year did investment provisions come into force (variable?)	Decision 291 established the obligations regarding foreign investment. Made in March 1991. Decision 292 deals with Andean Multinational Enterprises Its provisions generally yield to national stipulation on the subject	
1 Scope and coverage		
a Applicable to non-parties (when or when not)	yes	
b Positive or negative list approach	positive	
c Main exceptions (safeguards, sectors etc.)	Reserved sectors according to national law	
2 National Treatment	Yes but…. foreign investors shall have the same rights and obligations as those to which national investors are subject, except as provided for in the national legislation of each Member Country.	Decision 291 Article 2
	Decision 292 grants national treatment to Andean MNCs. National treatment with respect to government procurements, export incentives and taxation, the right to participate in economic sectors reserved for national companies and the right to open branches in any member country, and free transfer of funds related to investment.	
a Pre-establishment (all sectors?)	Not specified	
b Are there restrictions on ownership rules? (e.g. min equity share)	No	

c Operations by MNEs in the country	Not specified	
3 Most Favoured Nation and fair and equitable treatment	No	
a granted to parties		
non-parties		
4 Performance requirements	Yes but only establishes particular provisions for the performance of contracts for the license of technology, technical assistance, technical services, and other technological contracts under the national laws of each Member	Decision 291 Article 14
a Are they banned for new and existing investment?		
b Do they go beyond TRIMs?		
5 Transfers of funds		
a Are transfer of funds across borders allowed	Yes	Decision 291 Article 4 & 5
6 Do provisions with respect to expropriation exist (nationalisation ,etc.)	Yes	
7 Settlement of Disputes		
a State-to-state	Yes through the Andean Court of Justice	
b Investor-state	No	
c Access to International Dispute Settlement (ICSID, UNCITRAL)	Yes - ICSID	
8 Provisions for incentives and subsidies		
9 Rules of Origin		
a Do rules or origin exist	Yes	
b Value Content Criterion: Domestic/Regional Value Content (RVC) or Import Content (MC)	MC: 50%	
c Are there roll-up arrangements?		

d Are drawback allowed?	
e Mean/median value of restrictiveness	
10 Tariff structures	
a Does a Common External Tariff exist. If so what is it and will it be? If not, give indication of country dispersion	Yes since 1993. The resulting Customs Union is incomplete - the CET (with rates of 0, 5, 10, 15 and 20 per cent) is applied only to Colombia, Ecuador and Venezuela. Bolivia has been exempted from implementing it and maintains its flat national tariff.
b Level of intra-regional tariffs and plans	Intra-regional trade is duty free
c Exceptions	
11 Other relevant provisions (regional enterprise schemes, regional investment funds, etc.)	Decision 292 provides for the formation of Andean Multnational Enterprises Andean Development Corporation Andean Business Advisory Council

ASEAN

Members (late membership between parentheses)		08/08/1967 Sean Free Trade Area was set up in 1992
	Brunei Darussalam entered 8/1/1984) Cambodia (entered 30/4/1999) Indonesia Malaysia Myanmar (entered 23/7/1997) Laos (entered 23/7/1997) Philippines Singapore Thailand Vietnam (entered 28/7/1995)	
INVESTMENT RULES		
What year did investment provisions come into force (variable?)	Agreement for the Protection and Promotion of Investment, 1987. The Framework agreement on the Asean Investment Area (AIA) was signed on 7 October 1998	
1 Scope and coverage	This Agreement shall apply only to investments brought into, derived from or directly connected with investments brought into the territory of any Contracting Party by nationals or companies of any other Contracting Party and which are specifically approved in writing and registered by the host country and upon such conditions as it deems fit for the purposes of this Agreement.	AIA
a Applicable to non-parties (when or when not)	Yes - with respect to national treatment in AIA	
b Positive or negative list approach	1987 Agreement: positive. AIA: negative (Temporary Exclusion List & Sensitive List)	
c Main exceptions (safeguards, sectors etc.)	Temporary Exclusion List and Sensitive List	
2 National Treatment	Yes - To Asean members immediately and to non-Asean investors by 2020. national treatment to the admission, establishment, acquisition, expansion, management, operation, and disposition of investment	Article 7 AIA

a Pre-establishment (all sectors?)	Yes - subject to temporary exclusion list and sensitive list	
	As of 1 January 2003, the Temporary Exclusion Lists (TEL) for the manufacturing sector of Brunei Darussalam, Indonesia, Myanmar, Philippines, and Thailand have been phased out thereby broadening the scope of economic activities where ASEAN investors are given national treatment. Malaysia and Singapore have no temporary exclusion list.	
b Are there restrictions on ownership rules? (e.g. min equity share)	Yes - as a short term measure: a suspension of laws regulating equity joint venture between foreign and local enterprises and 100% foreign equity is allowed. Laws restricting foreign shareholders in national companies are also deregulated. However, since the 100% foreign equity and other special privileges granted in the short-term measures are not set as permanent measures, they are subject to change and may alter in the future or be extended depending on later circumstances. Currently, Brunei Darussalam, Indonesia, Laos, Malaysia allows 100% foreign equity ownership in certain sectors.	
c Operations by MNEs in the country	Yes	
3 Most Favoured Nation and fair and equitable treatment	Yes	
a granted to parties	Yes	
non-parties	No - however it does not exclude non-ASEAN investors who have formed a company in a member country, and they may be entitled to “ASEAN investor” status	Article 8 & 9
4 Performance requirements	No	
a Are they banned for new and existing investment?		
b Do they go beyond TRIMs?		
5 Transfers of funds		
a Are transfer of funds across borders allowed	Yes	Article 7, 1987
6 Do provisions with respect to expropriation exist (nationalisation ,etc.)	Investments of nationals or companies of any Contracting Party shall not be subject to expropriation nationalisation or any measure equivalent thereto (in the article referred to as "expropriation"), except for public use, or public purpose, or in the public interest, and-under due process of law, on a non-discriminatory basis and upon payment of adequate compensation	Article 6, 1987

7 Settlement of Disputes

a State-to-state	Yes - Any dispute between and among, the Contracting Parties concerning the interpretation or application of this Agreement shall, as far as possible, be settled amicably between the parties to the dispute. Such settlement shall be reported to the ASEAN Economic Ministers (AEM). If such a dispute cannot thus be settled it shall be submitted to the AEM for resolution.	Article 9, 1987
b Investor-state	Yes	Article 10, 1987
c Access to International Dispute Settlement (ICSID, UNCITRAL)	The dispute may be brought before the International Centre for Settlement of Investment Disputes (IGSID), the United Nations Commission on International Trade Law (UNCITRAL), the Regional Centre for Arbitration at Kuala Lumpur or any other regional centre for arbitration in ASEAN, whichever body the parties to the dispute mutually agree to appoint for the purposes of Conducting the arbitration.	
8 Provisions for incentives and subsidies	No	
9 Rules of Origin		
a Do rules or origin exist	Yes	
b Value Content Criterion: Domestic/Regional Value Content (RVC) or Import Content (MC)	MC: 60%	
c Are there roll-up arrangements?	Not mentioned	
d Are drawback allowed?	Yes	
e Mean/median value of restrictiveness	4	
10 Tariff structures		
a Does a Common External Tariff exist. If so what is it and will it be? If not, give indication of country dispersion	No. Afta was expected to reduce tariffs to between 0 - 5% for all trade between member nations by 2008. Common Effective Preferential Tariff scheme covers on average 90% of the tariff lines of all Asean members nations.	
b Level of intra-regional tariffs and plans (2003)	Brunei Darussalam: 0.92	
	Cambodia: 7.96	
	Indonesia: 3.70	
	Laos: 5.66	
	Malaysia: 3.19	
	Myanmar: 2.05	
	Philippines: 3.79	

	Singapore: 0 Thailand: 4.63 Vietnam: 2.02
c Exceptions	Sectors included in the Exclusion List and Sensitive List
11 Other relevant provisions (regional enterprise schemes, regional investment funds, etc.)	Asean Industrial Co-operation (AICO Scheme) Regional Investment Promotion Events ASEAN Investment Portal - gateway linking ASEAN to the world by providing a comprehensive coverage of up-to-date business and investment information on the region

COMESA

Members (late membership between parentheses)	Angola Burundi Comoros Democratic Republic of Congo Djibouti Egypt Eritrea Ethiopia Kenya Madagascar Malawi Mauritius Namibia Rwanda Seychelles (may leave SADC) Sudan Swaziland Uganda Zambia Zimbabwe	08/12/1994

INVESTMENT RULES

What year did investment provisions come into force (variable?)	Comesa Treaty 1994
1 Scope and coverage	
a Applicable to non-parties (when or when not)	No
b Positive or negative list approach	positive

c Main exceptions (safeguards, sectors etc.)		
2 National Treatment	No	
a Pre-establishment (all sectors?)		
b Are there restrictions on ownership rules? (e.g. min equity share)		
c Operations by MNEs in the country		
3 Most Favoured Nation and fair and equitable treatment	fair and equitable treatment to private investors	Article 159.1
a granted to parties		
non-parties		
4 Performance requirements	No	
a Are they banned for new and existing investment?		
b Do they go beyond TRIMs?		
5 Transfers of funds		
a Are transfer of funds across borders allowed	Yes	Article 159.5
6 Do provisions with respect to expropriation exist (nationalisation ,etc.)	Yes -subject to the accepted principle of public interest, refrain from nationalising or expropriating private investment and in the event private investment is nationalised or expropriated, pay adequate compensation	Article 159.3
7 Settlement of Disputes	Yes - Court of Justice for arbitration between member states and legal and natural persons	
a State-to-state	Yes	
b Investor-state	No	
c Access to International Dispute Settlement (ICSID, UNCITRAL)	Yes - most members have acceded to ICSID	

8 Provisions for incentives and subsidies

TRADE RULES

9 Rules of Origin

a Do rules or origin exist	Yes
b Value Content Criterion: Domestic/Regional Value Content (RVC) or Import Content (MC)	MC: 60% RVC35%
c Are there roll-up arrangements?	Yes
d Are drawback allowed?	Not after 10 years
e Mean/median value of restrictiveness	3

10 Tariff structures

a Does a Common External Tariff exist. If so what is it and will it be? If not, give indication of country dispersion	No. Its free-trade area (FTA) was set up on 1 November 2000; nine of its member countries were able to respect this deadline , whereas Burundi has been given a waiver to allow it to apply a 60 per cent reduction of its MFN tariffs on exports from COMESA. The customs union should come into effect on 1 November 2004, with a common external tariff (CET) comprising four rates: 0, 5, 15, and 30 per cent
b Level of intra-regional tariffs and plans	The tariff reduction schedule was as follows: 60% by 1993; 70% by 1994; 80% by 1996; 90% by 1998 and 100% by 2000 Nine member States - Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Sudan, Zambia and Zimbabwe have eliminated their tariffs on COMESA originating products, in accordance with the tariff reduction schedule which was adopted in 1992 for the gradual removal of tariffs to intra-COMESA trade. Angola: rate of tariff reduction is 0 Burundi: Under the reform process launched in January 2003, Burundi has introduced a new preferential tariff for COMESA member countries, providing for a standard reduction of 80 per cent of all MFN rates in force since 1 January 2003. As from January 2004, all products from COMESA countries are due to be granted duty-free entry into Burundi. Comoros: 80% tariff reduction DR Congo: zero Eritrea: 80% tariff reduction Ethiopia: 10% Rwanda: 90% tariff reduction

	Uganda: 80% tariff reduction
	Swaziland - CET for SACU. Has undertaken to seek the concurrence of SACU to join the FTA in 2004.
	Namibia - apply CET SACU
	Seychelles
c Exceptions	Some sub-sectors of agriculture

11 Other relevant provisions (regional enterprise schemes, regional investment funds, etc.)

SADC

Members (late membership between parentheses)		Southern African Development Coordination Conference was established in 01/03/1970. It was replaced by SADC on 17/7/1992
	Angola Botswana Democratic Republic of Congo Lesotho Malawi Mauritius Mozambique Seychelles South Africa Swaziland Tanzania Zambia Zimbabwe	
INVESTMENT RULES		
What year did investment provisions come into force (variable?)	Few investment provisions. Though plans to establish more comprehensive investment provisions under the Protocol on finance and investment	
1 Scope and coverage		
a Applicable to non-parties (when or when not)		
b Positive or negative list approach		
c Main exceptions (safeguards, sectors etc.)		
2 National Treatment	No	

a Pre-establishment (all sectors?)		
b Are there restrictions on ownership rules? (e.g. min equity share)		
c Operations by MNEs in the country		
3 Most Favoured Nation and fair and equitable treatment	No	
a granted to parties		
non-parties		
4 Performance requirements	No	
a Are they banned for new and existing investment?		
b Do they go beyond TRIMs?		
5 Transfers of funds	No	
a Are transfer of funds across borders allowed		
6 Do provisions with respect to expropriation exist (nationalisation ,etc.)	No	
7 Settlement of Disputes	Tribunal to settle disputes between state and community, between natural and legal persons and community	Article 17-19, protocol on Tribunal and the rules of procedure thereof
a State-to-state	Yes	
b Investor-state	No	
c Access to International Dispute Settlement (ICSID, UNCITRAL)	Yes	
8 Provisions for incentives and subsidies	No	

TRADE RULES

9 Rules of Origin

a Do rules or origin exist	Yes
b Value Content Criterion: Domestic/Regional Value Content (RVC) or Import Content (MC)	MC: 70-35%
c Are there roll-up arrangements?	Yes
d Are drawback allowed?	Not mentioned
e Mean/median value of restrictiveness	4

10 Tariff structures

a Does a Common External Tariff exist. If so what is it and will it be? If not, give indication of country dispersion	No
	Botswana applies the CET for SACU area
	Lesotho applies the CET for SACU
b Level of intra-regional tariffs and plans	Malawi: Under the SADC Trade Protocol, which commenced operation from January 2001, Malawi has begun to implement its commitments, and grants duty-free access, on a reciprocal basis, to imports of category A products (mostly capital goods and equipment) from other members that have also adopted the Protocol.
c Exceptions	Mauritius: Under the SADC Trade Protocol, Mauritius grants duty-free access, on a reciprocal basis, to imports of category A products (mostly capital goods and equipment) from the other members that have already deposited their implementation instruments (
	Namibia: applies CET for SACU
	Swaziland: CET for SACU
	Zambia: From 30 April 2001, Zambia began to implement its commitments under the SADC Trade Protocol and to grant duty-free access, on a reciprocal basis, to imports of Category A products from SADC members that have also deposited their implementation instruments

11 Other relevant provisions (regional enterprise schemes, regional investment funds, etc.)

PART III: CASE STUDIES OF BOLIVIA AND TANZANIA

Chapter 6 Regional Integration and poverty: The case of Bolivia*

Osvaldo Nina and Lykke E. Andersen

6.1 Introduction

The growth of regional trade blocks has been one of the major developments in international relations in recent years. Regional agreements vary widely, but all have the objective of reducing barriers to trade between member countries and are expected to significantly contribute to economic growth, development and poverty reduction.
In Bolivia, regional integration started progressing rapidly once macroeconomic stability was achieved in 1986. During the 1990s, the fundamental components of the trade reform program were the severe reduction of the coverage of non-tariff barriers, reduction of the average level of import tariffs, elimination of export taxes and expansion of the export markets for Bolivian goods by signing trade agreements with the main trading partners. Moreover, the investment policies have sought to attract foreign investors to augment the country's asset base.

These policies promoting openness, especially the regional integration agreements, contributed to some changes in the exports and imports structures, but to date there is little empirical evidence on the impact of regional integration on economic growth and poverty reduction. Thus, the objective of the present study is to analyze how regional integration has affected poverty in Bolivia. The analysis will concentrate on the structure of the labour market, where it is possible to analyze the effects of regional integration on employment and income.

The remainder of the chapter is organized as follow. Section 2 provides a description of the trade and investment provisions in the relevant regional trade agreements of Bolivia. Section 3 discuses how these provisions have affected the composition of trade and foreign direct investments. Section 4 discusses how such trade and investment has affected poverty. Section 5 concludes.

6.2 Regional Integration in Bolivia

The regional integration processes involving Bolivia started in 1960 with the Latin American Free Trade Association (LAFTA), which had the objective of promoting the integration of the region and create a common market12. The members, however, lacked political commitment to make progress towards a free trade zone (Uculmana, 2003). In 1969, based on this bad experience, the Andean countries created the Andean Pact with the objective of promoting development of the member countries

* We would like to thank Dirk Willem te Velde for many valuable comments and suggestions, and Paloma Aguilar, Fabian Soria and Oscar Molina for excellent research assistance.
[12] Until 1966, the members were Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Mexico, Paraguay, Peru Uruguay and Venezuela.

through social and economic integration. Moreover, in the beginning of the 1980s, the members of LAFTA created the Latin American Integration Association (LAIA) with the objectives of promoting bilateral and extra-regional agreements.

Between 1960 and 1990, Latin American countries, especially the Andeans, introduced protectionism and widespread regulations based on the theory of import-substitution. These heavy government interventions generated high external barriers that obstructed the regional integration process. However, during the 1990s, integration forces returned and the growth of regional trade blocks became one of the major developments in international relations. In Latin America, the majority of countries signed or revived regional trade agreements as part of their structural reforms intended to open their economies to trade and foreign direct investment. In 1991, for example, Andean countries revived the Andean Pact, and the Southern Cone countries that were not participating in any sub-regional agreements created the Common Market of the South (MERCOSUR).

Since 1992, Bolivia signed three partial integration agreements through LAIA: Chile (1993)[13], MERCOSUR (1997)[14] and Cuba (2000)[15], and one free trade agreement with Mexico (1995)[16]. Moreover, Bolivia is a beneficiary country of the Andean Trade Promotion and Drug Eradication Act (2002), which is a continuation of the Andean Trade Preference Act (1991)[17], from the United States, and the Andean Generalized System of Preferences (1990) from the European Union. Both agreements granted preferential tariffs as support for the Andean Community's war on drugs under the principle of shared responsibility.

Of the above-mentioned agreements, the ones with Mexico and Cuba are insignificant in terms of trade volume and investment. The remaining agreements and drug related trade preferences are described in detail in the remainder of the section.

The Latin American Integration Association (LAIA)

The Latin American Integration Association (LAIA) is an intergovernmental organisation, which continues the integration process started by the LAFTA (Latin American Free Trade Association). The 1980 Montevideo Treaty provides the legal framework that rules the LAIA[18]. The main objective of the organisation is the establishment of a common market, in order to stimulate the economic and social development of the region. LAIA is the largest Latin-American integration group and has twelve member countries: Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

[13] "Acuerdo de Complementación Económica entre Bolivia y Chile."
[14] "Acuerdo de Complementación Económica No. 36 Celebrado entre los Gobiernos de los Estados Partes del MERCOSUR y el Gobierno de la República de Bolivia."
[15] "Acuerdo de Complementación Económica No. 47 Celebrado entre la República de Bolivia y la República de Cuba."
[16] "Acuerdo de Complementación Económica No. 31" entre el Gobierno de los Estados Unidos Mexicanos y el Gobierno de la República de Bolivia.
[17] "Andean Trade Preference Act". Pub.L.102-182, title II, sec. 202, Dec. 4, 1991.
[18] The members of LAFTA signed this agreement on August 12, 1980.

LAIA established the basic provisions for trade between member countries and promoted sub-regional agreements. Currently, the sub-regional agreements have advanced substantially further than the basic LAIA agreements, somewhat diluting the advantage of this mechanism (Uculmana, 2003). However, LAIA has good possibilities of contributing to the creation of a Free Trade Area (FTA) in South America by coordinating and combining the sub-regional integration agreements.

Trade Provisions

The LAIA promotes the creation of an area of economic preferences in the region, aiming at a Latin-American common market, through three mechanisms: 1) regional tariff preference granted to products originating in the member countries; 2) regional scope agreements; and 3) partial scope agreements, between two or more countries of the area. Regional and/or partial scope agreements may cover tariff relief and trade promotion; economic complementation; agricultural trade; financial, fiscal, customs and health cooperation; environmental preservation; scientific and technological cooperation, tourism promotion; technical standards and many other fields.

A preference system consisting of market opening lists, special cooperation programs and countervailing measures on behalf of landlocked countries was granted to the Relatively Less Economically Developed Countries (Bolivia, Ecuador and Paraguay) to favor their full participation in the process of integration. There are four agreements signed by all member countries of the LAIA: Market-Opening Lists on behalf of Bolivia, Ecuador and Paraguay and the Regional Tariff Preference Agreement.

Market-Opening Agreements (MOAs) were signed April 30, 1983 granting Bolivia[19], Ecuador and Paraguay effective preferential treatment as member countries opened their markets to a wide range of products, granting them, without reciprocity, the total lift of customs duties and other restrictions.

Bolivia currently has around 2000 products in the market opening list. Categorized by the Harmonized Commodity Coding System[20], most of the main products are concentrated in: 1) Textile and textile articles (Section XI); 2) Live Animals and Animal Products (Section I); 3) Base Metals and Articles of Base Metals (Section XV); 4) Wood and Articles of Wood (Section IX); and 5) Vegetable Products (Section II). The number of products covered has been growing significantly during the last 20 years. By the beginning of the agreement, the number of products covered by MOAs was only 31 goods, which was concentrated in the section XV (Base metals and articles of base metals).

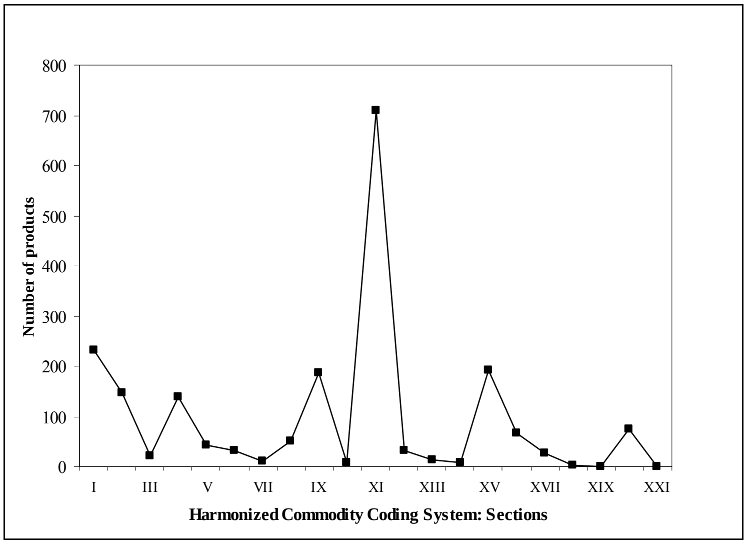
In compliance with the provisions of Article 5 of the 1980 Montevideo Treaty, all member countries grant, on a reciprocal basis, a reduction in the rate of duties levied on imports originating in the region.

The Regional Tariff Preference (RTP) differs according to the relative economic development of each country and applies to the entire tariff universe, except for a list of exempted products determined by each country. The current basic level of RTP is

[19] "Acuerdo Regional de Apertura de Mercados en Favor de Bolivia."
[20] See Appendix 6.1 for description of the Harmonized Commodity Description and Coding Section.

20%. In the case of Bolivia, the tariffs levied on its export products are lower, and tariffs on imports are higher, due to its landlocked condition.

Chart 6.1. Market Opening List: Bolivia, 2002



Source: LAIA

In order to protect some strategic industries, each country is allowed to have a list of exceptions from the tariff system of the association (NALADISA). The lists of exceptions have maximum limits: 1920 products for Relatively Less Economically Developed Countries, 960 products to Medium Economically Developed Countries and 480 products for the rest.

In order to receive the preferential treatment established in the 1980 Montevideo Treaty, goods have to qualify as "originating", according to the General Regime of Origin of the Association.

The origin of the goods has the following main categories:

1) Products manufactured entirely from native material of any member country;
2) Products of the animal, vegetable, and mineral kingdoms that are extracted, harvested or collected in its territory or territorial water and exclusive economic zones;
3) Products that are the result of operations or processes performed in its territory and the materials are substantially transformed into new and different products;
4) Products manufactured with materials from other countries, which are not participating in the agreement, but are product of a process of transformation carried out in some of the participating countries and are

new and different products that are classified in different sections with respect to materials in the NALADISA code system;

5) Products that are an outcome from assembly process, performed in any territory of the member country using native materials from the member and third countries, when the value CIF port of destination or CIF maritime port of the native materials of third party countries do not exceed 50%[21] of the value FOB of export of such merchandise.

These rules of origin have been applied to all sub-regional and partial scope agreements in Latin America, with some minor modifications, which will be mentioned below.

The Andean Community (CAN)

The Andean countries created the Andean Pact in 1969 through the Cartagena Agreement[22]. The main objective was to increase the development of the members through social and economic integration. The first couple of decades, there was little progress towards regional integration, but global developments and structural reforms caused a renewed interest in the integration process. In 1991, the Caracas Letter implemented the Andean Free Trade Zone and renamed the agreement the Andean Community (CAN). Moreover, the members created the Andean Integration System, which are institutions that work closely in the pursuit of the same objectives: to intensify Andean sub-regional integration, promote its external projection, and reinforce the actions connected with the process. Currently, the members are Bolivia, Colombia, Ecuador, Peru and Venezuela[23].

Trade Provisions

In the beginning of the process, the Andean Pact implemented fundamental instruments of the integration process, such as the Liberalisation Program and the Industrial Development Program. Nevertheless, these instruments did not help to promote regional integration because the prevailing import-substitution model, which had the objective of promoting industrialisation, required high external trade barriers. According to Schiff and Winters (2003), in general, the countries with these characteristics were very protectionist and interventionist in the sense of trying to determine administratively which industries to have and where they should be located.

After the revival of the Andean Pact, the trade provisions became substantially more liberal, creating a Free Trade Area, which eliminated the tariffs and all other duties between CAN member countries.

Since 1993, products have been circulating freely within the bloc, but the Common External Tariff did not enter into force due to several disagreements between member countries. Recently, the members agreed to apply the tariff levels that are effective in each country until May 2005.

[21] 60 % for the Relatively Less Economically Developed Countries.
[22] "Acuerdo de Cartagena (Pacto Andino) Acuerdo de Integración Sub-Regional."
[23] Chile was a founding member but left the organisation in 1976. Peru was not member during the 1992-1994 period.

The rules of origin of LAFTA governed trade among the Andean countries until 1987, when the members approved their own provisions for determining the origin of products. Nevertheless, the rapid advances in trade integration, particularly the formation of a customs union, generated the need for updating of the rules in order to establish precise criteria of origin. In 1997, Decision 416 introduced amendments where the provisions specify the conditions products must meet in order to be sub-regional origin goods and thereby benefit from the enlarged market.
The amendments were more specific with respect to goods in whose manufacture non-native materials were used. The basic criterion used for this type of goods is that the materials of non-native origin must either have undergone processing, as reflected in the change in tariff heading, or the CIF value of non-native materials should not exceed 50 % of the FOB value of the final products in the cases of Colombia, Venezuela and Peru, and 60 % in those of Bolivia and Ecuador.

Between 1995 and 2001, the Andean Community approved provisions that removed unnecessary technical obstacles to trade. These provisions are the Andean System of Standardisation, Accreditation, Testing, Certification, Technical Regulations and Metrology, the Andean Quality System, and the Andean Certificates of Products Marketed.

The Andean System of Standardisation, Accreditation, Testing, Certification, Technical Regulations and Metrology has the objective to clear the way for trade by removing unnecessary technical obstacles and to bring about an improvement in the quality of the goods and services that are produced in the Andean sub-region. The Andean Quality System covers all elements of the quality infrastructure: standardisation, accreditation, testing, certification, technical regulations, and metrology for all of the sub-region's products and services, except for those having to do with phytosanitary and zoosanitary matters[24]. Finally, the Andean Certificates of Products Marketed simplifies conformity evaluation activities by member countries and are aimed at establishing "Andean standards" for the products that are marketed in the sub-region by harmonizing the standards applied in each country or adopting international standards considered to be of interest to the sub-region.

The application of these Community provisions have the intention to shore up institutions in the member countries that are responsible for monitoring the fulfillment of the conformity evaluation provisions, technical regulations, and procedures of the World Trade Organisation's Agreement (WTO) on Technical Obstacles to Trade.

Investment Provisions

The Andean Community provisions with regard to investment have two parts. The first part covers the general regime governing foreign investment and the second regulates the case of the Andean multinational enterprises. However, these requirements must be complemented by national laws and regulations, especially through bilateral arrangements or agreements that promote and protect investments signed by member countries with third countries and even among themselves.

[24] Phyto- and zoosanitary regulation aims at protecting plants and animals from the spread of pests and diseases.

The general regime for foreign investment contains the definitions of direct foreign investment and classifies investors and enterprises into national, mixed, and foreign. Even though the regime sets out the rights and obligations of foreign investors, it gives the Andean countries full freedom to regulate this field through their own national legislation.
The regulation with respect to the Andean multinational enterprises secure that these enterprises enjoy national treatment in regard to the public procurement of goods and services; the right to transfer abroad in freely convertible currency all of the dividends for distribution; tax matters; and the right to open up branches in other member countries. They also enjoy equality compared to domestic taxes; provisions to avoid double taxation of income and on the transfer of capital abroad; and facilities for the hiring of sub-regional personnel. The main condition to have these facilities is that at least 60% of the capital of the multinational company belongs to national investors from two or more member countries.

Common Market of the South (MERCOSUR)

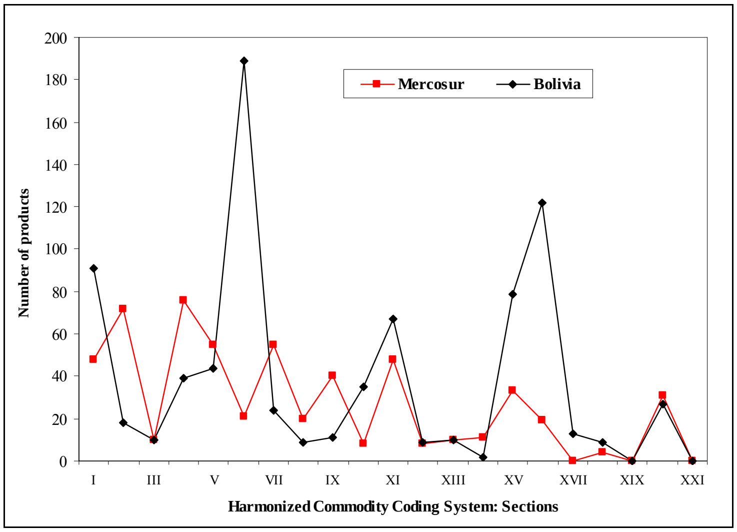
Motivated by trade imbalances and a desire for energetic integration in South America, MERCOSUR countries signed a partial economic integration agreement with Bolivia in 1996. The main objectives were to establish the legal and institutional framework of economic and physical cooperation and integration that facilitate the free circulation of goods and services, to create a Free Trade Area in ten years, and to establish a normative framework for promoting and protecting intra-regional investments, without limiting trade negotiations with third parties. This agreement entered into force on March 2, 1997, and previous agreements between involved countries became invalid.

Trade Provisions

The trade relations between Bolivia and MERCOSUR members, before signing the agreement, were according to LAIA's rules. The new agreement included a Trade Liberalisation Program consisting of immediate and progressive tariff reductions.
The Trade Liberalisation Program has several tariff reductions categories, depending on the sensitivity of the products. The first group which was fully duty-free had around 570 products for Bolivia and 800 for MERCOSUR. In the case of Bolivia, the goods with no tariffs were concentrated in the following main categories: 1) Foods, Beverages, Spirit and Tobacco (Section IV); 2) Vegetal products (Section II); 3) Mineral products (Section V); and 4) Plastic and Rubber (Section VII).

On the other hand, Bolivia set zero import tariffs on goods that are very important for capital investment. According to chart 6.2, the main categories are: 1) Products of the chemical or allied industries (Section VI); 2) Machinery and electrical equipment (XVI); 3) Live animals and animal products (Section I); and 4) Textile and textile articles (Section XI).

Chart 6.2. Products with immediate tariff reductions granted by MERCOSUR and Bolivia

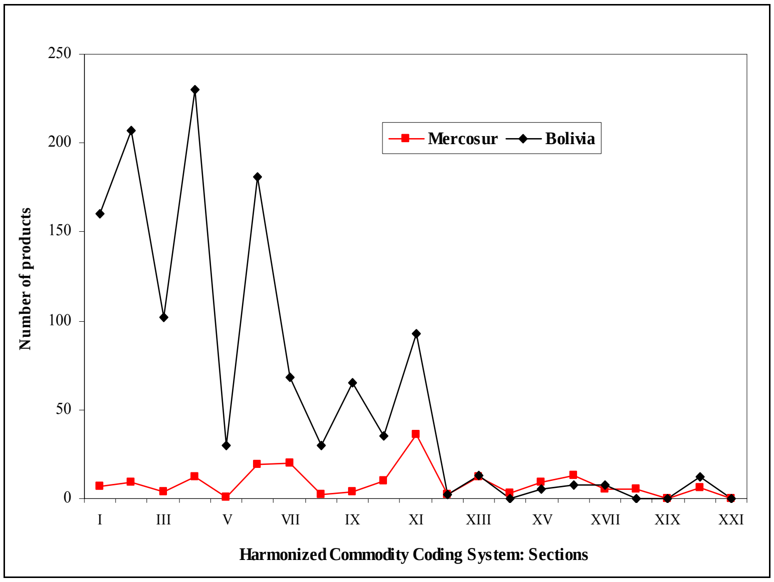


Source: LAIA.

The rules of origin from MERCOSUR have the same characteristics as the Andean Community and LAIA. The non-tariff barriers cover all elements of the standardisation, accreditation, testing, certification, technical regulations, metrology and, phytosanitary and zoosanitary matters. In general, the members are governed by the rules of WTO. However, products that receive local export incentives, in the form of tariff refunds on temporarily imported inputs, are not included in the Trade Liberalisation Program.

With respect to the progressive tariff reductions, chart 6.3 shows that Bolivia gives more benefit to MERCOSUR, especially in the sections that are related to the agricultural sector. The progressive tariff reductions cover around 1428 goods: 74% of them will have zero tariffs within 10 years of signing the agreements, and the rest within 15 to 20 years. Moreover, goods not included in the abovementioned agreements, received an immediate 30% reduction in the tariff, increasing gradually to 100% by 2006.

Chart 6.3. Products with progressive tariff reductions granted by MERCOSUR and Bolivia



Source: LAIA.

Investment Provisions

The agreement did not have explicit rules on FDI or multinational enterprises. Some articles mention that members should try to stimulate reciprocal investments, with the objective of intensifying the bilateral flows of trade and technology. These initiatives will respect national legislations.

In addition, it gives the possibility to make agreements on Promotion and Reciprocal Protection of Investments, while all bilateral agreements subscribed before the agreement will maintain full validity. The members have agreed to examine the possibility of subscribing agreements to avoid double taxation.

Chile

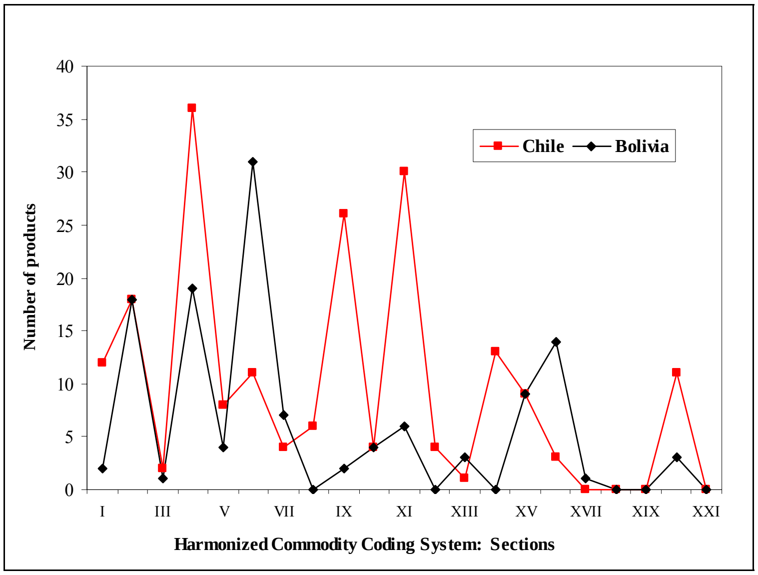
After Chile had decided to leave the Andean Pact, the trade relations between Bolivia and Chile were limited. In order to increase trade and economic relations, Bolivia signed a partial integration agreement with Chile in April 1993.

Trade Provisions

According to the agreement, the political liberalisation was to come in three levels. The first level provides duty free access without reciprocity and volume constraints to Chilean markets to some Bolivian products. The second level provides duty free access for some products with reciprocity. Finally, at the third level, each country grants a reduction on the rate of duties according to specific list of products.

chart 6.2 shows that Bolivia was granted tariff reductions for the following products: 1) Food, Beverages, and Tobacco (Section IV); 2) Textile and textile articles (Section XI); 3) Wood and articles of wood (Section XI); and 4) Vegetable products (II). On the other hand, Chile was granted: 1) Products of the chemical or allied industries (Section VI); Food, Beverages and Tobacco (Section IV); 3) Vegetable products (II); and 4) Machinery and Electrical Equipment.

Chart 6.4. Products with immediate tariff reductions granted by Chile and Bolivia



Source: LAIA

The benefits derived from the program of liberalisation of the present agreement will apply exclusively to native products and products originating in the territories of the member countries, following the standard rules of LAIA.

Investment Provisions

In order to stimulate investment, the agreement recommends that the countries adopt the following principle with respect to investment: Capital originating in any of the signatory countries will enjoy, in the territory of the other signatory country, a no less favorable treatment than that that is granted to national capital or capital originating from any another country.

Andean Trade Promotion and Drug Eradication Act (ATPDEA)

The Andean Trade Preference Act (ATPA) was signed into law on December 4, 1991 providing for a 10-year period of duty-free or reduced-rate treatment of selected American imports from Bolivia, Colombia, Ecuador, and Peru. The ATPA improved access to US markets of such exports to encourage economic alternatives to illicit drug activity and drug-crop production in the Andean region.

The ATPA expired on December 4, 2001, but the Trade Act of 2002 renewed this program under the Andean Trade Promotion and Drug Eradication Act (ATPDEA) on February 15, 2002. In addition, the United States, under the Generalized System of Preferences (GSP), provides preferential duty-free entry to approximately 3,000 products. The purpose of this program is to encourage economic growth of beneficiary countries.

Trade Provisions

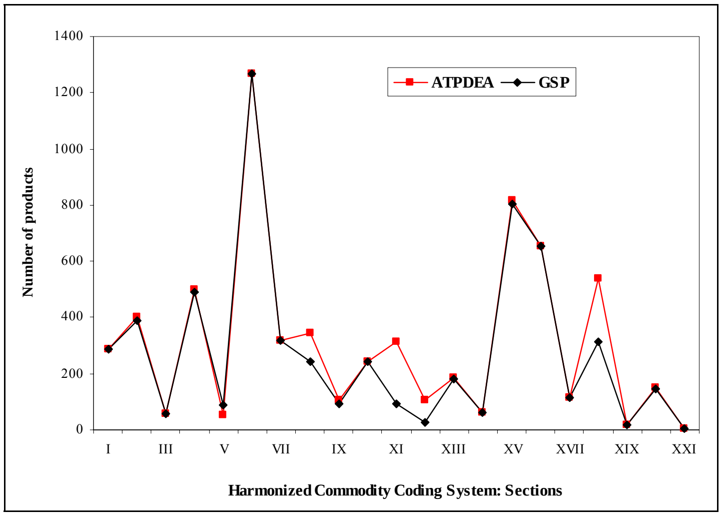
The ATPA provided duty-free access to US markets for some 5,600 products. The requirements to duty-free access of ATPDEA is similar as ATPA but some of the program's parameters were modified and extended to other Andean exports, such as textile articles, to broaden the program's effects. The ATPDEA extended new benefits to 700 additional products.

According to the Trade Act of 2002, duty-free treatment did not apply to the following products: rum and tafia; sugars, syrups, and sugar-containing products; and tuna. On the other hand, footwear; petroleum or any products derived from it; watches and their parts; and handbags, luggage, flat goods, work gloves, and leather wearing apparel may proclaim duty-free treatment if the President determines that such articles are not import-sensitive in the context of imports from ATPDEA beneficiary countries.

Moreover, ATPDEA provides duty-free access and free of any quantitative restrictions and limitations to apparel articles and certain textile articles. Theses products have to be: 1) manufactured or assembled from products of the United States or ATPDEA beneficiary countries; 2) assembled in one or more ATPDEA beneficiary countries from regional fabrics or regional components; or 3) hand loomed, handmade, and folklore articles. No article or material of a beneficiary country shall be eligible for such treatment by virtue of having merely undergone simple combining, packaging operations, or mere dilution that does not materially alter the characteristics of the article.

In 2002, the products that benefit from ATPDEA were around 6545 products, slightly more than the GSP (around 655 articles more). Chart 6.5 shows that the products are concentrated in the following categories: 1) Chemical or allied industries (Section VI); 2) Base metals and articles of base metal (Section XV); 3) Machinery and Electrical Equipment (Section XVI); and 4) Optical, photographic, medical or surgical instruments and apparatus (Section XVIII). In contrast to the GSP program, the ATPDEA provide duty-free access for more products from Section XVIII, Section XI (textiles and textiles articles) and Section VII (wood and articles of wood).

Chart 6.5 Products with duty free access to U.S. markets



In contrast to standard regional trade agreements, the ATPDEA requires that each country must meet all the following ATPDEA criteria to be a beneficiary country:

1) The beneficiary country should demonstrate a commitment to undertake its obligations under the WTO and participate in negotiations toward the completion of the FTAA or another free trade agreement.

2) The country should provide protection of intellectual property rights consistent with or greater than the protection afforded under the Agreement on Trade-Related Aspects of Intellectual Property Rights described in the Uruguay Round Agreements Act.

3) The country should provide internationally recognized worker rights and implement commitments to eliminate the worst forms of child labour.

4) The country should meet the counter-narcotics certification criteria set forth in the Foreign Assistance Act of 1961 for eligibility for United States assistance.

5) The country should have taken steps to become a party to and to implement the Inter-American Convention against Corruption. Moreover, it should apply transparent, nondiscriminatory, and competitive procedures in government procurement equivalent to those contained in the Agreement on Government Procurement of the Uruguay Round Agreements Act.

6) The country should support the efforts of the United States to combat terrorism.

Currently, Bolivia satisfies these conditions.

Andean Generalized System of Preferences (Andean GSP)

The European Union granted tariff preferences to Andean countries by the creation of the Andean Generalized System of Preferences (Andean GSP), as support for the Andean Community's war on drugs, under the principle of shared responsibility. The scheme has been in effect since December 13, 1990.

In 2001, the EU Council approved the regulations for application of a generalized tariff preferences plan for the period 2002-2004. This scheme was extended to 2005 in December 2003. In principle, countries that grow so fast that they become a high-income country (by World Bank definitions) would graduate from the programme, in the sense that they would no longer qualify for this special treatment. However, the new regulation contains a provision that excludes, in a non-discriminatory way, all beneficiary countries accounting for less than 1% of GSP imports from graduation. Because of this, no Andean Community countries will see their products graduate anymore. They also consider the possible renewal of the Andean preferential system for the decade of 2005-2014, which will depend upon a general evaluation of the results to be conducted over the three-year period of 2002-2004.

The Andean GSP enjoyed special and privileged treatment as compared with the general GSP in the EU. Not only did this instrument permit the preferential entry of a broad range of Andean products with a zero tariff, but also it secured that these preferences could not be suspended according to general GSP provisions.

Trade Provisions

In order to benefit from the Andean GSP upon importation into the EU, three conditions must be fulfilled: 1) the goods must originate in a beneficiary country in accordance with the rules of origin; 2) the goods must be transported directly from the beneficiary country to the EU; and 3) valid proof of origin must be submitted.

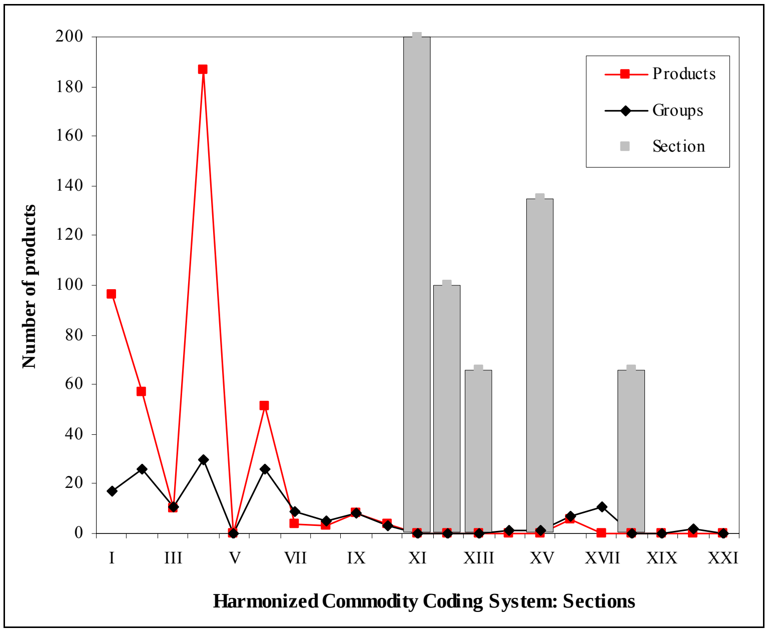
Tariffs differ between non-sensitive and sensitive products. Common Customs Tariff duties on products listed as non-sensitive products are entirely suspended, except for agricultural components. In respect to sensitive products, the Common Customs Tariff ad valorem duties are reduced by 3.5 %. For textile and textile articles (Section XI), the reduction is 20 % and for the specific duties 30%.

Moreover, there are special incentive arrangements that any country can receive if it meets the norms for the protection of labour rights and environment. In both cases, all Common Customs Tariff duties are reduced by another 5%.

The Andean Community has special and privileged treatment compared to the general GSP. According to the arrangements to combat drug production and trafficking, Common Customs Tariff ad valorem duties are entirely suspended on all products of Chapters 1 to 97, except those of Chapter 93 (watches and their parts).

According to chart 6.6, which shows the number, group and sections of products included in the special arrangements to combat drug production and trafficking, there are many products that benefit from zero duty and they are the products that are in the sensitive products category. For instance, all textiles and textile articles (Section XI) benefit from this special arrangement.

Chart 6.6. Products with preference tariff to European Union



Similar to the other trade initiatives to encourage access to new markets, the benefits derived from the Andean GSP apply exclusively to the goods that originate in a beneficiary country in accordance with the following rules of origin: 1) They must be wholly obtained in that country; or 2) sufficiently processed there.

The list of products basically uses three methods, or combinations of these methods, to lay down what amount of processing can be considered as "sufficient" in each case: 1) the change of heading criterion[25]; 2) the value or ad valorem criterion, where the value of non-originating materials used may not exceed a given percentage of the post-processing price of the product; and 3) the specific process criterion, when certain operations or stages in a manufacturing process have to be carried out on any non-originating materials are used.

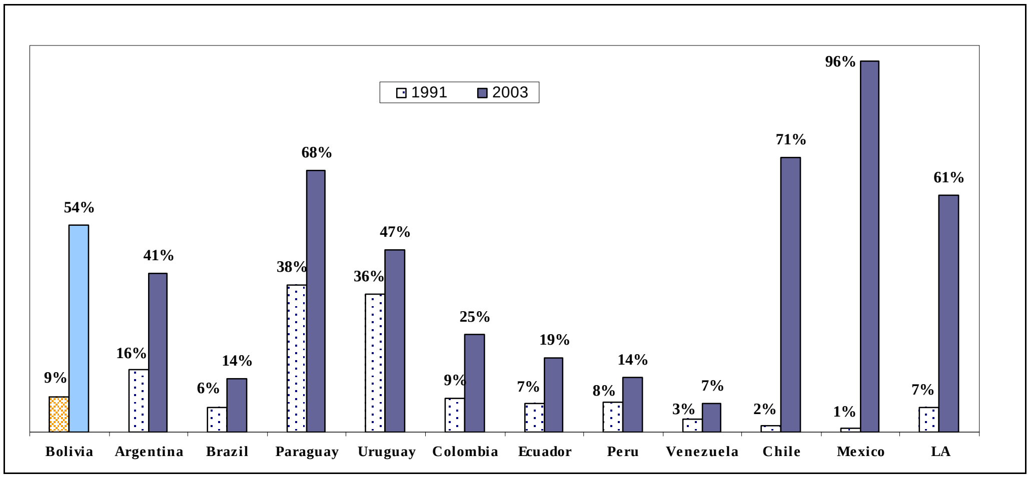
Conclusions

The review of trade agreements and drug related trade preferences, in general, demonstrates that a significant number of Bolivian goods has been granted preferential access to export markets, especially to US and CAN markets. Chart 6.7 indicates that Bolivia has been able to take advantage of these provisions, as the share of export value with preferential tariffs increased from just 9 percent in 1991 to 54 percent in 2003. This trend towards more trade under preferential agreements applies

[25] This means that a product is considered to be sufficiently processed when the product obtained is classified in a 4-digit heading of the Harmonized Commodity Coding System, which is different from those in which all the non-originating materials used in its manufacture are classified.

to all countries in Latin America, underscoring the progress towards regional integration of goods markets.

Chart 6.7 Percentage of export value with preferential agreement



Source: Machinea (2004)

In the following section, we will analyse in more detail how trade and FDI patterns have changed in response to the implementation of the regional integration agreements discussed in this section.

6.3 Regional Integration, Trade and FDI

It is difficult to disentangle the effects of regional integration from the effects of all the other major reforms that have taken place in Bolivia during the same period. Furthermore, it is virtually impossible to assign causal effects to the signing of any specific agreement or to the formulation of any specific provisions in these agreements. In this section we will review the changes in trade and FDI patterns that have followed the signing of the different integration agreements. We will then estimate a gravity model of trade, which can be used to formally test the impacts of these agreements on trade.

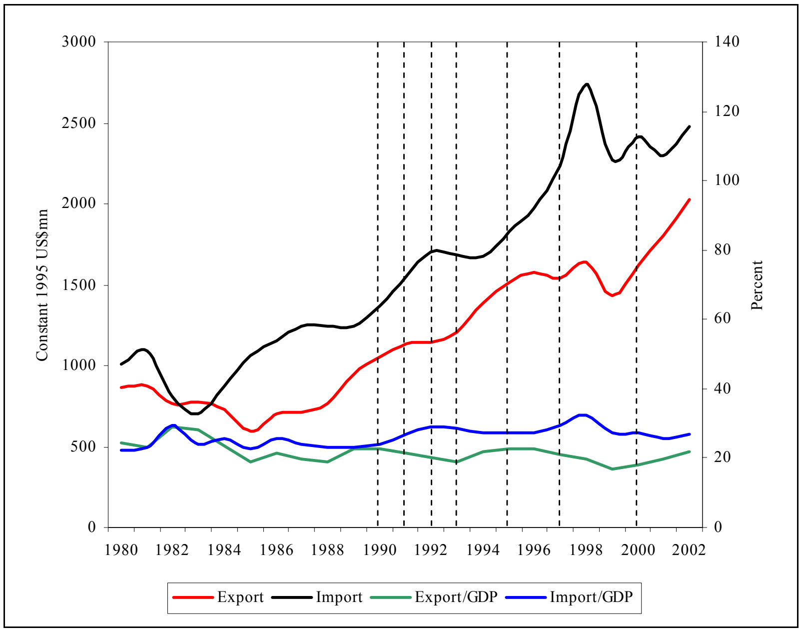
Trade

Trade policy during the last 18 years can be divided into three periods. The first period, 1986-1990, had the main objective of reversing the negative consequences of protectionism and its anti-export bias. The policies were characterized by four basic elements: 1) reduction in the average level of tariffs; 2) simplification of the tariff structure; 3) incentive mechanisms for exports; and 4) a unique[26] and realistic exchange rate.

[26] Meaning that the official exchange rate is identical to the black market exchange rate.

During this period, the tariffs decreased significantly, from an average of 30% to a single rate of 10% on all goods, except capital goods for which the tariff is only 5% (Peñaranda, 1993). These changes were based on the rules of GATT, of which Bolivia has been a member since 1990. In the case of exports, the government created the National Institute of Exports to facilitate an efficient legal framework and to reduce the bureaucracy associated with exporting. Chart 6.8 suggests that these policies may have helped reverting the negative trends in exports and GDP experienced during the early 1980s.

Chart 6.8 Official Exports and Imports, 1980 - 2002



Source: National Statistic Institute (INE).
Note: Regional Agreements: Andean Community (1991-revived); Chile (1993); Mexico (1995); MERCOSUR (1997); and Cuba (2000). Preferential Trade: Andean GSP (1990);

During the second period, 1991–1997, trade policies concentrated on expanding the export markets for Bolivian goods by signing trade agreements with main trading partners. Bolivia signed agreements with Chile, Mexico and MERCOSUR and became a member of the WTO in 1995. Chart 6.8 shows that both imports and exports grew strongly during the period of increased integration. For example, both imports and exports increased significantly right after signing the agreements with MERCOSUR in 1997.

A major accomplishment during this period was the approval of the Export Tax Law in 1993, which compiled and consolidated a range of previous rules regarding exports. The law stipulates: 1) free exports and imports without any license or permission, and 2) government guarantees for international export financing. Moreover, the government created six free trade zones (FTZs). Currently, FTZs exist in the three main cities and 3 cities on the borders of Brazil and Peru. They have not yet proven attractive to investors, though, because of the lack of roads and other basic infrastructure.

The performance of trade grew steadily until 1998, when the level of trade started decreasing due to external shocks and the implementation of the Customs Law in 1999. The latter had the objective of decreasing illegal imports and increasing the recollection of import tariffs.

The third period, 1998-2002, was characterized by economic recession, and the government implemented several temporary policies to try to revive the economy. Among these were tariff reductions on capital goods from 10% to 5% and tax exemptions for exporters.

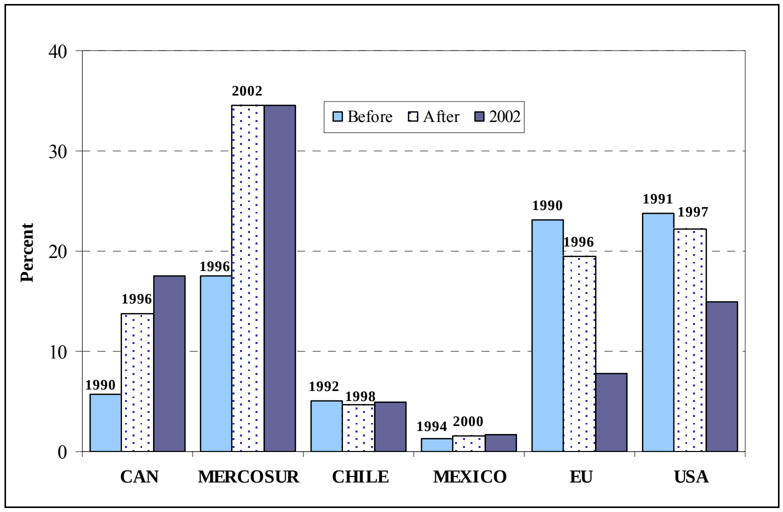
Although trade increased substantially in terms of value since the introduction of the NEP, trade as a share of GDP has remained roughly constant (see chart 6.8). Thus, regional integration has apparently not made Bolivia a more open economy, but, as we will see below, it did affect what goods are exported and to whom they are exported.

The impact of regional integration on trade

The trade agreements apparently contributed to changes in the relative importance of each trade bloc. Chart 6.9 shows that trade with CAN and MERCOSUR has increased substantially at the expense of trade with the US and the European Union. For example, one year before the signing of the CAN agreement, only 6 percent of Bolivian trade occurred with this bloc. Five years later, this percentage had increased to 14 percent, and by 2002 it has reached 18 percent. In contrast, trade with the European Union accounted for 23 percent of all Bolivian trade 1 year before receiving the drug related preferential trade concession, and 5 years later it had dropped to 19 percent, and by 2002 it is only 8 percent.

Especially the MERCOSUR agreement appears to have had a very large trade diversion effect. Within five years, 20 percent of all trade had been diverted from EU and US partners to MERCOSUR.

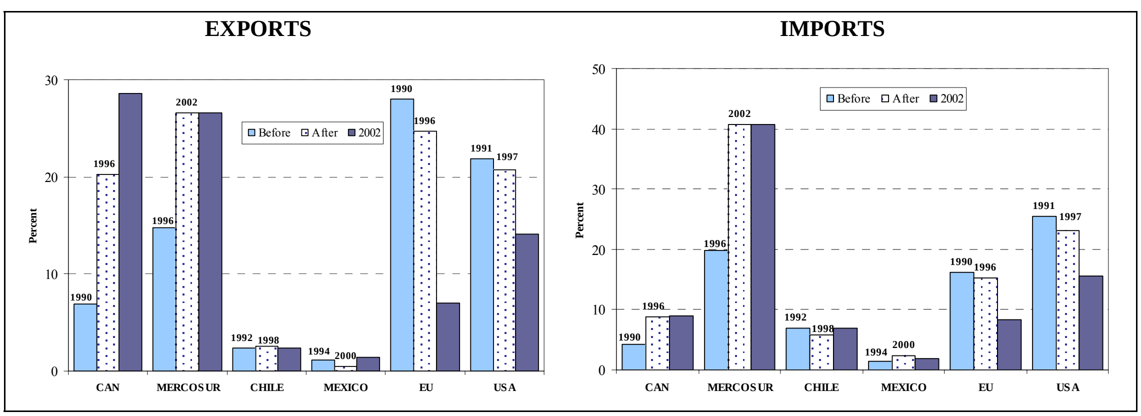
Chart 6.9. Share of Trade (Imports+Exports) from Partners One Year before and Five Years after Implementation of RIA



Source: National Statistic Institute (INE).

Chart 6.10 shows that the trade diversion effect is particularly large for exports, whereas imports were slightly more rigid. Still, imports from the European Union fell from 17 percent in 1990 to 8 percent in 2002, while imports from MERCOSUR doubled from 20 to 41 percent between 1996 and 2002.

Figure 6.10 Share of Exports and Imports from Partners One Year before and Five Years after Implementation of RIA



Source: National Statistic Institute (INE).

The trade diversion hypothesis can be formally tested in a classical gravitation model of the type that was first applied by Tinbergen (1962) and Pöyhönen (1963). The model stipulates that the amount of trade between two countries, T_{ij}, depend on the level of income, Y_i, in each of the two countries, and the distance, D_{ij}, between the two countries. The model also allows for some other factors, X_{ij}, which are usually dummies indicating whether the two countries share a common border or a common language. Thus, the gravity model of trade can be written as follows:

$$\ln(T_{ij}) = \alpha + \beta_1 \ln(Y_i^*) + \beta_2 \ln(Y_j) + \beta_3 D_{ij} + \beta_4 X_{ij} + \varepsilon_{ij}.$$

The model is estimated for Bolivia and its 66 trade partners using annual data from 1990 to 2002. To test whether the agreements reviewed in Section 2 have had a significant impact on the volume of trade, we include six trade agreement dummies in the gravity model. The CAN dummy, for example, takes on the value 1 for the years when the agreement was in place for the countries involved, and is 0 for all other countries and years. If the estimated coefficient is positive, it indicates that the agreement had a positive effect of trade, even while controlling for other factors, such as distance and income levels.

Table 6.1 shows the regression results. Trade is defined as imports plus exports measured in fixed 1995 US-dollars. Distance is measured as the distance between countries' capitals measured in kilometers[27]. The panel was supposed to have 858 observations, but a few observations on imports were missing, implying a total number of observations of 853. As expected, the coefficient on both Bolivian GDP and trade partner's GDP comes out positive, while distance has a highly significant negative effect on trade. A common border between the two countries tends to increase trade. There appears to be a negative trend in Bolivian trade during the 1990-2002 period, although the estimated coefficient is only significant at the 10% level.

[27] The results are robust to substituting distance in kilometers with the log of distance in kilometers, except that the dummy "Common border" becomes insignificant.

Table 6.1 Estimated Gravity Model of Trade, Bolivia, 1990-2002

Dependent Variable: ln(Imports+Exports+1)
Method: Pooled Least Squares
Sample: 1990 2002
Total panel (unbalanced) observations 853
White Heteroskedasticity-Consistent Standard Errors & Covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Constant	-49.24422	22.55099	-2.183684	0.0293
ln(GDP) (95$)	1.365768	0.035496	38.47618	0.0000
ln(GDPBOL) (95$)	4.974959	2.621218	1.897957	0.0580
CAN	2.543368	0.187035	13.59837	0.0000
MERCOSUR	1.290531	0.415018	3.109575	0.0019
MEXICO	0.598812	0.167401	3.577106	0.0004
CHILE	0.186356	0.225067	0.828000	0.4079
ATPA	-0.685342	0.227003	-3.019080	0.0026
EU	0.075713	0.151131	0.500979	0.6165
Trend	-0.170553	0.094085	-1.812763	0.0702
Distance (km)	-0.000196	1.55E-05	-12.63101	0.0000
Common border	1.690658	0.234863	7.198493	0.0000
R-squared	0.733066			

Source: Authors' estimation.

According to the regression results, the CAN agreement had a highly significant positive effect on trade between Bolivia and other members of the Andean Community. The coefficient is not only significant, but also very large. A coefficient of 2.5 implies approximately a twelve doubling of trade (measured in real terms) after the signing of the agreement compared to before the signing of the agreement.

The MERCOSUR agreement also had a statistically significant and positive impact on trade according to the estimated model. The coefficient of 1.29 suggests that trade between Bolivia and MERCOSUR countries more than tripled after signing the agreement.

The partial integration agreement with Mexico signed in 1995 also had a statistically significant positive effect on trade between Bolivia and Mexico. The coefficient of 0.60 suggests that trade between the two countries increased by 82% due to the signing the agreement.

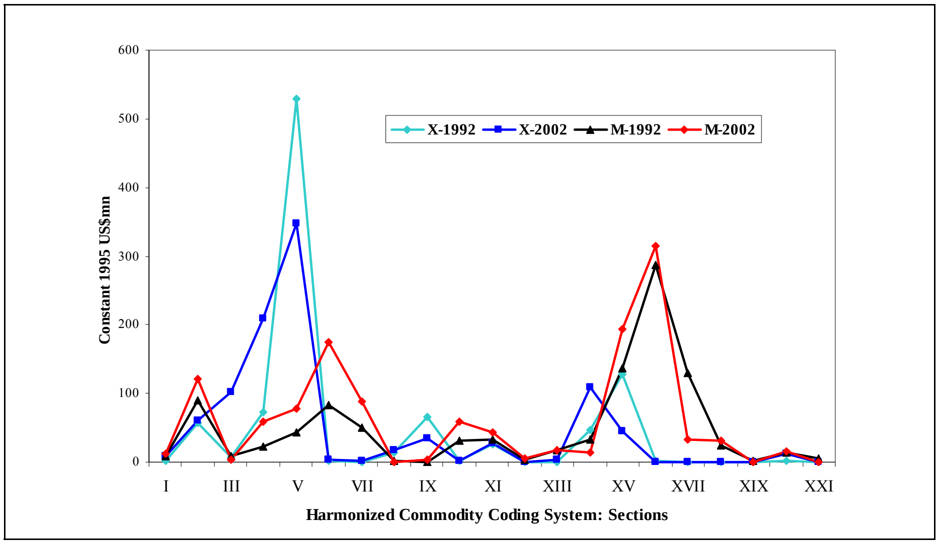
In contrast, the Andean Trade Preference Act (ATPA) granted by the United States appear to have had a negative effect on trade between Bolivia and the US. A coefficient of –0.69 suggests that trade fell by 50% after the agreement was signed in 1991. It is unlikely that the signing of the ATPA *caused* this drop in trade. Indeed, the estimated model cannot prove causality, only indicate what happened with trade before and after signing the various agreements compared to what would be expected given the GDP levels and geographical locations of each country. We do not know what would have happened with Bolivian-US trade if no ATPA had been signed, but the regression results, as well as charts 6.9 and 6.10 above suggest that the ATPA (followed by the ATPDEA) has not been successful in increasing trade between the two countries.

The Andean Generalized System of Preferences granted by the European Union did not have a positive effect on trade either. The estimated coefficient is positive, but not statistically significant. The same holds for the partial integration agreement signed with Chile in 1993.

The estimated gravity model of trade is consistent with the hypothesis of diversion of trade away from US and EU markets towards CAN and MERCOSUR markets. Although it is impossible to prove that this trade diversion was caused by the regional integration agreements, both empirical evidence and theory are at least consistent with that hypothesis. In the remainder of the chapter , we will tentatively attribute all the changes that have been observed in trade patterns to the regional integration processes, thus getting an upper bound on the impact of regional integration on poverty.

Since we are interested in the impact of trade on poverty, it is also important to analyze the changes in the composition of trade. Chart 6.11 shows that, between 1992 and 2002, Bolivian exports have become significantly more diversified. In 1992, exports were highly concentrated in section V products (Mineral products), whereas by 2002, this category had lost importance, while section III products (Animal and vegetable fat), section IV products (Food, beverages, and tobacco), and section XV products (Base metals and products thereof) all had become significant. A large part of current section III exports consists of soybean exports to other Andean countries under very favorable conditions due to trade provisions in the CAN. Bolivian soybean producers cannot compete with the much more efficient Brazilian soy bean producers, and the only reason Bolivia has a significant amount of soy bean exports, is the preferential access to Andean markets provided by the CAN agreement. Similarly, section IV exports also go mainly to CAN or MERCOSUR markets benefiting from favorable trade provisions.

Chart 6.11 Structure of Exports and Imports: 1992 and 2002 (Constant 1995 US$mn)



Source: National Statistic Institute (INE).

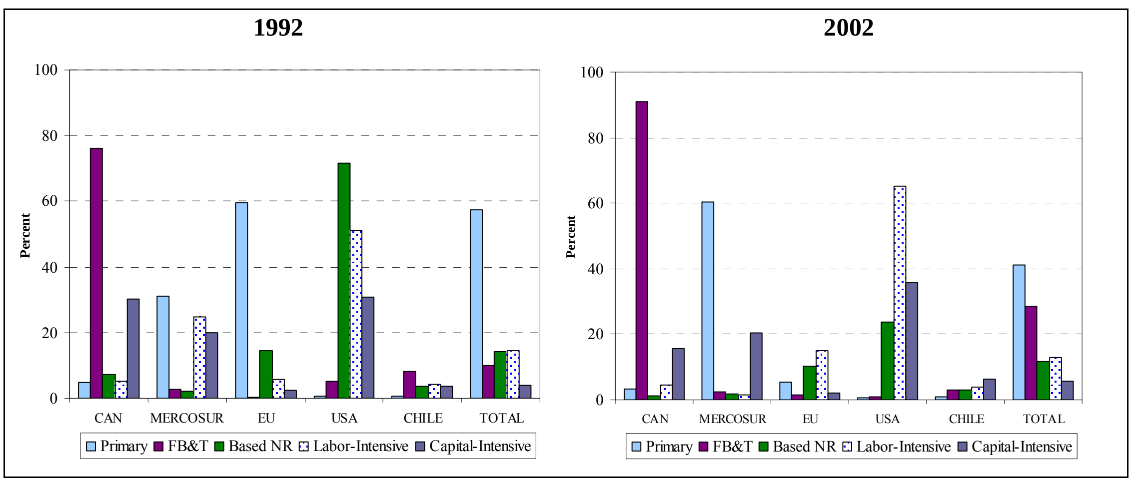
In contrast, in the case of Textiles and Textile Articles (Section XI), the reduction of tariff was gradual and zero tariff rates were only reached by the end of the period of analysis. Exports in this category had clearly not started to take off by 2002.

Chart 6.12 confirms that before signing the series of integration agreements, Bolivian exports were dominated by primary goods, mainly destined to the European Union, while MERCOSUR was relatively unimportant.

By 2002, primary goods are still the most important export category, but now the destination is almost exclusively MERCOSUR. Food, Beverages and Tobacco have also become very important, and the destination is CAN.

In terms of poverty, we would expect labour-intensive export products (Food, Beverages and Tobacco, Labour Intensive Industries) to have the most beneficial effects. Thus, it is likely that exports to CAN and the US will reduce poverty more than exports to other blocs. This hypothesis will be formally tested in Section 4 below.

Chart 6.12 Structure of Exports by Trade Blocs and Goods: 1992 and 2002



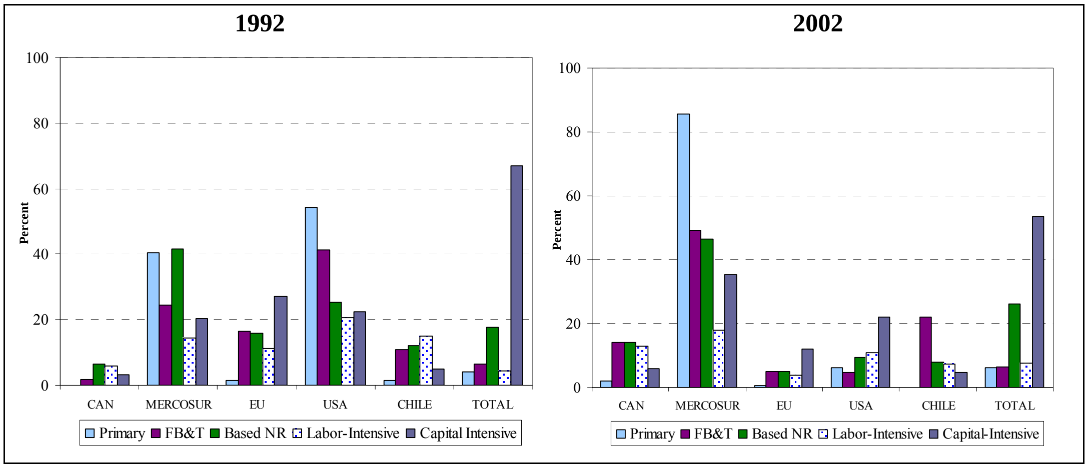
Source: UN Commodity Trade Statistics Database.
Primary: ISIC 011, 012, 013, 014, 015, 020, 050, 101, 102, 103, 111, 112, 1210, 121, 132, 141, 142.
Food, Beverages and Tobacco: ISIC 151, 152, 153, 154, 155, 160.
Based Natural Resources: ISIC 210, 241, 243, 251, 252, 271, 272. 273.
Labour Intensive: ISIC 171, 172, 173, 181, 182, 191, 192, 201, 202, 361, 369.

Trade integration not only promotes exports, however. Increased exports go hand in hand with increased imports as we saw in chart 6.8.

Chart 6.13 shows that Bolivia's main imports are capital goods. In 1992, these comprised 68 percent of all imports, and came mostly from the EU and the US. By 2002, the import share of capital goods had decreased to 58% and, more importantly, these imports came primarily from MERCOSUR.

Capital goods are essential for the Bolivian industry and do not compete with local production, as Bolivia has virtually no capital goods industry. In contrast, natural resource based products compete directly with Bolivian production, and the increase observed between 1992 and 2002 may thus have a detrimental effect on poverty. This is the backside of increased integration, and the problem is particularly big with MERCOSUR.

Chart 6.13 Structure of Imports by Trade Blocs and Goods: 1992 and 2002



Source: UN Commodity Trade Statistics Database.
Primary: ISIC 011, 012, 013, 014, 015, 020, 050, 101, 102, 103, 111, 112, 1210, 121, 132, 141, 142.
Food, Beverages and Tobacco: ISIC 151, 152, 153, 154, 155, 160.
Based Natural Resources: ISIC 210, 241, 243, 251, 252, 271, 272. 273.
Labor Intensive: ISIC 171, 172, 173, 181, 182, 191, 192, 201, 202, 361, 369.

Foreign Direct Investment

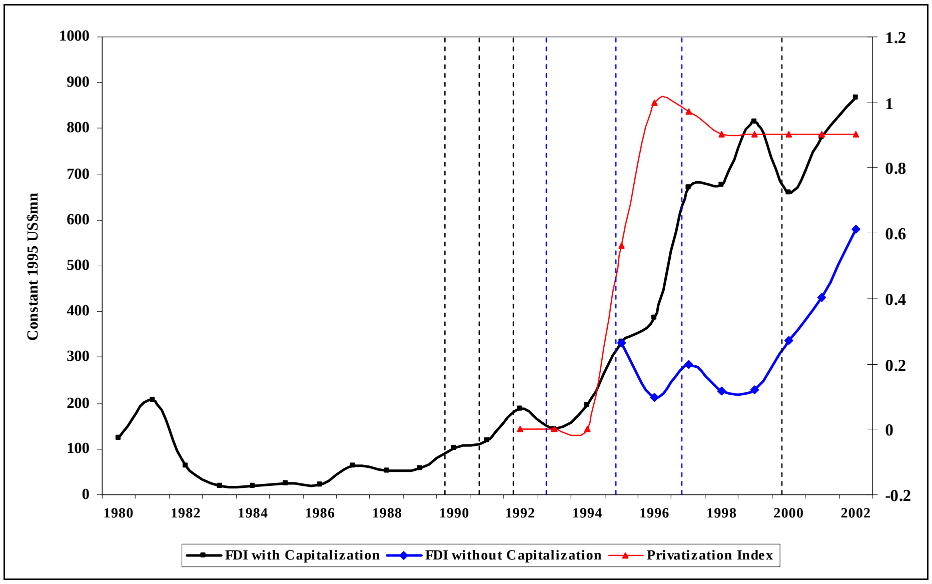
Once macroeconomic stability was achieved in 1986, investment policies have avidly sought to attract foreign investors to augment the country's asset base. During the first period, 1986-1990, the political instability and the uncertainty regarding the success of the stabilisation program together with an inappropriate policy framework to promote investment can in part explain the slow growth of FDI (see chart 6.14).

Clear rules for foreign investment were set out in the early 1990s, mainly trough the Investment Law (1990) and Privatisation Law (1992). The Investment Law guarantees that foreign investors will receive national treatment, have access to free currency conversion, enjoy unrestricted remittances, and have the right to international arbitration. These laws, together with a complete line of investment guarantees to foreign investors by IBRD's Multilateral Investment Guarantee Agency (MIGA), established favorable rules regarding market entry and foreign ownership. During this period, Bolivia also signed bilateral investment agreements with Argentina, Belgium/Luxembourg, China, France, Germany, Italy, Mexico, the Netherlands, Peru, Romania, Spain, Switzerland, the United Kingdom and the United States[28].

[28] See Appendix 6.2.

During the second half of the 1990s, when the Second Generation Structural Reforms improved the economic policy framework, the Capitalisation Law (1994) generated a large infusion of foreign direct investment due to the opening up of strategic state monopolies to private investors (see chart 6.14). Under the capitalisation process, the six principal state-owned enterprises, YPFB (oil and gas), ENDE (electricity), ENFE (railways), ENTEL (telecommunications), LAB (aviation) and EMV (mining and smelting), were put up for sale by international tender and the winning bidders gained management control and a 50% stake in the enterprise, while the government retained the remaining 50% share.

Chart 6.14 FDI and Privatisation Index



Source: National Statistic Institute (INE).

This program, nevertheless, maintained five temporary monopolies, now under private control, in the hydrocarbons, transportation, telecommunication, and electricity sectors. The last of these monopoly contracts expired by the end of 2002, when the telecommunication sector was opened up to free competition.

The government created the Sector Regulatory System (SIRESE) to balance the potential market power of the natural monopolies. SIRESE is an autonomous regulatory body, which regulates many aspects of business in the telecommunications, electricity, transport, hydrocarbons and water sectors. Prices of most public utilities are reviewed and approved by SIRESE. Market forces largely set prices, but, where necessary, a regulated price is established through relatively transparent procedures and formulas. The exception to this is potable water and garbage collection, where municipalities set the local rates.

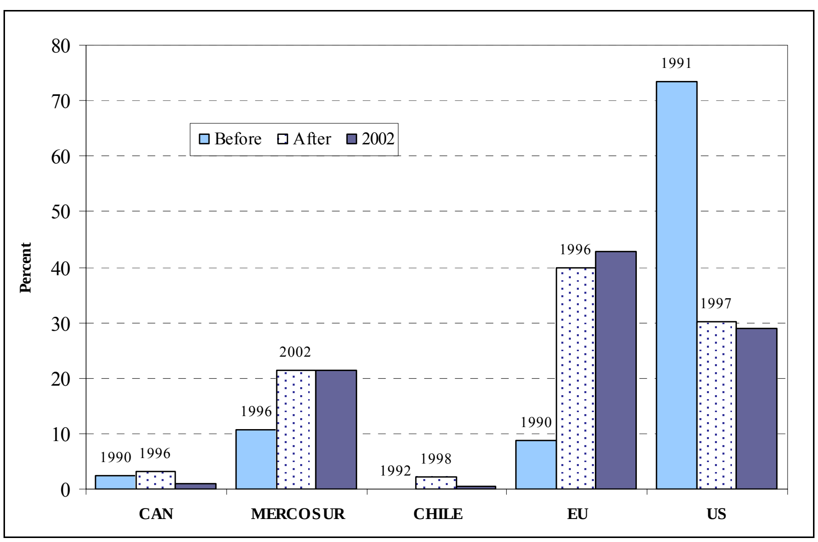
In general, the government, through time, has been entering into a series of bilateral and multilateral agreements and covenants to promote, protect and guarantee investments. Foreign ownership is allowed virtually throughout the economy, with no requirements to register foreign direct investment separately. The legal framework restricts investments by foreigners in operations along the border areas, unless the investment or project is declared of national interest. Foreign investment is neither screened nor treated in a discriminatory manner. There are no registration requirements for foreign direct investors in Bolivia or any special incentives for domestic or foreign investment. Finally, there are no restrictions on any kind of remittances or currency transfers.

The impact of regional integration on FDI

Chart 6.15 shows an increases in FDI after signing the regional integration agreement with MERCOSUR, but hardly any effect in the cases of CAN and Chile. The drug related concessions with the EU and the US did not directly address FDI issues, and the large increase observed in the case of the EU is due to bilateral investment agreements (see Appendix 6.2), which promoted large investments, especially from Italy and Spain in telecommunications and financial intermediation.

As indicated in chart 6.14, a large part of FDI during the period 1995-2002 is due to the capitalisation process (Nina and te Velde, 2003). While the capital inflows from the capitalisation process by nature were time limited, the chart indicates that other kinds of FDI keep increasing. It is likely that the integration process and the capitalisation process have reinforced each other in attracting FDI to Bolivia.

Chart 6.15 Share of FDI from Partners One Year before and Five Years after Implementation of RIA



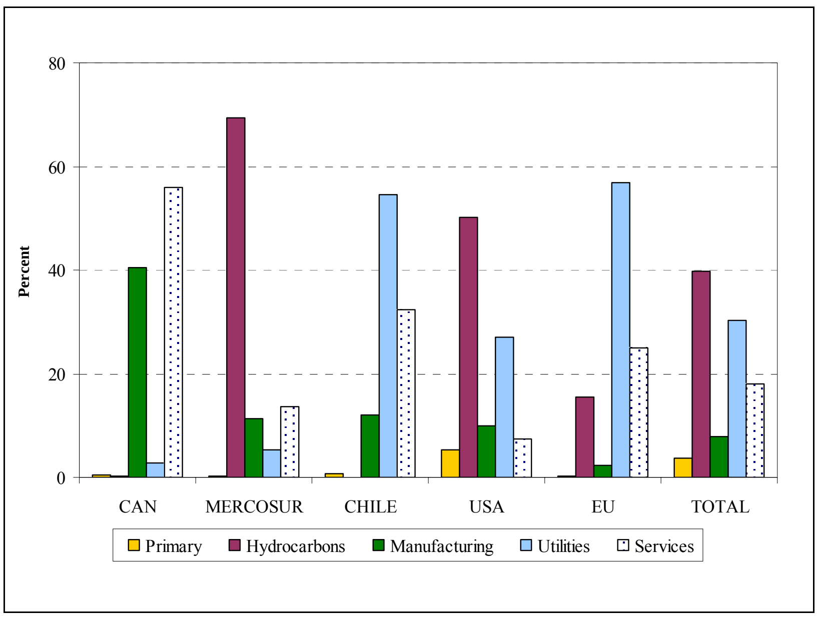
Source: National Statistic Institute (INE).

Chart 6.16 shows the distribution of cumulative foreign direct investment during 1996-2002, by economic activity and trade bloc. The hydrocarbon (oil and gas) sector attracted 40 percent of all FDI, with Brazil, Argentina, the US, and Spain being the main investors. Utilities and transportation attracted 30 percent of FDI, with Chile and

Italy being main actors through their investment in railways and telecommunication, respectively. The CAN bloc accounts for most of the investment in the service sector, due to the large Peruvian investments in financial intermediation. The distribution of investment across source countries is not related to regional investment provisions, as Bolivia is non-discriminatory with respect to the source of FDI.

Investment in the manufacturing and primary goods sectors accounted for only 12% of total FDI during the period. Since these two sectors are much more labour intensive than the other three groups, they would likely have had a more beneficial impact on poverty reduction in Bolivia. This issue will be investigated further in the following section.

Chart 6.16. Structure of FDI by Economic Blocs and Economic Activities - Accumulated Stock, 1996-2002



Source: National Statistic Institute (INE).

Conclusions

While both distant (US, EU) and nearby (MERCOSUR, CAN) trading partners have provided free access for thousands of Bolivian products, the effect on trade has been most favorable for nearby markets. Indeed, it appears that regional integration processes have caused a diversion of trade away from US and EU markets towards MERCOSUR and CAN markets.

In addition, exports became considerably more diversified, possibly due to the different structure of demand in neighboring countries compared to EU and US markets. Whether these changes have a positive or negative impact on poverty, is the central question in the section that follows.

6.4 Regional Integration and Poverty

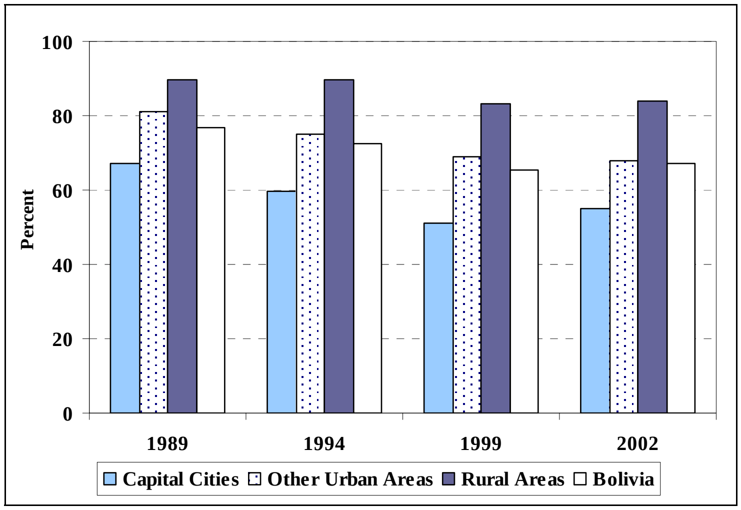
The framework in chapters 2-4 examines the effects of regional integration on poverty and discusses the routes from RI to poverty on the basis of a simple mapping of a set of links describing how poverty in a country is affected by RI processes. The first set of links between RI and poverty is through trade. Regional Trade Agreements (RTAs) include certain provisions that may affect the volume, price and "poverty focus" of trade. The second set of links is through foreign direct investment. RTAs included certain provisions that may affect the volume, and "poverty focus" of investment. The third set of links can be termed "other" links and relate to non-trade and non-FDI issues in RTAs that may affect poverty. Finally, these links, in general, may in turn affect different characteristics of poverty intermediated through complementary conditions including public policies.

These sets of links will depend on the structure of the labour and goods markets. In the labour markets, for example, it is possible to analyze the RTA effects on employment and income when the RTA has resulted in a change in the relative importance of each sector. On the other hand, the RTA can lower import and domestic prices of products (goods and services) consumed directly by the poor or used in production processes that benefit the poor indirectly. Thus, it is also important to analyze the poverty effect of changes in the prices of goods and services induced by FDI.

Poverty

According to a recent study by Spatz, Bolivia experienced a reduction in the incidence of poverty between 1989 and 1999. However, during the late 1990s, the poverty trend reversed and the poverty in Bolivia started to increase again (see chart 6.17). Moreover, the study shows that urban poverty is closely linked to macroeconomic performance, whereas rural poverty follows its own logic (more linked to weather conditions and the coca-economy).

Chart 6.17 Monetary Poverty by Region: 1989-2002



Source: Spatz (2004)
Note: [1] Poverty headcount

The study concludes that rural areas in Bolivia are quite detached both from improvements and from deteriorations in the overall economic environment. Thus, it is reasonable to assume that the RI effect on poverty can mainly be observed in urban areas.

According to table 6.2, urban poverty fell rapidly during the economic boom in 1992-1997, and much more slowly during the economic downturn in 1998-2002. There are large differences between sectors, however, and these differences can, to some extent, be explained by patterns in trade and FDI. For example, the table shows that poverty among workers in the hydrocarbon sector fell from 51% in 1992 to 0% in 2002, in capital cities. The same was the case for workers in the electricity, gas, and water sectors, and to a lesser extent for workers in the financial sector. These large reductions in poverty coincide with the sectors that attracted the main part of FDI. In contrast, the agricultural sector, which did not receive any FDI, experienced a much slower reduction in poverty.

The table also shows that the sectors that experienced rapid growth in exports (especially food, beverages and tobacco), saw faster decreases in poverty rates among workers. In contrast, the wood sector, which saw exports fall, experienced an increase in poverty. The mining sector, however, do not conform to this general idea, as poverty fell rapidly together with exports. Further below, formal models will be estimated linking exports, imports, and FDI to poverty, while controlling for changes in other factors.

Table 6.2 Monetary Poverty[1] by Economic Activities: 1992, 1997 and 2002

Economic Activity	Capital Cities			Bolivia		Annual Average Growth (%): 92-02	
	1992	1997	2002	1997	2002	Exports	Imports
Agriculture	62.5	52.8	57.5	78.7	78.8	-8.6	6.9
Hydrocarbons	50.5	19.9	0.0	23.0	2.9	5.6	60.4
Mining	82.5	64.2	41.5	63.3	57.5	-7.1	3.1
Manufacturing	78.6	55.9	61.8	59.3	63.2	4.9	2.1
Chemicals, Plastic and Refined Petroleum	57.1	26.6	20.4	26.7	22.2	23.4	8.6
Food, Beverages and Tobacco	82.2	52.4	53.9	57.4	55.1	12.9	2.5
Textiles, Leather and Wearing Apparels	82.7	63.8	59.4	66.1	65.6	3.9	8.2
Other Manufacturing industries	73.4	55.1	74.2	62.5	71.5	3.6	-6.1
Paper, Publishing and Printing	71.6	42.0	62.5	43.5	62.9	2.9	6.4
Machinery and Equipment	82.6	57.1	71.0	54.1	69.5	2.0	0.5
Basic metals and non metallic mineral	79.6	55.1	58.9	56.3	63.9	-0.5	4.4
Wood and Cork	74.9	55.1	100.0	59.5	79.9	-5.9	15.2
Electricity, Gas and Water Supply	70.1	18.5	0.0	26.1	29.4		
Construction	81.7	59.8	63.1	60.8	69.9		
Commerce	73.8	52.5	48.7	51.9	50.7		
Hotels and Restaurants	79.5	59.3	54.8	58.6	54.5		
Transport, Storage and Communications	67.1	44.0	39.2	45.7	43.1		
Financial Intermediation	42.8	17.3	33.7	23.8	35.3		
Other Services	55.5	41.9	31.6	45.7	38.9		
Total	**67.2**	**49.7**	**44.3**	**62.2**	**56.9**		

Source: Authors' estimations based on household surveys by the National Statistic Institute (INE).
Note: [1] We use the official poverty classification of each household as determined by INE. The assignment to sectors is based on the work sector of the person in each household who has the highest labor income. Poverty is thus "blamed" on the main income earner, rather than on spouses' and children's failure to bring in enough supplementary income.

According to the economic literature, the effects of RI on poverty is best analyzed through a computable general equilibrium model, where it is possible to include certain provisions that may affect the volume, price and "poverty focus" of trade and FDI. This approach not only requires a complete social accounting matrix, but also a microeconomic component based on household surveys, like IMMPA (Integrated Macroeconomic Model for Poverty Analysis) developed by the World Bank.

The approach that is used in the present study to test the effects of RI on Poverty is similar to the one used in the Bolivian Poverty Report by the World Bank (2000); but includes variables on export, import and FDI at the individual level according to each individual's sector of work (down to four digits of the ISIC code). The analysis was done at the household level, using the work sector of the family member with the highest labour income[29].

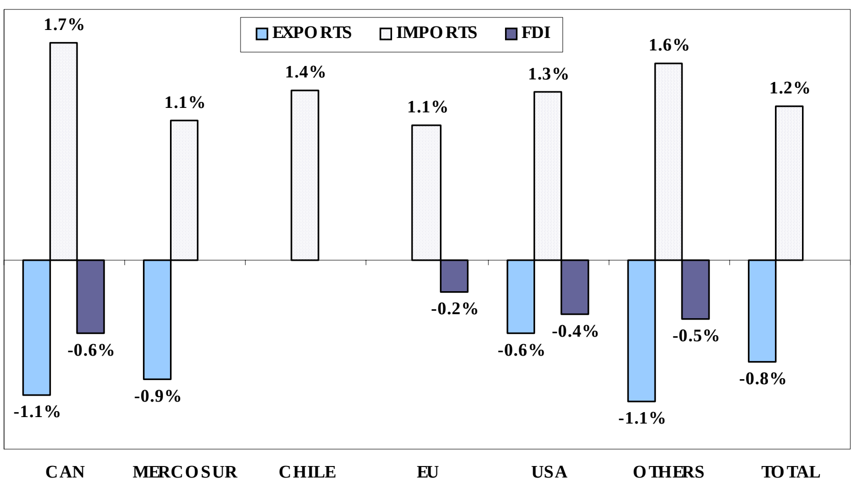
Chart 6.18 summarizes the results of this analysis, indicating that exports tend to reduce poverty, while imports tend to increase poverty. For example, a doubling of exports to CAN, would result in a reduction in poverty of 1.1 percentage points. Unfortunately, a doubling of imports from CAN would more than cancel this benefit out, as this would cause an increase in poverty of 1.7 percentage points. For all trade blocs the negative effect of imports are larger than the positive effect of exports, but the difference is smallest in the case of MERCOSUR. This can be explained by the

[29] See Appendix 6.3 for full results.

fact that imports from MERCOSUR are mainly capital goods, which do not compete with local production. In contrast, imports from CAN are concentrated in sectors that compete with Bolivian production (Food, Beverages, Tobacco; Natural Resource Based Manufacturing; and Labour Intensive Industries – see chart 6.13).

At the aggregate level, FDI was not found to have a significant impact on poverty. However, when analyzed by trade bloc, some FDI was found to be more beneficial than others. For example, a doubling of FDI from CAN was estimated to cause a 0.6 percentage point decrease in poverty, whereas FDI from Chile and MERCOSUR did not have any beneficial impact. The reason for these differences is that FDI from Chile and MERCOSUR was concentrated in hydrocarbons and financial intermediation, which are both highly capital intensive and have very limited effects on employment, as we will see below. In contrast, the FDI that came from CAN targeted more labour-intensive industries.

Chart 6.18 Estimated impact of a doubling of exports/imports/FDI on the probability of being poor, 2002



Source: Author's estimation. Full probit regression results in Table 3a and 3b in Appendix 6.3.
Note: The impacts are calculated as the dF/dX*ln(2), where dF/dX is the marginal effect evaluated at the mean of X (reported by Statas dprobit command) and ln(2)=0.691347 is the change in lnX required to double X.

The relatively small impacts of trade on poverty are due to the structure of labour markets and trade in Bolivia, and especially due to the fact that most poor people are concentrated in traditional agriculture and non-tradable sectors, which have only very indirect links with trade.

In order to assess the total impact of regional integration on poverty, we would have to multiply the elasticities in chart 6.18 with the total changes in imports, exports and FDI caused by regional integration. We do not know the latter for sure, but chart 6.10 suggests that regional integration has caused exports to CAN and MERCOSUR to go up significantly and exports to US and EU to go down significantly. The same chart suggests that imports from MERCOSUR have gone up and imports from EU and US have gone down. In the case of FDI, chart 6.15 suggests it has gone up for MERCOSUR and EU and down for US. We can thus construct the following table which allows us to assess at least the signs of the impacts on poverty.

Remember that a negative sign is desirable, as it means a reduction in poverty. For example, the increase in exports to CAN and MERCOSUR multiplied by the negative elasticity of exports on poverty, implies a negative (beneficial) effect on poverty. However, this is partially counterbalanced by reductions in exports to the US and by increases in imports which has a positive (adverse) effect on poverty.

In the case of FDI, there appear to be a beneficial effect from more FDI from the EU, but an adverse effect from less FDI from the US. For CAN and MERCOSUR there were no FDI impacts, in the first case because there was no quantity change and in the second because the poverty elasticity of FDI was estimated at zero. In total, there may have been a slightly beneficial effect of regional integration on poverty.

Table 6.3 Sign analysis of the poverty impact of regional integration

	change in quantity * elasticity = impact on poverty				
	CAN	**MERCOSUR**	**US**	**EU**	**TOTAL**
Exports	+ * ÷ = ÷	+ * ÷ = ÷	÷ * ÷ = +	÷ * 0 = 0	÷
Imports	+ * + = +	0 * + = 0	÷ * + = ÷	÷ * + = ÷	÷
FDI	0 * ÷ = 0	+ * 0 = 0	÷ * ÷ = +	+ * ÷ = ÷	0
Total	0	÷	+	÷	÷

This poverty analysis is obviously very crude, but it does give an overview of the rather mixed effects of regional integration. In the following, we will complement it with a more detailed analysis on the impact of trade and FDI on individual salaries and employment.

The Structure of Production, Exports and Imports

Although the overall division of economic activity between agriculture, manufacturing, and services hardly changed during the 10-year period from 1992 to 2002, there were still interesting developments to be observed. For example, table 6.4 shows that exports from the manufacturing sector increased from 5.6 percent of GDP in 1992 to 9.9 percent in 2002. This is hardly due to FDI, of which the manufacturing sector received little, but may have been substantially influenced by trade policies, and especially by the integration agreements with CAN and MERCOSUR.

Table 6.4 Composition of Production, Export and Import by Economic Activity (% of GDP)

Economic Activity	Production			Export			Import		
	1992	1997	2002	1992	1997	2002	1992	1997	2002
Agriculture, Hunting, Forestry and Fishing	15.1	15.2	14.2	0.4	1.3	0.2	0.7	0.7	1.4
Hydrocarbons	4.1	4.4	5.1	2.2	1.2	4.2	0.0	0.0	0.0
Mining	5.8	5.3	4.3	4.9	3.5	2.6	0.0	0.2	0.0
Manufacturing	16.6	16.7	16.5	5.6	8.9	9.9	18.2	21.0	20.9
Food, Beverages and Tobacco				1.3	3.0	4.8	1.2	1.0	1.4
Basic metals and Non Metallic Mineral				1.8	2.7	1.9	2.3	2.0	3.3
Other Manufacturing Industries				0.8	1.1	1.2	4.7	5.8	2.3
Textiles, Leather and Wearing Apparel				0.4	0.6	0.7	0.6	0.5	1.2
Wood and Cork				0.9	1.1	0.5	0.0	0.0	0.0
Machinery and Equipment				0.3	0.1	0.4	6.3	7.1	6.2
Chemicals, Plastic and Refined Petroleum				0.0	0.2	0.3	2.6	3.6	5.6
Paper, Publishing and Printing				0.0	0.1	0.0	0.5	0.8	0.9
Services	58.4	58.4	59.9	0.0	0.0	0.0	0.3	0.0	0.0
Total	100.0	100.0	100.0	13.2	15.0	16.8	19.2	22.0	22.3

Source: National Statistic Institute (INE).

The manufacturing sector has become substantially more export oriented since 1992, when only 30 percent of production was destined for export. This share is now above 60 percent. However, the service sector accounts for almost 60% of total economic activity in Bolivia, explaining why trade is likely to have only a limited effect on poverty. Although manufacturing exports have increased impressively, they still only account for about 10% of GDP, and 11% of employment, as will be seen next.

Employment and Labour Income

The effects of trade and FDI on poverty depend mainly on the labour market. However, table 6.5 shows that the composition of the labour market hardly changed at all between 1992 and 2002. The service sector still absorbs more than ¾ of the labour force in the main cities, while the share dedicated to manufacturing has remained constant just below 20 percent. At the national level, there were no significant changes, either.

Table 6.5 Labour Market Composition by Economic Activities: 1992, 1997, 2002 (Percent)

Economic Activity	Capital Cities			Bolivia		Average Annual Growth	
						Cities	Bolivia
	1992	1997	2002	1997	2002	92-02	97-02
Agriculture	2.1	1.9	3.0	43.2	42.4	8.5	1.0
Hydrocarbons	0.7	0.5	0.2	0.2	0.1	-8.9	-17.0
Mining	1.1	0.8	0.8	1.6	0.9	1.8	-8.2
Manufacturing	19.6	19.8	19.7	11.0	11.4	4.8	2.1
Textiles, Leather and Wearing Apparels	7.7	7.9	6.9	3.9	3.6	3.8	-0.2
Food, Beverages and Tobacco	4.0	3.1	5.0	2.5	3.3	7.1	7.1
Other Manufacturing Industries	3.0	3.9	2.9	2.0	1.5	4.3	-4.2
Machinery and Equipment	1.4	1.5	1.7	0.7	0.9	6.3	6.7
Basic Metals and Other non Metallic mineral	1.1	0.9	1.1	0.7	0.9	4.8	6.0
Paper, Publishing and Printing	1.1	1.4	1.0	0.5	0.4	4.4	-2.1
Chemicals, Plastic and Refined Petroleum	0.8	0.6	0.6	0.3	0.3	1.6	2.4
Wood and Cork	0.6	0.6	0.5	0.4	0.5	4.6	5.5
Services	76.5	77.0	76.4	44.0	45.1	4.8	1.9
Electricity, Gas and Water Supply	0.7	0.6	0.3	0.3	0.2	-4.0	-6.8
Construction	9.3	8.9	8.4	5.2	5.5	3.8	2.3
Commerce	25.2	24.4	24.7	14.2	14.4	4.6	1.7
Hotels and Restaurants	3.8	5.3	6.9	3.5	4.1	11.2	4.3
Transport, Storage and Communications	7.1	8.7	7.1	4.8	4.4	4.8	-0.1
Financial Intermediation	0.8	1.3	0.8	0.6	0.4	5.3	-3.7
Others Services	29.5	27.9	28.0	15.4	16.1	4.3	2.3
TOTAL (Millions)	1.0	1.3	1.6	3.6	3.8	4.8	1.4

Source: Authors' estimations based on household surveys by the National Statistic Institute (INE).

While FDI and regional integration apparently have not affected the structure of the labour market, table 6.6 shows that it may have had significant impact on labour incomes in some of the sectors. For example, the average monthly salary in utilities more than doubled from $251 in 1992 to $587 in 2002, while the average in main cities remained constant at $156. Salaries in the main FDI receiving sector, hydrocarbons, also increased substantially, from an already high level. In contrast, the average salary in manufacturing fell from $132/month in 1992 to $108 in 2002. There thus appear to be a positive relationship between FDI and salary growth[30].

[30] These numbers should only be taken as rough indications because the surveys used were not designed to be representative at this sector disaggregation.

Table 6.6 Monthly Labour Income by Economic Activities: 1992, 1997, 2002 (Constant 1995 US$)

Economic Activity	Capital Cities			Bolivia		Average Annual Growth (%)	
						Cities	Bolivia
	1992	1997	2002	1997	2002	92-02	97-02
Agriculture	303	389	168	91	54	-5.7	-9.8
Hydrocarbons	359	456	513	445	448	3.6	0.1
Mining	152	214	115	149	118	-2.8	-4.5
Manufacturing	132	143	108	138	101	-1.9	-6.0
Food, Beverages and Tobacco	99	184	135	153	115	3.2	-5.4
Textiles, Leather and Wearing apparel	107	94	71	89	66	-4.0	-5.8
Wood and Cork	189	138	134	129	124	-3.4	-0.8
Paper, Publishing and Printing	179	131	131	134	138	-3.1	0.6
Chemicals, Plastic and Refined Petroleum	131	208	233	237	212	6.0	-2.2
Basic metals and other non metallic mineral	134	259	176	234	141	2.8	-9.6
Machinery and Equipment	159	172	97	188	98	-4.8	-12.3
Other Manufacturing industries	149	160	96	148	98	-4.3	-8.0
Electricity, Gas and Water Supply	251	483	587	401	447	8.9	2.2
Construction	157	172	129	154	118	-1.9	-5.1
Commerce	131	159	132	151	122	0.0	-4.1
Hotels and Restaurants	167	136	111	137	108	-4.0	-4.7
Transport, Storage and Communications	199	245	172	224	164	-1.5	-6.1
Financial Intermediation	338	352	440	321	391	2.7	4.0
Others Services	160	181	204	161	182	2.5	2.5
TOTAL	156	180	156	148	118	0.0	-4.4

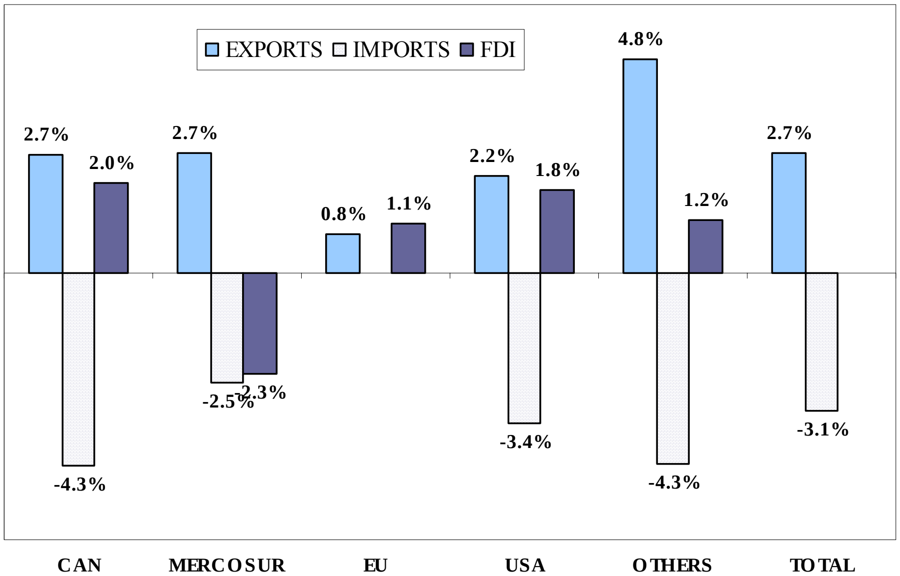
Source: Authors' estimations based on household surveys by the National Statistic Institute (INE).

A large part of the salary increases observed in the sectors receiving FDI appears to be made possible by efficiency gains (or lay-offs in less rosy words). While the average salary in the electricity, gas and water sector, for example, increased by 2.2% per year between 1997 and 2002, the number of people employed in the same sector fell by 6.8% per year. Salaries in the hydrocarbon sector also rose at the expense of rapidly falling employment. Indeed, the only sector that simultaneously managed to raise salaries and employment is "Other services", which mainly covers public services such as education and health.

Chart 6.19 shows the result from a micro-level analysis of exports, imports, and FDI on labour income[31]. The analysis uses individual workers, in contrast to the poverty analysis in chart 6.18, which used households as the unit of analysis. The present analysis thus captures a more direct effect of regional integration. In general, exports have a positive effect on salaries in the exporting sectors, while imports have a negative effect. The effect of FDI is ambiguous.

[31] See Appendix 6.4 for full results.

Chart 6.19 Estimated impacts of a doubling of exports/imports/FDI on labour income, 2002



Source: Authors' estimation. See full regression results in Tables 4a-4d in Appendix 6.4.
Note: Impact is calculated as β*ln(2), where ln(2) is the correction factor that should be used for a doubling of X.

While exports in general have a positive effect on salaries, the elasticity is biggest for the countries with which Bolivia does not have any agreements. This suggests that it is not necessarily an advantage to have trade agreements. It all depends on the type of exports.

Imports generally have a negative effect on the salaries in the sectors with which they compete. Imports from CAN and "Other countries" appear to compete more directly with Bolivian products, as the estimated elasticities are quite large. Imports from the EU, on the other hand, does not appear to have a negative effect on salaries, most likely because these imports are composed mainly of goods, which do not compete with Bolivian products.

FDI that went into monopolistic service sectors generally had a positive impact on salaries, but those salary increases were to a large extent made possible by lay-offs in the same sectors. In the case of MERCOSUR, the estimated effect of FDI on salaries is significantly negative. This is because the few employees who enjoyed high salary increases in the hydrocarbon sector were out-weighed by a large number of workers in labour-intensive sectors that also received FDI, but which use low salaries as a competitive advantage (manufacturing sectors).

The preceding analysis indicates that it would be very difficult to reduce poverty significantly through trade alone. Although, the sectors that have received more FDI and have increased exports faster, have also seen more rapid reduction in poverty, this has mainly been accomplished by laying off workers in these sectors.

6.5 Conclusions

The present analysis has shown that Bolivia enjoys relatively favorable conditions for access to export markets both in Latin America and in the United States and the European Union. In practice, however, Bolivia is mostly taking advantage of the regional markets, while exports to the US and EU have decreased during the last decade. Imports have also been diverted away from the traditional suppliers in the US and EU towards new suppliers in MERCOSUR. Thus, while the regional integration processes have contributed to increased trade within the region, overall trade, as a percentage of GDP, has not increased for Bolivia. Even if trade had increased substantially, the effect on poverty would likely have been negligible, since the positive effect of increased exports would be fully compensated by the negative effects of increased imports.

The change towards regional markets has also implied a change in the composition of exports. Manufacturing products now account for a larger share of exports, and primary goods for less. This change has an ambiguous effect on workers. The traditional export goods to Europe (minerals) had a high content of natural resource rents, which benefited workers. On the other hand, the manufacturing sector tends to use the low wage levels in Bolivia as a competitive advantage, which does not benefit the workers that much.

Foreign direct investment has concentrated in two main areas: 1) Hydrocarbons, to exploit the rapidly growing regional markets, and 2) Utilities, to exploit natural monopolies. Very little FDI has gone into manufacturing and agriculture, where most poor people are concentrated. Very few people benefited from the rapidly growing salaries in the hydrocarbon sector and in the utilities, implying that FDI had no impact on neither salaries nor poverty at the aggregate level.

For trade and FDI to have a beneficial effect on household incomes in Bolivia, it would have to concentrate on labour-intensive sectors that also exploit some natural resource rents. Natural resource rents that are extracted by very capital-intensive technologies will not benefit the population, while labour-intensive activities without any rents will keep workers at minimum salaries. Examples of sectors that exploit both would be modern agriculture and tourism.

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Appendix 6.1 Harmonized Commodity Description and Coding

Sections	Categories
I	ANIMALS & ANIMAL PRODUCTS
II	VEGETABLE PRODUCTS
III	ANIMAL OR VEGETABLE FATS
IV	PREPARED FOODSTUFFS
V	MINERAL PRODUCTS
VI	CHEMICAL PRODUCTS
VII	PLASTICS & RUBBER
VIII	HIDES, SKINS, LEATHER AND FUR
IX	WOOD & WOOD PRODUCTS
X	WOOD PULP PRODUCTS
XI	TEXTILES & TEXTILE ARTICLES
XII	FOOTWEAR, HEADGEAR
XIII	ARTICLES OF STONE, PLASTER, CEMENT, CERAMIC, GLASS
XIV	PEARLS, PRECIOUS OR SEMI-PRECIOUS STONES, METALS
XV	BASE METALS & ARTICLES THEREOF
XVI	MACHINERY & MECHANICAL APPLIANCES
XVII	TRANSPORTATION EQUIPMENT
XVIII	INSTRUMENTS - MEASURING, MUSICAL
IXX	ARMS & AMMUNITION
XX	MISCELLANEOUS
XXI	WORKS OF ART

Appendix 6.2 Bilateral Investment Treaties

COUNTRY	BILATERAL INVESTMENT TREATY	ENTRY INTO FORCE
United Kingdom	Covenant for the Promotion and Reciprocal Protection of Capital Investments, signed in La Paz on May 24, 1988.	February 16, 1990.
Germany	Treaty on Reciprocal Protection of Capital Investments, signed in La Paz on March 23, 1987	November 9, 1990
Switzerland	Agreement for the Promotion and Reciprocal Protection of Investments, signed in la Paz on November 06, 1987.	May 13, 1991
Italy	Agreement for the Promotion and Reciprocal Protection of Investments signed in Roma on April 30, 1990.	February 22, 1992
Spain	Agreement for the Promotion and Reciprocal Protection of Investments, signed in Roma on March 24, 1990.	May 12, 1992
Sweden	Covenant for the Promotion and Reciprocal Protection of Investments, signed in Stockholm on September 20, 1990.	July 3, 1992
Popular China	Covenant for the Promotion and Reciprocal Protection of Investments, signed in Beijing on May 08, 1992.	July 26, 1992
Netherlands	Agreement for the Promotion and Reciprocal Protection of Investments, signed in La Paz on March 10, 1992	November 1, 1994
Peru	Covenant for the Promotion and Reciprocal Protection of Investments signed in Ilo on July 30, 1993.	March 19, 1995
Argentina	Covenant for the Promotion and Reciprocal Protection of Investments, signed in Buenos Aires on March 17, 1994	May 1, 1995
France	Covenant for the Promotion and Reciprocal Protection of Investments, signed in Paris on October 25, 1989.	October 12, 1996
Rumania	Agreement for the Promotion and Reciprocal Protection of Investments, signed in Bucharest on October 09, 1995.	March 16, 1997.
Denmark	Agreement for the Promotion and Reciprocal Protection of Investments, signed in Copenhagen on March 12, 1995.	March 23, 1997
Korea	Covenant for the Promotion and Reciprocal Protection of Investments, signed on April 1, 1996.	June 4, 1997
Ecuador:	Covenant for the Promotion and Reciprocal Protection of Investments signed in Quito on May 25, 1995	August 15, 1997
Cuba	Covenant for the Promotion and Reciprocal Protection of Investments signed in La Havana on May 6, 1995.	August 23, 1998
U.S.A.	Covenant for the Promotion and Reciprocal Protection of Investments signed in Santiago de Chile on April 17, 1998.	July 7, 2001
Chile	Treaty on Promotion and Reciprocal Protection of Investments signed in La Paz on September 22, 1994.	May 5, 1999
Belgium - Luxemburg	Agreement for the Promotion and Reciprocal Protection of Investments, signed in Brussels on April 25, 1990.	The exchange of ratifications did not take place.
Austria	Agreement for the Promotion and Reciprocal Protection of Investments, signed in Viena on April 04, 1997.	The exchange of ratifications did not take place.
Spain	Agreement for the Promotion and Reciprocal Protection of Investments, signed in Madrid on October 29, 2001.	The exchange of ratifications did not take place.

Source: Ministry of Foreign Trade and Investment of Bolivia.

Appendix 6.3 Probit regression results

Table 3a. **Impact of Regional Integration on Poverty: 2002**

Variable	(1)		(2)		(3)		(4)	
	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation
Constant	0.3939	0.2225	0.3418 *	0.2253	0.3587 *	0.2245	0.3564 *	0.2238
Number of children	0.3081	0.0171	0.3115	0.0172	0.3055	0.0171	0.3065	0.0171
Number of children squared	-0.0118	0.0011	-0.0120	0.0011	-0.0117	0.0011	-0.0118	0.0011
Female Head	-0.2802	0.0503	-0.2719	0.0504	-0.2691	0.0502	-0.2755	0.0501
Age of the head	-0.0110	0.0013	-0.0107	0.0013	-0.0111	0.0013	-0.0109	0.0013
No spouse for the head	0.6944	0.1996	0.7120	0.2026	0.7122	0.2021	0.7070	0.2015
Native	0.2536	0.0393	0.2513	0.0392	0.2410	0.0390	0.2461	0.0390
HEAD								
Education	-0.0694	0.0051	-0.0686	0.0051	-0.0686	0.0051	-0.0689	0.0051
Worker	-0.2170	0.0612	-0.1752	0.0625	-0.1918	0.0624	-0.2076	0.0609
Employee	-0.3429	0.0579	-0.3177	0.0588	-0.3258	0.0584	-0.3380	0.0577
Cooperative			0.4856	0.1895	0.4964	0.1920		
Family Worker	0.3371	0.1619	0.3300	0.1626	0.3348	0.1607	0.3310	0.1612
Second Activity	-0.3240	0.0566	-0.3235	0.0568	-0.3428	0.0561	-0.3343	0.0560
Size of firm								
1 to 4 workers	-0.1887	0.0506	-0.1952	0.0509	-0.1962	0.0503	-0.1998	0.0500
5 to 9 workers	-0.1849	0.0738	-0.2005	0.0738	-0.2007	0.0733	-0.2023	0.0730
10 to 14 workers	-0.2630	0.1090	-0.2796	0.1100	-0.2899	0.1087	-0.3089	0.1087
20 to 49 workers	-0.3777	0.0964	-0.3768	0.0958	-0.3883	0.0958	-0.4008	0.0964
50 to 99 workers	-0.4330	0.1496	-0.4375	0.1510	-0.4537	0.1500	-0.4502	0.1489
more than 99	-0.3666	0.1061	-0.4140	0.1151	-0.4146	0.1147	-0.3699	0.1058
SPOUSE								
Education	-0.0193	0.0054	-0.0193	0.0054	-0.0182	0.0054	-0.0187	0.0054
Employee	-0.3731	0.0816	-0.3680	0.0817	-0.3683	0.0818	-0.3658	0.0816
Family Worker	0.4007	0.0706	0.3951	0.0708	0.3876	0.0692	0.3927	0.0691
Size of firm								
1 to 4 workers	-0.1345	0.0503	-0.1363	0.0505	-0.1339	0.0503	-0.1343	0.0504
Rural	-0.0980	0.0489	-0.1034	0.0489				
Traditional Agriculture	0.5433	0.0739	0.5681	0.0741	0.4979	0.0698	0.4956	0.0695
Ln (Total Exports)	-0.0306	0.0116						
Ln (Total Imports)	0.0467	0.0113						
Ln (Exports to CAN)			-0.0408	0.0105				
Ln (Imports to CAN)			0.0661	0.0111				
Ln (Exports to MERCOSUR)					-0.0361	0.0121		
Ln (Imports from MERCOSUR)					0.0424	0.0093		
Ln (Exports to Chile)							-0.0069 *	0.0132
Ln (Imports from Chile)							0.0516	0.0130
Observations	5746		5746		5746		5746	
Pseudo R2	0.2450		0.2473		0.2451		0.2451	

Note: * Not Significant at 5%

Table 3b. **Impact of Regional Integration on Poverty: 2002**

Variable	(5)		(6)		(7)		(8)	
	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation
Constant	0.3810	0.2234	0.3852	0.2225	0.3544 *	0.2241	0.3379 *	0.2243
Number of children	0.3082	0.0171	0.3051	0.0171	0.3090	0.0172	0.3087	0.0171
Number of children squared	-0.0117	0.0011	-0.0118	0.0011	-0.0120	0.0011	-0.0119	0.0011
Female Head	-0.2782	0.0502	-0.2771	0.0502	-0.2676	0.0502	-0.2757	0.0504
Age of the head	-0.0109	0.0013	-0.0111	0.0013	-0.0108	0.0013	-0.0109	0.0013
No spouse for the head	0.7005	0.2010	0.7047	0.2001	0.7020	0.2013	0.7044	0.1999
Native	0.2450	0.0389	0.2454	0.0390	0.2529	0.0393	0.2451	0.0392
HEAD								
Education	-0.0703	0.0051	-0.0696	0.0051	-0.0684	0.0051	-0.0692	0.0051
Worker	-0.2044	0.0610	-0.2159	0.0612	-0.1860	0.0620	-0.2131	0.0613
Employee	-0.3475	0.0577	-0.3441	0.0576	-0.3130	0.0584	-0.3327	0.0578
Cooperative					0.3964	0.1876		
Family Worker	0.3483	0.1619	0.3406	0.1608	0.3462	0.1627	0.3552	0.1627
Second Activity	-0.3277	0.0561	-0.3395	0.0560	-0.3298	0.0568	-0.3424	0.0560
Size of firm								
1 to 4 workers	-0.1870	0.0498	-0.1960	0.0501	-0.1879	0.0507	-0.1945	0.0502
5 to 9 workers	-0.1821	0.0730	-0.1891	0.0733	-0.1948	0.0737	-0.1918	0.0737
10 to 14 workers	-0.2769	0.1096	-0.2677	0.1084	-0.2861	0.1090	-0.2462	0.1092
20 to 49 workers	-0.3801	0.0968	-0.3810	0.0961	-0.3929	0.0961	-0.3805	0.0962
50 to 99 workers	-0.4271	0.1494	-0.4424	0.1490	-0.4589	0.1501	-0.4306	0.1504
more than 99	-0.3623	0.1083	-0.3506	0.1066	-0.4480	0.1150	-0.3552	0.1071
SPOUSE								
Education	-0.0189	0.0054	-0.0186	0.0054	-0.0195	0.0054	-0.0184	0.0054
Employee	-0.3711	0.0821	-0.3701	0.0817	-0.3680	0.0817	-0.3667	0.0818
Family Worker	0.4143	0.0686	0.3944	0.0689	0.3966	0.0707	0.3939	0.0694
Size of firm								
1 to 4 workers	-0.1388	0.0502	-0.1328	0.0502	-0.1299	0.0503	-0.1333	0.0502
Other Urban Areas							0.0856	0.0433
Rural					-0.1132	0.0489		
Traditional Agriculture	0.4552	0.0674	0.4798	0.0692	0.5713	0.0738	0.5043	0.0700
Ln (Exports to Mexico)	-0.0075 *	0.0109						
Ln (Imports from Mexico)	0.0820	0.0186						
Ln (Exports to Europe Union)			-0.0074 *	0.0087				
Ln (Imports from Europe Union)			0.0412	0.0121				
Ln (Exports to United States)					-0.0218	0.0110		
Ln (Imports from United States)					0.0511	0.0112		
Ln (Exports to Others)							-0.0425	0.0119
Ln (Imports from Others)							0.0598	0.0121
Observations	5746		5746		5746		5746	
Pseudo R2	0.2447		0.2438		0.2458		0.2456	

Note: * Not Significant at 5%

Table 3c. **Impact of Regional Integration on Poverty: 2002**

Variable	(1)		(2)		(3)		(4)	
	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation
Constant	0.4878	0.2248	0.4050	0.2217	0.4569	0.2235	0.4597	0.2231
Number of children	0.3089	0.0172	0.3025	0.0168	0.3081	0.0171	0.3081	0.0171
Number of children squared	-0.0118	0.0011	-0.0116	0.0011	-0.0117	0.0011	-0.0117	0.0011
Female Head	-0.2911	0.0504	-0.2846	0.0502	-0.2856	0.0504	-0.2865	0.0502
Age of the head	-0.0112	0.0013	-0.0111	0.0013	-0.0111	0.0013	-0.0111	0.0013
No spouse for the head	0.6929	0.2009	0.7058	0.2013	0.6924	0.2005	0.6931	0.2005
Native	0.2556	0.0392	0.2515	0.0392	0.2540	0.0392	0.2542	0.0392
HEAD								
Education	-0.0723	0.0051	-0.0722	0.0051	-0.0715	0.0051	-0.0716	0.0051
Worker	-0.2067	0.0621	-0.2214	0.0609	-0.2224	0.0622	-0.2201	0.0615
Employee	-0.3544	0.0576	-0.3822	0.0549	-0.3483	0.0575	-0.3493	0.0573
Family Worker	0.3342	0.1620	0.2984	0.1611	0.3382	0.1624	0.3379	0.1624
Second Activity	-0.3267	0.0564	-0.3338	0.0562	-0.3271	0.0564	-0.3265	0.0564
Size of Firm								
1 to 4 workers	-0.1245	0.0514			-0.1309	0.0512	-0.1304	0.0511
5 to 9 workers	-0.1360	0.0736			-0.1447	0.0733	-0.1439	0.0732
10 to 14 workers	-0.2361	0.1083			-0.2466	0.1082	-0.2456	0.1081
20 to 49 workers	-0.3583	0.0957	-0.2545	0.0884	-0.3670	0.0956	-0.3664	0.0956
50 to 99 workers	-0.3981	0.1478	-0.2974	0.1431	-0.4113	0.1478	-0.4101	0.1476
more than 99	-0.3652	0.1026	-0.2950	0.0958	-0.3858	0.1009	-0.3867	0.1008
SPOUSE								
Education	-0.0180	0.0054	-0.0187	0.0054	-0.0182	0.0054	-0.0182	0.0054
Employee	-0.4019	0.0821	-0.4047	0.0825	-0.3980	0.0819	-0.3981	0.0819
Family Worker	0.4154	0.0701	0.3860	0.0693	0.4177	0.0702	0.4180	0.0702
Size of Firm								
1 to 4 workers	-0.1241	0.0505	-0.1202	0.0500	-0.1279	0.0506	-0.1277	0.0506
Rural	-0.1062	0.0492	-0.1416	0.0488	-0.1032	0.0492	-0.1029	0.0493
Traditional Agriculture	0.4062	0.0729	0.4052	0.0700	0.4347	0.0716	0.4313	0.0700
Trade & Commerce	-0.1508	0.0619	-0.1718	0.0596	-0.1275	0.0608	-0.1301	0.0597
Transport	-0.2182	0.0805	-0.2320	0.0790	-0.2056	0.0808	-0.2088	0.0798
Ln (Total FDI)	-0.0061 *	0.0046						
Ln (FDI CAN)			-0.0220	0.0095				
Ln (FDI MERCOSUR)					0.0013 *	0.0054		
Ln (FDI Chile)							0.0024 *	0.0165
Pseudo R2	0.2440		0.2431		0.2437		0.2437	
Observations	5746		5746		5746		5746	

Note: * Not Significant at 5%
FDI: Foreign Direct Investment

Table 3d. **Impact of Regional Integration on Poverty: 2002**

Variable	(5)		(6)		(7)		(8)	
	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation
Constant	0.4592	0.2232	0.4252	0.2226	0.4834	0.2242	0.4294	0.2228
Number of children	0.3083	0.0171	0.3038	0.0169	0.3095	0.0172	0.3051	0.0169
Number of children square	-0.0117	0.0011	-0.0117	0.0011	-0.0118	0.0011	-0.0118	0.0011
Female Head	-0.2860	0.0502	-0.2828	0.0502	-0.2916	0.0504	-0.2864	0.0502
Age of the head	-0.0111	0.0013	-0.0112	0.0013	-0.0112	0.0013	-0.0112	0.0013
No spouse for the head	0.6934	0.2005	0.6972	0.2013	0.6940	0.2006	0.6976	0.2018
Native	0.2547	0.0392	0.2537	0.0392	0.2562	0.0393	0.2515	0.0393
HEAD								
Education	-0.0715	0.0051	-0.0721	0.0051	-0.0719	0.0051	-0.0723	0.0051
Worker	-0.2201	0.0615	-0.2296	0.0602	-0.2011	0.0621	-0.2074	0.0612
Employee	-0.3479	0.0574	-0.4036	0.0546	-0.3594	0.0579	-0.3945	0.0550
Family Worker	0.3366	0.1623	0.3098	0.1611	0.3301	0.1623		
Second Activity	-0.3269	0.0564	-0.3345	0.0561	-0.3252	0.0565	-0.3366	0.0563
Size of Firm								
1 to 4 workers	-0.1315	0.0511			-0.1261	0.0512		
5 to 9 workers	-0.1431	0.0733			-0.1364	0.0735		
10 to 14 workers	-0.2472	0.1081			-0.2359	0.1084		
20 to 49 workers	-0.3680	0.0956	-0.2240	0.0881	-0.3561	0.0957	-0.2470	0.0884
50 to 99 workers	-0.4114	0.1476			-0.3900	0.1478	-0.2991	0.1420
more than 99	-0.3884	0.1009	-0.2127	0.0972	-0.3613	0.1020	-0.2438	0.0960
SPOUSE								
Education	-0.0182	0.0054	-0.0187	0.0054	-0.0182	0.0054	-0.0182	0.0054
Employee	-0.3989	0.0819	-0.4121	0.0828	-0.4042	0.0822	-0.4149	0.0823
Family Worker	0.4176	0.0702	0.3786	0.0694	0.4081	0.0703	0.3775	0.0693
Size of Firm								
1 to 4 workers	-0.1274	0.0505	-0.1164	0.0500	-0.1223	0.0506	-0.1120	0.0497
Rural	-0.1035	0.0492	-0.1404	0.0488	-0.1109	0.0495	-0.1320	0.0485
Traditional Agriculture	0.4320	0.0700	0.3928	0.0704	0.4162	0.0707	0.3863	0.0708
Trade & Commerce	-0.1262	0.0599	-0.1842	0.0601	-0.1493	0.0609	-0.1855	0.0600
Transport	-0.2081	0.0798	-0.2621	0.0805	-0.2228	0.0809	-0.2471	0.0790
Ln (FDI Mexico)	-0.1132 *	0.1090						
Ln (FDI United States)			-0.0165	0.0056				
Ln (FDI Europe Union)					-0.0094	0.0052		
Ln (FDI Others)							-0.0179	0.0056
Pseudo R2	0.2438		0.2430		0.2442		0.2432	
Observations	5746		5746		5746		5746	

Note: * Not Significant at 5%
FDI: Foreign Direct Investment

Appendix 6.4 Earnings Regression Results

Table 4a. **Impact of Regional Integration on Labor Income: 2002**

Variable	(1)		(2)		(3)		(4)	
	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation
Constant	4.7675	0.0950	4.8386	0.0908	4.7552	0.0878	4.7432	0.0890
Age	0.0803	0.0040	0.0798	0.0040	0.0802	0.0040	0.0812	0.0040
Age2	-0.0009	0.0000	-0.0009	0.0000	-0.0009	0.0000	-0.0009	0.0000
Education	0.0529	0.0030	0.0533	0.0029	0.0529	0.0030	0.0536	0.0030
Gender	-0.4118	0.0272	-0.4058	0.0272	-0.4141	0.0272	-0.4136	0.0274
Public Institution	0.0907	0.0357	0.0912	0.0356	0.0918	0.0356	0.0917	0.0357
Self - Employed	-0.5571	0.0285	-0.5444	0.0286	-0.5532	0.0285	-0.5624	0.0285
Cooperative	-0.2591	0.1077	-0.4128	0.1123	-0.3969	0.1157		
Family Worker	-0.5570	0.1030	-0.5415	0.1028	-0.5545	0.1031	-0.5726	0.1033
Native	-0.2881	0.0216	-0.2822	0.0215	-0.2825	0.0215	-0.2834	0.0216
Other Urban Areas	-0.0778	0.0259	-0.0829	0.0259	-0.0769	0.0259	-0.0785	0.0258
Rural	-0.3078	0.0310	-0.3154	0.0310	-0.3142	0.0310	-0.3137	0.0316
Traditional Agriculture	-0.6443	0.0708	-0.7177	0.0634	-0.6316	0.0596	-0.6312	0.0608
Electricity	0.4732	0.1499	0.4263	0.1469	0.5145	0.1458	0.4986	0.1472
Construction	0.2699	0.0647	0.2006	0.0557	0.2804	0.0510	0.2732	0.0541
Trade & Commerce	0.3142	0.0667	0.2346	0.0589	0.3240	0.0532	0.3209	0.0583
Hotels & Restaurants	0.4783	0.0777	0.4008	0.0711	0.4898	0.0664	0.4856	0.0706
Transport	0.4632	0.0705	0.3912	0.0625	0.4729	0.0580	0.4657	0.0615
Banking	0.6036	0.1449	0.5327	0.1414	0.6168	0.1391	0.6025	0.1410
Services	0.1815	0.0643	0.1100	0.0563	0.1941	0.0505	0.1804	0.0562
Ln (Total Exports)	0.0386	0.0076						
Ln (Total Imports)	-0.0451	0.0087						
Ln (Exports to CAN)			0.0383	0.0072				
Ln (Imports to CAN)			-0.0628	0.0090				
Ln (Exports to MERCOSUR)					0.0383	0.0076		
Ln (Imports from MERCOSUR)					-0.0359	0.0068		
Ln (Exports to Chile)							-0.0124 *	0.0085
Ln (Imports from Chile)							-0.0132 *	0.0085
Observations	7941		7941		7941		7941	
F-statistic	249.33		250.96		248.15		259.97	
R-squared	0.4160		0.4184		0.4161		0.4139	

Note: * Not Significant at 5%

Table 4b. **Impact of Regional Integration on Labor Income: 2002**

Variable	(5)		(6)		(7)		(8)	
	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation
Constant	4.6383	0.0840	4.6678	0.0894	4.7915	0.0893	4.7111	0.0869
Age	0.0803	0.0040	0.0805	0.0040	0.0805	0.0040	0.0794	0.0040
Age2	-0.0009	0.0000	-0.0009	0.0000	-0.0009	0.0000	-0.0009	0.0000
Education	0.0525	0.0030	0.0532	0.0030	0.0526	0.0030	0.0532	0.0029
Gender	-0.4208	0.0271	-0.4141	0.0272	-0.4243	0.0271	-0.4066	0.0270
Public Institution	0.0932	0.0356	0.0949	0.0357	0.0908	0.0357	0.0962	0.0356
Self - Employed	-0.5548	0.0285	-0.5562	0.0286	-0.5519	0.0286	-0.5343	0.0285
Cooperative	-0.3424	0.1167			-0.3365	0.1105	-0.4077	0.1117
Family Worker	-0.5509	0.1032	-0.5621	0.1032	-0.5418	0.1030	-0.5349	0.1034
Native	-0.2870	0.0217	-0.2869	0.0216	-0.2863	0.0216	-0.2810	0.0216
Other Urban Areas	-0.0767	0.0261	-0.0814	0.0258	-0.0749	0.0259	-0.0872	0.0259
Rural	-0.2970	0.0321	-0.3083	0.0313	-0.2927	0.0310	-0.3241	0.0312
Traditional Agriculture	-0.5263	0.0516	-0.5480	0.0608	-0.6901	0.0621	-0.5808	0.0597
Electricity	0.6325	0.1442	0.5940	0.1470	0.4740	0.1474	0.5269	0.1441
Construction	0.3969	0.0438	0.3647	0.0538	0.2370	0.0538	0.3365	0.0520
Trade & Commerce	0.4465	0.0463	0.4104	0.0559	0.2873	0.0567	0.3662	0.0541
Hotels & Restaurants	0.6125	0.0611	0.5756	0.0685	0.4545	0.0692	0.5345	0.0670
Transport	0.5917	0.0519	0.5578	0.0607	0.4313	0.0607	0.5257	0.0589
Banking	0.7380	0.1370	0.6973	0.1402	0.5799	0.1404	0.6703	0.1397
Services	0.3132	0.0449	0.2732	0.0537	0.1577	0.0540	0.2467	0.0517
Ln (Exports to Mexico)	0.0379	0.0080						
Ln (Imports from Mexico)	-0.0151 *	0.0111						
Ln (Exports to Europe Union)			0.0120	0.0060				
Ln (Imports to Europe Union)			-0.0136 *	0.0085				
Ln (Exports to United States)					0.0313	0.0069		
Ln (Imports from United States)					-0.0491	0.0090		
Ln (Exports to Others)							0.0691	0.0079
Ln (Imports from Others)							-0.0618	0.0081
Observations	7941		7941		7941		7941	
F-statistic	247.87		259.68		248.23		251.19	
R-squared	0.4151		0.4139		0.4164		0.4199	

Note: * Not significant at 5%

Table 4c. **Impact of Regional Integration on Labor Income: 2002**

Variable	(1)		(2)		(3)		(4)	
	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation
Constant	4.6627	0.0833	4.6425	0.0822	4.6953	0.0818	4.6553	0.0821
Age	0.0810	0.0040	0.0809	0.0040	0.0808	0.0039	0.0810	0.0040
Age2	-0.0009	0.0000	-0.0009	0.0000	-0.0009	0.0000	-0.0009	0.0000
Education	0.0531	0.0030	0.0533	0.0030	0.0532	0.0030	0.0528	0.0030
Gender	-0.4188	0.0271	-0.4174	0.0270	-0.4243	0.0269	-0.4172	0.0270
Public Institution	0.0920	0.0357	0.0907	0.0357	0.1006	0.0358	0.0954	0.0357
Self - Employed	-0.5655	0.0291	-0.5570	0.0285	-0.5687	0.0284	-0.5624	0.0285
Family Worker	-0.5719	0.1032	-0.5652	0.1034	-0.5464	0.1031	-0.5695	0.1032
Native	-0.2846	0.0215	-0.2829	0.0216	-0.2816	0.0214	-0.2846	0.0215
Other Urban Areas	-0.0756	0.0256	-0.0745	0.0256	-0.0726	0.0256	-0.0739	0.0256
Rural	-0.3021	0.0309	-0.2969	0.0309	-0.2830	0.0310	-0.2980	0.0310
Traditional Agriculture	-0.5539	0.0503	-0.5452	0.0490	-0.6071	0.0490	-0.5498	0.0490
Electricity	0.5931	0.1444	0.6047	0.1420	0.7186	0.1408	0.5967	0.1423
Construction	0.3657	0.0491	0.2018	0.0564	0.6834	0.0701	0.3660	0.0377
Trade & Commerce	0.4110	0.0400	0.4180	0.0394	0.3866	0.0393	0.4143	0.0393
Hotels	0.5795	0.0577	0.5885	0.0563	0.5426	0.0564	0.5821	0.0563
Transport	0.5541	0.0462	0.5304	0.0458	0.5309	0.0460	0.5534	0.0461
Banking	0.6956	0.1345	0.5986	0.1362	0.7651	0.1373	0.6468	0.1355
Services	0.2698	0.0390	0.2852	0.0376	0.2499	0.0374	0.2761	0.0376
Ln (Total FDI)	-0.0007 *	0.0037						
Ln (FDI CAN)			0.0289	0.0076				
Ln (FDI MERCOSUR)					-0.0326	0.0056		
Ln (FDI Chile)							0.0149 *	0.0091
Observations	7941		7941		7941		7941	
F-statistic	273.16		273.97		274		273.53	
R-squared	0.4134		0.4142		0.4164		0.4136	

Note: * Not Significant at 5%
FDI: Foreign Direct Investment

Table 4d. **Impact of Regional Integration on Labor Income: 2002**

Variable	(5)		(6)		(7)		(8)	
	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation	Coeficient	Standard Deviation
Constant	4.6599	0.0820	4.6569	0.0820	4.6409	0.0820	4.6406	0.0824
Age	0.0810	0.0040	0.0804	0.0040	0.0805	0.0040	0.0804	0.0040
Age2	-0.0009	0.0000	-0.0009	0.0000	-0.0009	0.0000	-0.0009	0.0000
Education	0.0531	0.0030	0.0526	0.0030	0.0522	0.0029	0.0529	0.0030
Gender	-0.4184	0.0270	-0.4155	0.0270	-0.4097	0.0271	-0.4132	0.0272
Public Institution	0.0923	0.0357	0.0994	0.0358	0.0978	0.0357	0.1022	0.0357
Self - Employed	-0.5641	0.0284	-0.5496	0.0289	-0.5449	0.0289	-0.5453	0.0289
Cooperative					-0.2892	0.1093		
Family Worker	-0.5714	0.1032	-0.5601	0.1032	-0.5566	0.1034	-0.5577	0.1034
Native	-0.2847	0.0215	-0.2876	0.0216	-0.2860	0.0216	-0.2861	0.0215
Other Urban Areas	-0.0756	0.0256	-0.0809	0.0257	-0.0748	0.0258	-0.0838	0.0258
Rural	-0.3021	0.0309	-0.3031	0.0309	-0.2998	0.0309	-0.3086	0.0310
Traditional Agriculture	-0.5515	0.0490	-0.5410	0.0491	-0.5372	0.0491	-0.5265	0.0495
Electricity	0.5891	0.1418	0.4478	0.1492	0.3728	0.1477	0.6243	0.1423
Construction	0.3604	0.0375	0.1937	0.0664	0.1367	0.0571	0.2203	0.0565
Trade & Commerce	0.4121	0.0395	0.4197	0.0394	0.4176	0.0395	0.4292	0.0395
Hotels	0.5775	0.0562	0.5439	0.0571	0.4253	0.0627	0.5871	0.0562
Transport	0.5551	0.0461	0.5580	0.0460	0.5555	0.0464	0.5559	0.0458
Banking	0.6956	0.1344	0.6453	0.1347	0.6353	0.1364	0.6616	0.1349
Services	0.2722	0.0373	0.2866	0.0378	0.2882	0.0378	0.2962	0.0381
Ln (FDI Mexico)	0.0210 *	0.0274						
Ln (FDI United States)			0.0157	0.0050				
Ln (FDI Europe Union)					0.0267	0.0050		
Ln (FDI Others)							0.0166	0.0049
Observations	7941		7941		7941		7941	
F-statistic	274.10		273.55		260.68		273.10	
R-squared	0.4134		0.4141		0.4154		0.4143	

Note: * Not Significant at 10%

FDI: Foreign Direct Investment

Chapter 7 Regional Integration and poverty: The case of Tanzania[32]

Josaphat Kweka and Phillip Mboya [33]

7.1 Introduction

One of the critical challenges facing Tanzania is how to enhance the country's economic competitiveness and increase the share of Tanzania in global trade in order to achieve the poverty reduction targets. Among the various strategies adopted to surmount this challenge, Tanzania has joined several regional economic groupings including the East African Community (EAC), the Southern African Development Community (SADC), the Common Market for Eastern and Central African States (COMESA)[34] and the Cross Border Initiative (CBI)[35]. But Tanzania is not alone in adopting this strategy. Many countries of the world have grouped together to form, expand or strengthen various regional integration arrangements (RIAs) in the last decade. In addition, the efficacy of RIAs in revamping integration of the developing countries in the global economy and subsequently their impact in reducing poverty have become important subjects of analysis in the last decade. Many recognise that regional integration forms an important part of the strategy for developing countries to achieve a 'smooth and gradual' integration into the world economy (Kennes, W, 1997). An ensuing analytical question is whether and how Regional Integration Arrangements (RIAs) have affected poverty in a low income country such as Tanzania?

The literature admits that the precise pathways through which formation of regional groupings affect poverty are rather indirect - through trade, investment, and other regional socio-economic cooperation. A theoretical framework mapping these links is proposed by Te Velde, Page and Morrissey (2004). The empirical literature has tended to address each channel separately; research on the investment channel, for instance, has examined how the investment and trade related provisions in the RIA affects poverty (see Te Velde and Fahnbulleh, 2003), the impact of Regional Integration (RI) on FDI (Te Velde and Bezemer, 2004; Bende-Nabende, 2003), and the impact of trade on poverty (Winters, 2000). The literature for Tanzania is limited. A few existing studies concern the impact of regional integration on Tanzanian economy more generally and trade in particular without a focus on poverty (see Musonda, 2000, 2004). Others have examined the impact of trade on poverty (see Booth and Kweka, 2004), or the impact of investment on the economy (see for example Madete, 2000; Mboya, 2003; Mashindano, 2004) without reference to RI processes. The study by Wanga and Matambalya (2001) examines the impact of RI on poverty in SADC economies with a minor focus on Trade and investment provisions.

[32] We are grateful for obtaining information from the interviewed firms and institutions that made this study possible.

[33] Authors are respectively Research Fellow and Consultant at the Economic and Social Research Foundation (ESRF), Dar es Salaam, Tanzania.

[34] Tanzania withdrew from COMESA in 2000.

[35] CBI changed its name in 2000 to Regional Integration Investment Facilitation Forum.

This study examines regional integration and poverty in Tanzania. In particular, the objective of the study is to assess how Regional Integration has affected poverty in Tanzania following the following links:

- RI can affect poverty through increased volume and poverty focus of trade
- RI can affect poverty through increased volume and poverty focus of investment
- RI can affect poverty through other routes.

The regions covered include EAC and SADC, but where possible also other relevant RI efforts[36]. Since the study focuses on the trade and investment provisions of RIAs in which Tanzania is a member, it is in no way a comprehensive assessment of the link between regional integration and poverty. In addition, Tanzania has implemented a number of policy reforms aimed at improving the trade and investment regime independent of regional integration process (see Appendix 7.1 and 7.2).

The chapter is organised as follows. The theoretical framework and methodology used for this study is summarized in Section 2 (see Te Velde, Page and Morrissey, 2004). Section 3 describes the status of regional integration processes by identifying the challenges and prospects of RIAs for Tanzania, namely the EAC, SADC, COMESA and others (e.g. CBI and Multilateral initiatives). Section 4 examines the investment links between Regional Integration and Poverty, while section 5 examines the trade links. Through a survey of sampled firms, section 5 also provides industry perspectives on the efficacy of intra regional trade and investment in poverty reduction. Other routes through which RI affects poverty are examined in Section 6 paying attention to the various socio-economic programmes implemented in a regional context. Finally section 7 concludes.

[36] In some aspects of this analysis, we also cover COMESA for comparison purposes although Tanzania withdrew as a member in 2000. This is important for two reasons. First, Tanzania has stayed in COMESA for many years to warrant examination of its effectiveness in poverty reduction. Second, some members of EAC and SADC are also members of COMESA, which will have inherent impact on the analysis; and finally, analysts still argue for Tanzania to reconsider its decision to withdraw.

7.2 Analytical Framework and methodology

7.2.1 The Analytical Framework

There are both analytical and methodological challenges in examining the impact of RI on poverty for a low-income country such as Tanzania. First, regional integration is still in formative stages in most aspects so there is a lack of evidence. For instance, the Custom Union (CU) as part of the RI process is only less than a year old in EAC and not yet fully operational, while SADC plans to establish an FTA in 2008. Second, low-income countries often suffer from a serious lack of reliable data to perform meaningful analysis. Third, members of a RIA may choose to cooperate on other aspects of social importance, which are eventually difficult to measure. For instance, Tanzania's objective in joining SADC was less based on economic integration than on socio-political cooperation compared to COMESA or EAC. Finally, there are many factors other than RI that affect development or poverty reduction, such as e.g. change in social norms or behaviours, increased effectiveness of institutions and endowment of natural resources. These factors impair a credible analysis of how RI has affected poverty in the context of Tanzania. Therefore, the analytical framework (following chapters 2-4 in part I of this book) will be applied with caution in mind.

7.2.2 Methodology

In general, due to the limitations identified above, analyses and evidence provided for the link between RI and Poverty use a number of approaches; (i) use of both secondary and primary data and information; (ii) interviews with key stakeholders in RIAs (e.g. firms and institutions) and (iii) information from literature and related studies on Tanzania.

Secondary data from published and national sources were used to examine both the performance and poverty-focus of intra and extra regional Investment and Trade. Where data are available, correlations of FDI with poverty and trade with poverty indicators are made to examine the impact of RI. Disaggregation of the RI effect is constrained by the limited availability of data, necessitating the use of total (intra and extra regional) figures to indicate potential impact. This may not be problematic given the fact that most RI investment and trade provisions are a long way from being effectively operational. Therefore the general impacts are likely to be good proxies for regional impacts. Secondary information from documents was used to identify other routes through which RI affects poverty in Tanzania. Primary data was collected from a sample of 30 firms in 3 regions surveyed to investigate trade and FDI impact and prospects for Tanzania. We consider this important to "hear from Horse's mouth" and evaluate, using semi-structured questionnaire, investors confidence and opinions on RI and its efficacy for reducing poverty.

We also interviewed a number of stakeholders to obtain a qualitative assessment of how RI affects poverty in Tanzania. Interviews were held with investors and with a number of institutions managing the RI process for Tanzania. These included government departments, the Tanzania Investment Centre, the EAC secretariat and the SADC coordinating officer. Others include the Bank of Tanzania, beneficiaries and managers of regional socio-economic projects (e.g. NGOs and Fisheries department of Lake Victoria, East African Development Bank - EADB). Private sector apex bodies were also interviewed for similar purposes, such as the Tanzania Chamber of Commerce Industry and Agriculture(TCCIA) and the Confederation of Tanzania Industries (CTI).

As noted before, there are a number of studies in Tanzania that address different and partial aspects of the analytical framework. The three approaches of the methodology are interdependent in modelling the link between RI and poverty in the circumstances of Tanzania. For instance, stakeholders provided secondary data for analysis while the literature also reports evidence from survey data.

7.3 Regional Integration and the poverty reduction challenge for Tanzania

As a background to the subsequent sections, this section describes the current status and challenges of various Regional Integration Arrangements and highlights the Poverty Reduction Strategy (PRS) for Tanzania. A description of RIAs will show their variation in terms of focus, integration process and challenges for poverty reduction. More importantly, and subject to the available information, we will identify for each RIA, any trade, investment or other provisions that have implications for poverty reduction. In highlighting the poverty reduction challenge for Tanzania, we firstly review the macroeconomic performance of the economy to assess the potential of growth of trade and investment to reduce poverty in Tanzania.

7.3.1 Performance of the Economy

Tanzania depends substantially on the agriculture sector for export earnings and employment. The economy is characterised by a large traditional rural sector and a small modern urban sector. Agriculture is the primary economic activity, accounting for about and 50 percent of export earnings. The manufacturing sector is small. Infrastructure, particularly the transport sector, is still underdeveloped. Exports comprise of a few cash crops, notably coffee, cotton and cashew nuts, but in the recent years tourism and mining have become the largest earner of foreign exchange. The level of government spending as a proportion of GDP has been high, albeit growing at a slower rate in recent years. Donor financing assumed greater importance after adoption of economic reforms in 1986. The servicing of foreign debt absorbs an increasing share of current revenue, which relies heavily on indirect taxes.

Examination of the post reform economic performance in Tanzania shows three interesting facts. First, economic growth improved significantly since the adoption of economic reforms. In recent years, the economy has been growing at about 5% per year in 2002. Second, and related to the first, there is an impressive macroeconomic stability illustrated by a significant reduction in the inflation rate to single digit levels since 2000. Finally, although the government has put in place an elaborate policy framework for poverty reduction (Poverty Reduction Strategy Paper – PRSP), the above macroeconomic achievements have not resulted in the expected reduction in poverty levels.

According to the various poverty reduction strategy review reports, there has been little progress achieved in poverty reduction, though the prospects for a substantial decline in poverty are still considered feasible. Currently, the government has reviewed its poverty reduction strategy to emphasise the growth and employment aspects of the PRSP. Private investment has increased following reforms, compensating for a reduction in public investment. The revival of economic growth was also accompanied by substantive changes in the structure of the economy. For instance, services and mineral exports have been responsible for most of the increased growth in exports. The share of merchandise exports declined from over 70% to about 54% respectively.

7.3.2 Overlapping Membership of Trade Agreements

It is a policy choice for a country to join a particular RIA. Tanzania is party to several trade agreements both at the regional and multilateral level (see tables 7.1 and 7.2). Multiplicity of membership raises the problem of coordination and commitment for individual country in terms of adequacy and efficiency of human and financial resources. For a poor country such as Tanzania with inadequate resources and human capacity and inefficient institutions, this is considered a daunting challenge, which limits the effectiveness and implementation of agreed protocols (Musonda, 2004).

However, it is important to note that RIAs are different in focus, so that Tanzania might have different reasons for joining or leaving different regional trade arrangements and hence may decide to speed up the integration process of one while slowing on another (variable geometry argument) based on a perceived cost-benefit analysis. Objectives of different RIAs range from purely market/economic integration to socio-political cooperation agreements. The market integration model is based on Viner's (1950) custom union theory associated at increasing trade flows amongst member states. The theory predicts two possible outcomes of eliminating trade barriers in a regional context: *trade creation* (increased trade flow from efficient producers in the region) and *trade diversion* (increased trade flow from inefficient producers in the region). The development integration model of RIAs follows a conscious intervention by member states to pursue certain benefits of cooperation. This is particularly relevant when there are barriers to realising economic benefits to trade and investment. The model includes the common provision of regional public goods such as regional infrastructure and other public utilities. However, one of the criticisms of development integration model is that the need for flexibility may entrench backwardness since there are no specific time frames or quantifiable benchmarks for the achievement of targets.

Tanzania withdrew membership from COMESA in 2000 because the government perceived fewer benefits in it compared with EAC and SADC, and believed that the agendas of these organisations were incompatible with COMESA. The fact that Tanzania's leading trade partners are members of EAC (Kenya) and recently SADC (South Africa) make it unlikely that Tanzania can benefit significantly from COMESA. We corroborate this argument in section 5 by noting the marginal level of trade to COMESA members that are not in SADC or EAC. The desire to further promote an economic relationship with South Africa was another deciding factor[37]. However, the private sector in Tanzania still believes that COMESA is beneficial to Tanzania and has opened the debate whether the country should reinstate her membership. Part of the problem is that there are no efforts by authorities to

[37] South Africa has been one of the significant sources of Tanzania's FDI in the recent years (See Kabelwa, 2004).

disseminate information about private sector opportunities available in the SADC market. The motives for forming SADC, however, were also about socio-political cooperation (e.g. the then liberation struggle for independence in Zimbabwe and the fight against Apartheid policies in South Africa). In all cases Tanzania has been a committed member in advocating the fraternity objective of SADC states.

Table 7.1 Overlapping Membership of Selected Trade Agreements

Country	WTO	COMESA	SADC	SACU	IOC	EAC	RIFF
Angola	*	*	*				
Botswana	*		*	*			
Burundi	*	*					*
Comoros					*		
DRC	*	*	*				
Djibouti	*	*					
Egypt	*	*					
Eritrea			*				
Ethiopia			*				
Kenya	*	*				*	*
Lesotho	*		*	*			
Madagascar	*	*			*		
Malawi	*	*	*				*
Mauritius	*	*	*		*		*
Mozambique	*		*				
Namibia	*	*	*	*			*
Rwanda	*	*					*
Seychelles		*	*		*		*
South Africa	*		*	*			
Sudan		*					
Swaziland	*	*	*	*			*
Tanzania	*****		*****			*****	*****
Uganda	*	*				*	*
Zambia	*	*	*			*	*
Zimbabwe	*	*	*				*

Source: Various documents from the reference list.
* Membership

7.3.3 Trade, Investment and other Provisions in RIAs

Table 7.2 gives a snapshot summary of the status of various Regional and Multilateral Agreements in which Tanzania is involved. Below we describe and discuss each in turn.

Table 7.2 Summary of International Trade Agreements for Tanzania

No.	Agreements	Membership for Tanzania (year)	Nature of Agreements	Current Status
1	COMESA	▪ 1995-endorsed ▪ 2000-withdrew	Started with FTA and now in progress to establish Custom Union	Working towards a Custom Union
2	SADC	▪ 1992 signed the declaration and treaty ▪ 1996-adopt SADC protocol in Trade	Establish a Free Trade Area in SADC region between 2008 to 2012	Preparing for implementation of various protocols
3	EAC	▪ 1999-signed the treaty ▪ 2000-ratified by the parliament	Regional trade Integration with Custom Union as the entry point	Custom Union signed in March, 2004. EALA unanimously approved the Custom Management Bill in December 2004.
4	Cross-Border Initiative (now RIFF)	▪ 1999-signed ▪ 2002 changed into Regional Investment Facilitation Forum	Facilitating forum to remove tariff and non-tariff barriers across the countries	Not active. Donors withdrew their support in December 2003.
5	ACP-EU Cooperation	▪ 1975- First Lome Convention ▪ Eligible for EBA initiative ▪ 2000-Cotonou Agreement	Reciprocal EPAs compatible with WTO regulations may be negotiated EBA provides duty free access to the EU market for Tanzania	Still on the preparation process
6	AGOA (extension of US GSP)	▪ July 2002, eligible	Bilateral, conditional upon meeting all the criteria by the US	Tanzania has qualified in all the criteria
7	WTO	▪ 1995	Multilateral rules in various issues	Tanzania like other LDCs benefits from SDT options
8	Indian Ocean RIM	▪ March 1995	Regional cooperation to strengthen trade and business cooperation among the members	Is not a very active inter-regional cooperation
9	NEPAD Initiatives	▪ July 2001	Try to implement what is agreed within AU	Tanzania has not been active participant
10	Bilateral Initiatives	▪ There are more than twenty bilateral treaties	Most of them are technical or cultural cooperation	Most of them are not active

Source: Various documents from the reference list

7.3.3.1 The East African Community (EAC)

One of the greatest achievements of the new EAC is the establishment of the Custom Union. The Protocol was signed on 2nd March 2004, and the East African Legislative Assembly (EALA) unanimously approved the EAC Custom Management Bill in December 2004 (*Daily News*, December 17, 2004). In addition, the integration process in EAC has succeeded in putting in place a strong institutional base and programmes which determine the effectiveness of this RIA. The EAC institutional framework was taken from the old EAC with a few changes (see Musonda, 2004:82). The Treaty establishing the new EAC was signed in 1999 and in 2000 the community came into force again after its collapse in 1977. The failure of the old EAC was due to different political and economic ideologies among members, a change of the government in Uganda (1971), a sustained perception of unequal sharing of benefits and a compensation mechanism inadequate to address this situation. The main objective of the community is the development of policies and programmes aimed at widening and deepening co-operation among its members in various fields of development.

Having achieved a strong institutional base upon which to implement the integration agreement, the community must still meet several challenges before becoming a fully operational RIA. First, the EAC needs to maintain political will towards implementation of the entire treaty. Second, EAC should ensure agreement on implementing a transfer mechanism that allows less developed members to catch up with the richer ones. Third, identification of alternative sources of revenue to compensate for the immediate but short-term losses arising from the elimination of intra-regional tariffs. And finally, securing of adequate sources of funding for the regional secretariat to implement the various programmes identified in its development strategy. The second and third challenges are particularly important for Tanzania and Uganda whose duties on imports from Kenya are relatively substantial. This is why it is important to examine trade and investment provisions that may have serious implications for the efficacy of RI on poverty reduction.

The EAC has formed a committee on Trade, Industry and Investment to undertake various initiatives relating to trade and investment. Such initiatives have culminated into the establishment of a Protocol for the East African Custom Union. The objectives of the customs union are to (i) further liberalise intra-regional trade in goods on the basis of mutually beneficial trade arrangements among partner states; (ii) promote efficiency in production within the community; (iii) enhance domestic, cross border and foreign investment in the region and (iv) promote economic development and diversification by supporting the industrialisation process (for detailed description, see www.eac.int.).

Trade and Investment Provisions

The Protocol for establishing a Custom Union provides for the elimination of all internal tariffs; the establishment of a three band common external tariff with a minimum rate of *[*0*]* percent (for capital goods), a middle rate of *[*10*]* percent (for intermediate goods) and a maximum rate of *[*25*]* percent (for final consumption goods) on all products imported into the community. The protocol also includes immediate removal of all existing non-tariff barriers to imports from other partner states and the adoption of the East African Community Rules of Origin. Other provisions include national treatment, ant-dumping measures, subsidies, countervailing and safeguard measures, competition, restrictions and prohibitions to trade and re-exportation of goods.

Under the CU, Kenya will reduce its internal tariffs to zero on all products upon the coming into force of the Protocol, whereas Tanzania and Uganda will gradually remove the internal tariffs for a small list of products deemed to be sensitive by the partner states over a period of five years. Tanzania has included over 800 goods on the sensitive list and Uganda 149 goods. Thus the majority of the products will be duty free from the first year because in the case of Tanzania, the residual products whose duty is to be phased out gradually accounts for only 15% of the total Kenya's exports to Tanzania. Trade between Uganda and Tanzania will be duty free on coming into force of the Protocol. The products whose duties will be phased out gradually are those that are deemed to have a great revenue impact/loss and serious industrial development consequences.

There are two issues of immediate concern for Tanzania and other partner states. First, as the Protocol is signed, agreement on which goods fall within the CET books and which fall outside the CET bands (sensitive) is yet to be reached. The products which are within the CET and for which agreement is yet to be reached include palm oil, tyres, paper and paper products, iron and aluminium products and motor vehicles, etc. There is also a list of products considered sensitive from both sides for which each country still maintains high tariffs (textile products e.g. *Kitenge*). Secondly, there is an issue of dual membership. This issue is likely to remain unresolved for some time as a broad integration vision of the three schemes (SADC, EAC and COMESA) is not yet feasible and may be complicated further by the differing rules of origin. Another important investment provision under the EAC is the model investment code that is being developed (but not yet agreed) for the EAC as described in Box 7.1.

Box 7.1 The EAC Model Investment Code (2002)

The EAC Model Investment code – 2002 (herein after "the code") is in advanced stage of preparation after the consultant (see Ruhindi, F 2002) completed the drafting and a workshop to discuss it in 2002. The code is now going through the usual process of adoption and ratification within the regional and national bureaucracy. The Code is composed of four parts. The first is the preliminary part highlighting on the title, interpretation and scope of the code. The second part is a more substantive section of the code, and it deals with the rights to establish and benefit an enterprise from the code and other operational investment incentives procedures. Part three describes the rationale and objectives for establishing a regional investment promotion agency. Part four covers the establishment, operation and incentives for the special economic zones. Finally, part five contains miscellaneous clauses/issues and regulation of the code. From a region trying to hasten its integration process for growth and poverty reduction, the code is a very welcome idea, although reading the code; one comes to a conclusion that its content and structure is not of any substantive difference with the Tanzanian investment policy/code.

The code outlines some key benefits of establishing the regional investment code/agency as being: improving the investment climate in the region by advocating policies and regulations that are favorable to foreign investment; harmonizing national investment policies/agencies in order to achieve the regional development goals; and finally, the code is envisaged to provide the international best practices in investment promotion and practices that will enhance increased flow and impact of foreign investment in the region. Establishment of the regional investment agency and code do not replace but rather complements the respective national code/agency. It should also be noted that the investment code is not intended to be a legal instrument, rather a guiding document for a particular member state that, in turn, may want to incorporate into their national investment policies or laws. In the interim before harmonization of investment policies and laws is made, investors are obliged to access their respective incentive packages from their national investment agencies.

The code provides for national treatment and non-discrimination, and avail the facilitative services of investment agency of a partner state to any eligible investors. Eligible investors for the investment incentive certificates are only those meeting the minimum thresh-hold; and those intending to invest in the allowable areas/sectors (see section 5(5) and section 8 of part (I). The investment laws of the respective partner states cover the minimum thresh-holds for portfolio investment for foreign and local investment.

Furthermore, the code includes several investment provisions relating to eligibility and granting of incentive certificates, incorporation and registration of investment, transfer and retention of funds, compensation in case of expropriation and settlement of dispute etc. The investment is allowed to employ only four or less foreigners but can employ more if deemed necessary and approved by the immigration department. Other incentives for investors include a uniform corporation tax of 30%, exemption on import duty for all machinery and raw materials, duty draw back for all exporters, 100% deduction allowance on training, research and mineral exploration expenditures and loss carried forward to be offset against future taxable profits. The code also provides for establishment of (and conditions thereof) special economic zones including the export processing zone, free trade zone, technology parks and tourism centers and virtual zones. The special economic zones are given specific fiscal and nonfiscal incentives according to specific investment activities. These are shown in Annexure I of the code.

In addition, the EAC has provided for cooperation and development of capital markets of the three member countries. Capital market development is one of the important strategies for achieving higher rates of investment in general, and one of the factors behind attracting FDI. As part of the broader cooperation in financial and monetary sectors, efforts to develop capital markets in the regional blocks have been made in the EAC as discussed in its development strategy. This includes harmonisation of regulatory and legislative framework, promotion of cross-border listings, and development of a regional rating system for securities. For instance, the Ugandan Capital Markets Authority allowed East African Breweries to cross list on the Uganda Securities Exchange in addition to its initial listing on the Kenyan Stock Exchange

(Musonda, 2004:101). One of the benefits expected from this cooperation is to enable companies in the member countries to diversify their funding sources for investment. Savers would also benefit from a variety of investment opportunities. The East Africa Securities and Regulatory Authority (EASRA) that is comprised of capital market authorities for Kenya, Tanzania and Uganda has emerged. However, of the three capital market authorities, the Kenyan market is most advanced – and is likely to take the lead in the integration process (Masinde and Kibua, 2004).

In the case of Tanzania, the Capital Market and Securities Authority (CMSA) was established under the Capital Markets and Securities Act of 1994 as a regulatory body of the stock and securities exchange. The Dar es Salaam stock exchange (DSE) is expanding, but the number of listing and share transactions is expanding at a slow rate. So far only 6 Business establishments are listed by the CMSA in the DSE. Out of these, only two are flexible and can sell shares to foreign investors; the remaining four are already above the ceiling (65% or more) for foreign ownership (Mashindano, 2004:13)[38]. Nevertheless, the CMSA has succeeded to educate and engage the public on the importance of trading shares in the stock exchange.

Table 7.3. provides a summary of the status of major projects under the EAC

[38] The rules governing capital markets in Tanzania allow foreigners to buy purchase shares at the DSE with certain restrictions. Fore example, foreigners can only purchase shares if the company is less than 65% foreign owned. The objective is to protect the Tanzanian capital account from financial instability that is hazardous to the economy. However, the 65% foreign ownership restriction is considered too high to provide opportunity of financial liberalisation to Tanzanians, but also limit the extent of supply response from foreigners, as the prevailing demand for stocks is probably too low.

Table 7.3 Summary of Major Projects/Programmes under the EAC

S/N	Elements to be contained in the Protocol	Current Status	Remarks/Further work envisaged
1	The elimination of internal tariffs and other charges	In December 2003, the relevant Permanent Secretaries re-aligned the list of category B products in line with the proposed EAC CET. Tanzania substituted the proposed special trading arrangement for tea with tariffs.	With the arrangements earlier reached, there are no outstanding issues in this area.
2	Establishment of EAC Common External Tariff	Extra-ordinary meeting of heads of state of 20 June 2003 approved the EAC CET as : 0%, 10%, and 25%. The partner states have categorized and classified products within the CET structure albeit there being some outstanding matters including: unresolved tariff lines within the EAC–CET, proposed EAC–CET tariff splits, criteria for selection of sensitive products on the basis of impact on public revenue, issue of sensitive products, national measure to be applied to the sensitive products already adopted by the council.	More than 95% of the work has been completed. The HLTF meeting and that of the permanent secretaries of the week of 2nd February 2004 are expected to address the outstanding matters.
3	Simplification and harmonisation of trade documentation and procedures	-Customs documentations to be used once the Protocol on an EAC customs union comes into force, have been simplified and harmonized. -Much of the work on simplification and harmonisation of customs procedures has been concluded. Pending work include review of other customs forms such as the F-series and P-series, review of registers, financial procedures, reporting and returns, procedures for customs preventive services, Cross border transfer of duty paid goods and all other customs procedures, harmonisation of the different computer systems (ASYCUDA and BOFIN)	Remaining work shall be addressed within the context of the on going drafting of EAC common customs law. However, the outstanding work not substantive and cannot therefore hinder conclusion of the Protocol
4	Harmonisation of commodity description and coding system	Work on the EAC commodity description and coding system has been completed and draft EAC customs Nomenclature has been produced	Outstanding work is in respect of developing explanatory notes to the customs nomenclature. This will be undertaken following finalisation of categorisation of imports
5	Harmonisation of exempting regime	A matrix of harmonized EAC exempting regimes and a text of the proposed harmonized exemption regime for the EAC have been produced. However, consensus has not been reached in respect of harmonisation of the Armed Forces and Non governmental organisations	Consultations in respect of outstanding exemptions are ongoing
6	Establishment of EAC rules of origin	At their meeting of 27-28 November 2003, the sectoral council on legal and judicial affairs approved the annexure on the EAC rules of origin. The annexure was adopted by the Council at its 6th meeting. Following the adoption by the council work on the EAC rules of origin has been successfully adopted.	Work on the EAC Rules of Origin including drafting of the users notes has been completed.

S/N	Elements to be contained in the Protocol	Current Status	Remarks/Further work envisaged
7	Harmonisation of Duty Drawback and other export promotion schemes	Harmonisation of Duty Drawback and other export promotion schemes has been completed. Drafts regulations have been developed in respect of: - Duty Drawback scheme - Duty/Value added tax remission scheme - Refund and remission of duty and taxes - Manufacturing under bond (MUB) and - Export processing zones (EPZs) The draft regulations on export promotion schemes have been referred to the Working Group on the EAC common customs law for incorporation.	The Working Group is expected to incorporate the draft regulations in the EAC common customs law.
8	Ant-dumping practices and subsidies and countervailing measures	The (ant-dumping measures) regulation have been drafted and considered by the sectoral committee on the legal and judicial affairs and are awaiting consideration and adoption by the sectoral council in the legal and judicial affairs.	Work on the regulations has been completed and they await adoption by the sectoral council on legal and judicial affairs
9	Application of the principle of asymmetry	The principle of asymmetry has been applied in the modalities and programme for elimination of internal tariffs and other charges of equivalent effect. Final study report on the application of the principle was completed and presented to the Permanent Secretaries on implementation of Article 75(7) of the Treaty	The final study report on application of the principle of asymmetry has been completed and considered by the Permanent Secretaries.
10	Elimination of non-tariff barriers to trade	Article 75(5) of the Treaty provides for removal by partner states of all the existing non-tariff barriers on the importation into their territory of goods originating from the other partner states and thereafter to refrain from imposing any further non tariff barriers.	The secretariat is formulating a mechanism for monitoring removal of non-tariff barriers. The draft proposal has been submitted to the trade/industry committee in March 2004.
11	Customs cooperation	The relevant text with respect to customs cooperation has been included in the draft protocol.	This matter is completed
12	Re-exportation of goods	The relevant text with respect to re-exportation of goods has been included in the draft protocol.	This matter is completed
13	Security and other restrictions to trade	The relevant text with respect to security and other restrictions has been included in the draft protocol.	This matter is completed
14	Formulation of EAC competition policy and law.	The EAC competition policy and law have been completed. The enactment of the EAC competition law by the East African legislative assembly was envisaged by 15 May 2004	The EAC competition law is pending enactment.
15	Formulation of legal, institutional and administrative structure of an EAC customs union	The council at its 6th meeting approved an institutional and administrative structure for the EAC customs union. The preparation and adoption of EAC Custom Law is in an advanced stage of completion by the EAC working Group on Custom Law.	Outstanding work is the on-going work on the EAC common customs law.
16	Preparation of a draft protocol on the establishment of an EAC customs union	Except articles 12(2) and 15(4) awaiting consultation by the summit and council respectively, the draft protocol No 5 has been completed and approved by the council for signature by the Heads of State	Outstanding work relate to articles 12(2) and 15(4), which await further consultation.

Source: EAC Secretariat - Report of the Council, 2004)

7.3.3.2 South African Development Community (SADC)

Trade and Investment Provisions

As part of its objective, SADC encourages intra-SADC cross-border flow of investment to bring about diversification and industrialisation in the region. More importantly, SADC intends to establish a fully-fledged Free Trade Area (FTA) by the year 2012. The implementation of tariff elimination schedules, rules of origin and dispute settlement mechanism have now begun.

The SADC trade protocol came into effect in 2000 and is aimed at removing tariff and non-tariff trade barriers within eight years. Up to now, eleven SADC countries have been implementing the Protocol through their tariff cut schedules and special agreements for various sectors. By 2001, about 47 percent of goods traded in the region were at zero tariffs. Preparations are underway to carry out a mid-term review of the implementation of the Protocol. An agreement has been reached on rules of origin for most products. These rules have been designed to encourage regional manufacturers to make use of regional raw materials and to boost investments in processing and manufacturing industries. Substantial work has been done to harmonise documentation and procedures in the areas of customs cooperation. The Integrated Committee of Ministers (ICM) developed and approved a code of conduct for customs officials with the aim of improving the performance and efficiency of customs border clearance system and reducing transaction costs for traders. In line with this, a lot has been done to ensure that regional products are competitive and comply with internationally accepted standards, quality assertion, and accreditation. Substantial work has also been done on the harmonisation of sanitary and phytosanitary measures that will enhance intra-SADC trade in agricultural products. Non-tariff barriers have been removed except for a few barriers related to administrative systems, which are also being dealt with.

The member states are implementing macroeconomic policies that encourage the development of a sound investment climate, enhance savings, and stimulate investment flows, technology transfer and innovation in the region. Efforts are being made to ensure that national investment acts and guidelines facilitate foreign direct investment in the region and that investment policies promote free movement of capital in the SADC region. Emphasis has also been put on mobilising domestic investment resources. In this respect, a network of Development Finance Institutions (DFIs) has been created to mobilise resources for financing development projects in the region. A feasibility study is underway for the establishment of a SADC Development Fund (SDF) for mobilising both domestic and international resources for investment in the region. This fund will play a catalytic role as a promoter and thus raise confidence levels among other potential investors in the region. The EU/SADC Investment Promotion Programme (ESIPP), worth Euro 18 million, has been established in order to improve the overall investment climate in the region. The programme will carry out sector studies and organise face-to-face fora at which the project promoters from SADC will meet potential investors from the EU and other third countries. This programme is expected to substantially improve the investment climate in the region. On December 2004, agreement on the Mtwara Development Corridor was signed by Presidents of four of the SADC countries, namely Tanzania, Malawi, Zambia and Mozambique in Lilongwe. This is a multi-billion-dollar regional project aimed at enhancing economic cooperation and developing jointly the cross-border resources and infrastructure of the four countries. Investment projects identified for the Mtwara Development Corridor are at advanced stages of preparation.

The key challenge facing SADC is to establish a free trade area within a reasonable time frame given the problem of overlapping membership of SADC countries in other different regional bodies, and the conflicting obligations arising thereof. Conducting trade according to more than one regional provision can prove difficult and may mean choosing one out of a number of conflicting sets of rules of origin. The other challenge is to formulate new policies and strategies that will target vulnerable groups, especially the poor, to ensure that they benefit from regional policies. The 14 member countries are expected to sign a free-trade area agreement by 2008 and implement the Custom Union Protocol by 2010 and the Common Market in 2012 (SADC secretariat, 2004).

The EU-EPA challenge
The countries in the African Caribbean and Pacific (ACP) group will negotiate Economic Partnership Agreements with the EU in several regions. All the countries that are members of both COMESA and SADC have already chosen to negotiate with the EU as ESA[39]. SADC has lagged and been overtaken by events. The fact that COMESA members have chosen ESA would suggest that SADC is fragile. And, given that COMESA is relatively more experienced in market integration than SADC, it may benefit trade-wise more readily with the EU compared to SADC Botswana, Namibia, Lesotho, and Swaziland do not need to negotiate anything because they are implicitly bound by the South African EU agreement, so it is Tanzania, Angola, and Mozambique that will effectively constitute the SADC-EU EPA, but Mozambique may join SACU leaving Tanzania desperate if it actually wants to negotiate an EPA. The SADC secretariat is taking a lead in the preparation for negotiations about how SADC can improve its access to the EU market.

7.3.3.3 Common Market for East and Southern Africa (COMESA)

The Treaty establishing COMESA was signed in 1993 and ratified in 1994. It is progressing to a Free Trade Area (FTA) in 2000 through annual reduction in tariffs. The region’s main objectives are to cooperate in exploiting member countries’ natural and human resources and maintain peace and security for the common good of all their people. COMESA objectives are to remove the structural and institutional weaknesses in the member states by pooling their resources together in order to sustain their development efforts either individually or collectively. The member countries are as shown in table 7.1. Tanzania withdrew her membership in 2000 for reasons discussed earlier. However, there has been mixed opinion regarding the government’s decision to withdraw from COMESA. Some members of the business community are against this decision while others find no reason to complain in the

[39] There are 16 countries forming the ESA group namely: Burundi, Comoros, DR Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia, and Zimbabwe.

absence of supporting evidence as to whether the membership was beneficial to the country. It is however unlikely that the government will rejoin the body. There are also opinions that the debate on rejoining COMESA is heated by a few industrialists with particular interests in COMESA, but this was difficult to corroborate by this study.

Trade and Investment Provisions

To expand trade and investment opportunities, nine members of COMESA (Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Sudan, Zambia and Zimbabwe) launched the COMESA Free Trade Area (FTA) on 31 October 2000. These countries are trading on quota-free and duty-free terms for all goods originating from their territories, but continue to impose their own national tariffs on goods imported from the rest of the world. Meanwhile, COMESA is working to establish the COMESA Common Investment Area (CCIA) in order to attract greater and sustainable levels of investment. This objective is expected to be achieved by creating an international competitive investment area that allows for free movement of capital, labour, goods and services across borders of Member States. CCIA is expected to enhance the operations in the Free Trade Area and thus increase intra-COMESA trade. More details in relation to COMESA trade and investment arrangement are not relevant for this study since such arrangements commenced after Tanzania had withdrawn her membership.

7.3.3.4 Regional Integration Facilitation Forum (RIFF)

RIFF (formerly known as Cross-Border Initiative) is a programme for stimulating cross-border trade and investment amongst countries of the Eastern, Central and Southern African regions, with the objective of accelerating the process of trade liberalisation and curbing food insecurity. The programme was funded by the African Development Bank (ADB), The World Bank (WB), International Monetary Fund (IMF), and the European Union (EU). The sponsors awarded financial incentives to the CBI members whose tariff and non-tariff barriers have performed above the agreed targets. The donors withdrew their support since December 2003 coinciding with the change of name to Regional Integration Facilitation Forum (RIFF).

RIFF was signed in 1999 and aimed at reducing import duties and statutory exemptions. According to the assessment conducted for the IMF by Jose Fajgenbaum and others (see Fajgenbaum *et al*, 1999), the CBI initiative that started in 1993 had made tremendous (but uneven) achievement in trade liberalisation (reducing tariffs and none-tariff barriers) as at the end of 1998, although none of the members had fully eliminated intra-regional tariff. In 1993, about 93% of the CBI countries had a very restrictive trade regime but in 1999, only 43% had maintained a restrictive trade regime, 36% (compared to 22% for non-CBI) had established an open regime and 21% were moderate.

Almost all member countries have eliminated the state trade monopoly and harmonised road transit charges (as part of trade facilitation targets). Progress was made also in the area of investment deregulation by instituting one-stop investment centres in almost all countries. With the exception of a few countries, most of the investment codes included some form of tariff exemptions. Little or no progress was evident in the area of agreement on double taxation, labour mobility and tariff exemptions. While its objectives are laudable, RIFF seems much weaker in terms of policy influence than the regional integration efforts of the EAC and SADC.

7.3.3.5 Multilateral trade and investment provisions

Tanzania as a Least Developed Country receives numerous trade preferences in the current Multilateral Trade System (MTS) under WTO in the form of GSP. In addition, Tanzania benefits from specific bilateral initiatives notably by the US (the familiar AGOA programme is an extension of GSP into products such as textiles and clothing) and the EU (under EBA, and recently EPAs). Our coverage of these initiatives is relatively limited given the focus of the study to the specific RIAs mentioned above. However, three points are particularly worth noting. First, the traditional focus of the MTS on trade issues has altered to include other issues including investment issues such as trade related investment measures (TRIMs), which may affect the ability to attract inward FDI to developing countries. Second, although Tanzania has qualified for many of the trade preferences at the multilateral level, the performance in terms of access to these markets for Tanzanian exports has been dismal. The problem does not lie only in the obvious low productive capacity of the economy and inefficiency of market and supporting institutions, but also on the policy response. For instance, despite all the opportunities offered under successive EU arrangements, Tanzania's total exports to the EU declined over the 1990s. The new EU-ACP partnership under the familiar Cotonou Agreement entails much longer-term cooperation with each other through the EPAs. EPAs can include trade and investment provision in addition to development assistance, but Tanzania does not seem abreast of the opportunities. How much of a problem EPA is depends on how much Tanzania wants to be in an EPA. Purely from the point of view of access to the EU market, the permanent privileges it enjoys as a Least Developed Country under the EBA initiative means that it does not need to sign an EPA.

7.3.4 Poverty Reduction Challenge for Tanzania

Tanzania is one of the poorest countries in the world with about 36 percent of its population without sufficient income to meet their basic human needs. Income and non-income indicators shown in table 7.4 portray evidence of the depth of poverty. The table indicates that Tanzania is poorer than the average developing country in terms of under five-mortality rate, maternal mortality, literacy rate, primary school enrolment, average life expectancy, doctor patient ratio etc.

Table 7.4 Comparison of Poverty between Tanzania and developing countries

Indicators	Unit	Tanzania	Developing Countries
GDP per Capita	US$	270	970
Population below poverty line	Per cent	51.1	n.a
Under-five mortality rate	Per 1000 live births	165	88
Maternal mortality	Per 1000,000	530	384

Literacy rate	Per cent	76	85.5
Primary school enrolment	Per cent	63	77
Secondary school enrolment	Per cent	6	35-47
Doctor-patient ratio	Patients per doctor	23000	5767
Severe malnutrition	Per cent	29	30
Average life expectancy	Years	44	63.3
Families with water supply at home	Per cent	11	70
People living in temporary settlements	Per cent	60-70	30-60

Source: World Bank, World Development Indicators, 2003

The 2000/01 Household Budget Survey reveals that (i) 19 percent of the total population cannot meet basic food requirements; (ii) 87 percent of all poor people live in the rural areas; (iii) 51 percent of the poor people were in the households whose head had not attained primary education; (iv) Households that depend on subsistence agriculture have high levels of poverty; (v) High level of poverty is in the households with larger number of members and whose heads have neither fulfilled economic activities nor followed primary education; (vi) Low proportion of students from poor families attend primary school; (vii) Declining poor people's access to health services especially after the introduction of a cost sharing system; (viii) Much long distance to water sources for the poorest people of whom 54 percent depend on unprotected water sources.

As a response to this situation, the government of Tanzania embarked on a National Poverty Eradication Strategy in 1998 aimed at providing a framework to guide poverty eradication initiatives. Goals were set to reduce absolute poverty by half by 2010 and to completely eradicate absolute poverty by 2025. Subsequently, the formulation of the PRSP[40] involved broad based participation by civil society and private sector in all of its operational steps. Tanzania's first Poverty Reduction Strategy Paper (PRSP) was finalised in 2000 and since then, a series of poverty reduction initiatives have been made. Progress on poverty reduction initiatives is updated on an annual basis in the PRS progress reports. The third PRS progress report notes that divergent efforts have been made to improve delivery of social services such as education, health and water but argues that greater attention has to be paid to quality and equity issues in the delivery of these services (URT, 2004). The private sector (in growth issues and trade) has become the subject of attention due to its critical role in poverty reduction. As a result, the new PRS framework (2004) is called the '*National Strategy for Growth and Reduction of Poverty – NSGR*' *(*in Swahili, *MKUKUTA)*[41]. Since increased trade and investment is considered key for Tanzania's effort to achieve the growth rate needed for poverty reduction, regional

[40] Poverty Reduction Strategy Papers are to provide the basis for assistance from the World Bank and the IMF as well as debt relief under the HIPC initiative. PRSPs are country-driven, comprehensive in scope, partnership-oriented, and participatory. A country only needs to write a PRSP every three years. Changes are made to the content of a PRSP using an Annual Progress Report.

[41] As part of the first PRS, a number of sectors have been identified as key. These include, education, health, agriculture, infrastructure (rural roads), water, Judiciary and cross cutting issues (governance, HIV/AIDS, environment and Gender).

integration assumes an important role in the poverty reduction strategy because RI is expected to increase intra-regional trade and investment. It is against this background that we assess, in the next two sections, the extent to which RI has affected poverty in Tanzania via trade and investment channels.

7.4 Regional integration and poverty reduction through FDI

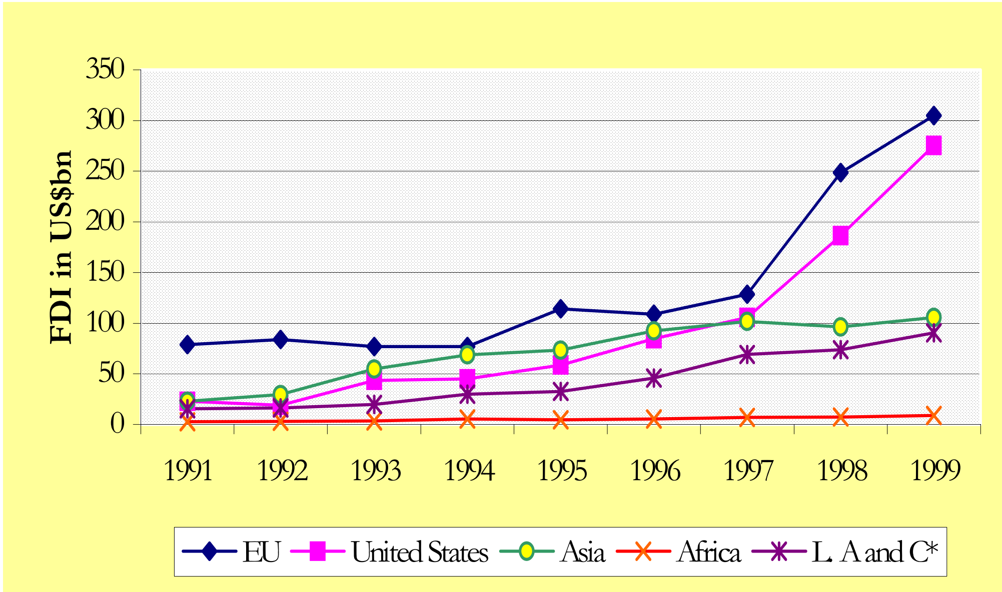
The literature offers little guidance on how and whether regionalisation increases FDI in developing countries (see Te Velde and Bezemer, 2004; OECD, 2001; Hartzenberg, 2000; Collier and Pattillio, 2000). However, for a country such as Tanzania, the answer to this question may be complicated further by the fact that most RIAs in Sub-Sahara African countries are at an infant stage of implementation, thus limiting a quantitative analysis. The issue for this study is whether the investment provisions in the RIA are conducive to an environment favourable to attracting FDI, even when it is extra-regional. And if so, to what extent is this FDI poverty reducing? We address these questions first by examining the performance of FDI flows to Tanzania both intra and extra regionally. We then discuss the poverty focus of FDI flows by examining the sectoral and regional (sub-national) distribution of FDI to determine the extent to which key sectors for poverty reduction (e.g. agriculture, health, education, and manufacturing) have received increased FDI. In addition, we correlate indices of FDI flows to the poverty (e.g. Human Development) index to examine the potential relationship between the two variables.

7.4.1 Global and Africa Trends of FDI Inflows

Trends in global FDI flows (see chart 7.1) show a small share of FDI going to Africa, whereas the EU, USA and Japan have been the focal points for FDI. During the 1980s, approximately 81 percent of FDI outflows originated from EU, USA and Japan, while 71 percent was destined to the same regions (UNCTAD, 2002). The attractiveness of Africa as a location for FDI has been unfavourable because the continent is often associated with factors that discourage FDI– e.g. civil unrest, deadly diseases and economic disorders. This raises the challenge for African countries to support regional initiatives that can tame such negative factors and also encourage intra regional FDI in Africa. Most African countries have formed regional groupings and, sometimes as part of structural reforms, liberalised their investment and trade regimes in the last two decades in order to attract more FDI. However, the direction of FDI flows has been determined more by the growth potential and level of productivity of the host economies than by the liberalisation agenda.

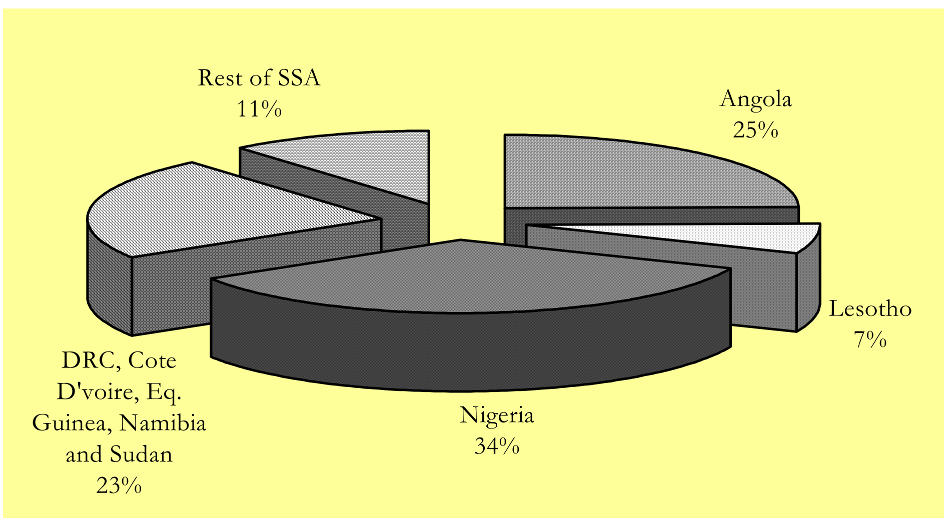
While Africa’s share of global FDI has been minimal, the pattern of FDI flows has been unevenly distributed across African countries where oil-rich countries (Angola and Nigeria) have been on the lead (see chart 7.1). FDI in Africa has traditionally concentrated in the primary sector but of late, the manufacturing and service sectors are becoming key sectors for FDI inflows.

Chart 7.1 Global FDI inflow by major regions



* L. A and C - Latin America and Caribbean
Source: Data from UNCTAD, various years.

Chart 7.2 Composition of FDI in Sub –Saharan Africa



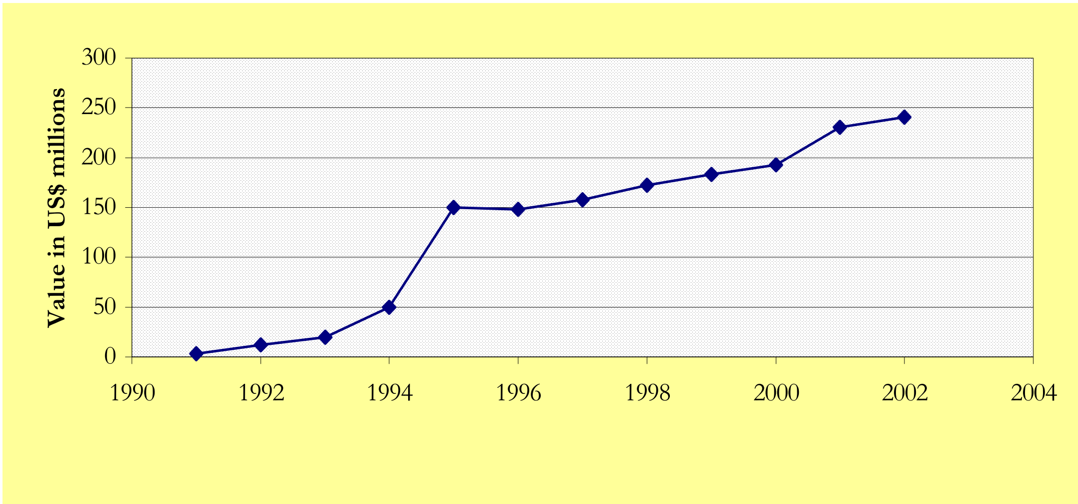
Source: UNCTAD, 2001

7.4.2 Trend of FDI Inflow to Tanzania

Tanzania is quickly becoming an FDI front-runner in Africa with FDI inflow increasing from less than US$ 2 million in 1992 to about US$ 250 million in 2002 (see Fig 4.3) attributable to comprehensive national reform policies implemented (UNCTAD, 2002). The stock of FDI in 1995-2000 amounted to US$1 billion compared to less than US$ 2 million during 1986-1992. Tanzania’s share of FDI inflows into LDCs doubled from 2.7% in 1991-1995 to 5.3% in 1996-1999 and more than doubled in the case of Sub-Sahara African countries from 1.5% to 3.3%

respectively. Aware of the benefits associated with FDI, the government has made concerted efforts to attract FDI since the mid 1980s. These efforts included economic liberalisation towards a market-oriented economy, the restoration of macroeconomic stability and implementation of various institutional reforms such as the establishment of the Tanzania Investment Centre (TIC)[42], Parastatal Sector Reforms Commission (PSRC) and Tanzania Revenue Authority, and formation of sector specific policies.

Chart 7.3 FDI inflows to Tanzania, 1991 – 2002



Source: Tanzania Investment Report, 2001 and The Economic Survey, 2002

In addition to the reform policy impact, regional integration efforts in EAC also contributed to the positive trend of FDI flows to the region, particularly for Uganda and Tanzania. Parallel with the impressive performance of Tanzania, the three East African countries increased their total FDI inflows 10 times from less than $50 mill in 1985 to over US$ 500 million in 2002. Comparison of the three countries show that from 1970 to 1991, the region received a total of US$ 270 million FDI inflows, with 90% to Kenya, 10% to Tanzania and hardly any for Uganda[43]. The picture changed completely during the 1990s so that by 2000, total FDI inflows to the three countries amounted to US$500 million, half of this went to Uganda, and 40% to Tanzania and Kenya attracted only 10%.

7.4.2.1 FDI Distribution by Country of Origin

We can report on data on the FDI distribution by country of origin, by sector and region for Tanzania. Table 7.5 shows FDI flows by country of origin. The leading countries that have invested in Tanzania for the period 1998 – 2001 are the United

[42] Established in 1997, TIC is a primary agency of the government to coordinate, encourage, promote and facilitate investment in Tanzania and to advice the government on investment related matters. It is a 'one stop facilitative center for all investors' engaged in the business of marketing Tanzania as an investment destination.

[43] Anecdotal evidence shows that some Kenyan firms (which used to supply/export to Tanzania) have decided to establish plants in Dar es Salaam to take advantage of the market but also the fiscal incentive offered to FDI; and especially as the avenues for corruption in importing have been shut.

Kingdom, Ghana and South Africa. It is widely believed that the dominance of UK as a source of FDI inflows into Tanzania is for historical reasons. Of late, the mining sector has become important source of FDI attraction as it has drawn in new investors from Ghana, South Africa, Australia, Canada and USA.

As is shown in table 7.5, the top six countries account for 63 percent of FDI inflows to Tanzania. South Africa and Kenya are the only two African countries that are important sources of FDI inflows to Tanzania accounting for 13% and 3% of total FDI respectively. This indicates that the two countries are most well positioned to take advantage of trade investment provisions in the SADC and EAC respectively.

7.4.2.2 Distribution by Sector

Table 7.6 indicates that most FDI in Tanzania has gone to mining and quarrying sector (about 31%), followed by manufacturing (20.3%), wholesale & retail trade, catering & accommodation services (14.8%) and transport, storage & communication (11%). These four sectors alone accounted for about 77 percent of total FDI inflows at the end of 2001. The agriculture sector received a low share of 7.7 percent of the total FDI inflows in spite of its accorded importance in the economy and poverty reduction (as the largest employer and source of export revenue).

Table 7.5 FDI inflows by Country of Origin, 1998 - 2001(US$ million, except **)

ORIGIN	1998*	1999	2000	2001	Total	% of Total**
EAC						
Kenya	53.7	21.1	6.5	12.5	93.8	3.2
Uganda	0.4	1.8	0.4	0	2.6	0.1
Sub-Total	*54.1*	*22.9*	*6.9*	*12.5*	*96.4*	*3.3*
SADC						
South Africa	32.4	44.3	133.5	174.5	384.7	13.2
Mauritius	70.4	16.5	4.6	3.7	95.3	3.3
Swaziland	0.2	8	1.2	2.8	12.2	0.4
Malawi	10.5	1.1	0	0	11.6	0.4
Zambia	8.6	0.6	0	0	9.2	0.3
Sub-Total	*122.1*	*70.5*	*139.3*	*181*	*513*	*17.6*
America and Australia						
Canada	96.7	78.9	0	20.6	196.2	6.8
USA	122.2	24	27.6	27.6	201.4	6.9
Australia	106.3	48.5	4	3.9	162.7	5.6
Sub-Total	*325.2*	*151.4*	*31.6*	*52.1*	*560.3*	*19.3*
Europe						
United Kingdom	313.8	30.7	24.4	82.2	451.2	15.5
France	30.2	13.1	2.3	2.2	47.8	1.6
Switzerland	28.3	9	30.8	23.8	91.9	3.2
Germany	35.1	8.5	12.2	1.2	56.9	2.0
Denmark	24	6.3	0.4	0.1	30.8	1.1
Norway	31.5	5.5	1.6	4.6	43.2	1.5
Netherlands	106.4	5.5	1.7	58.5	172.2	5.9
Italy	68.1	3.5	1.5	1.2	74.3	2.6
Sweden	24.5	3.5	4.1	5.4	37.5	1.3
Luxembourg	16.5	0.6	0	2.4	19.4	0.7
Japan	6.5	0.4	16.8	0	23.7	0.8
Isle of Man	13	0.1	0	1.6	14.7	0.5
Sub-Total	*697.9*	*86.7*	*95.8*	*183.2*	*1063.6*	*36.7*
Rest of Africa and World						
Ghana	265.1	162.7	0	1.5	429.3	14.8
Lebanon	1	6.4	0	0.9	8.3	0.3
Saudi Arabia	4.1	6.1	0	0	10.2	0.4
Bermuda	61.2	5.3	0	0	66.5	2.3
Foreign-Not Specified	3.7	4.1	0.2	1.3	9.3	0.3
Malaysia	40.5	3.7	0.1	1	45.4	1.6
Panama	1	2.4	0	5	8.4	0.3
China	9.9	0.8	1.9	1.5	14.2	0.5
United Arab Emirates	2.2	0.6	2.2	0.3	5.4	0.2
India	4.7	0.5	1.5	1.8	8.5	0.3
Sub-Total	*393.4*	*192.6*	*5.9*	*13.3*	*605.5*	*21.0*
Grand Total	**1592.7**	**524.1**	**279.5**	**442.1**	**2838.8**	**97.9**

* 1998 represent FDI stock, and the subsequent years are flows.

** Total does not add because of rounding-off errors and the fact that our calculation omitted countries with insignificant value of FDI to Tanzania.

Source: Tanzania Investment Report & TIC (2002)

Examination of the key sectors for growth (namely agriculture, manufacturing and services) and the priority sectors for poverty reduction shows that the types of FDI inflows to Tanzania are not well poverty focused. For instance, the mining sector has lower sectoral linkages and multiplier effects compared to the cash crop sector such as cotton or a service sector such as tourism (Kweka, Morrissey and Blake, 2003). The revealed structure of FDI inflows is more a testimony of FDI preferences and opportunities available in the high concentration sectors than promotion efforts in such sectors. In addition, social sectors identified as key for poverty reduction (in the first PRS) have attracted a small share of total FDI. This implies that the direct impact of FDI on poverty in Tanzania is limited. The small share of FDI in the agriculture sector in total FDI is also attributed to the adverse conditions in the agriculture sector (including adverse weather condition, low prices of agriculture products in the world market, insufficient domestic markets and other supply side and institutional bottlenecks).

There have been insufficient policy efforts to establish an environment that encourages FDI to the agriculture sector. The government needs to take deliberate efforts to attract more FDI to the agriculture sector as a way of enhancing its efforts to alleviate poverty by among other things, expediting land ownership reforms and addressing the infrastructure and other supply side bottlenecks to rural enterprises.

Table 7.6 Distribution of FDI inflows by Sector, 1998 – 2001 (US$ million)

Sector	1998*	1999	2000	2001	Total	% of total
Mining and Quarrying	568.2	293.6	9.5	37.7	908.95	30.9
Manufacturing	407.1	94.0	47.0	48.5	596.57	20.3
Wholesale & Retail trade, catering & accommodation services	251.5	64.7	58.8	58.4	433.34	14.8
Construction	93.02	28.1	5.9	6.2	133.22	4.5
Agriculture, hunting, forestry and fishing	105.34	23.1	50.4	47.5	226.43	7.7
Transport, storage & communication	47.7	15.6	100.7	158.1	322.07	11.0
Financing, Insurance, real estate, and business services	132.5	14.9	3.5	8.9	159.84	5.4
Community, social and personal services	1.4	2.1	3.5	1.8	8.79	0.3
Utilities	35.36	0.0	0.2	83.0	118.56	4.0
Others	29.36	0.0	0.0	0.0	29.36	1.0
Total	**1671.48**	**536.2**	**279.4**	**450.1**	**2,937.12**	**100.0**

*Figures for 1998 are FDI in Stock
Source: Tanzania Investment Report, 2001 & TIC

7.4.2.3 Distribution by Region

The regional distribution of FDI in Tanzania is also highly skewed in favour of a few regions, namely Dar es Salaam, Mwanza, Shinyanga, Arusha and Morogoro (see table 7.7). By the end of 2001, these five regions accounted for about 87% of FDI inflows to the country. During this period, Dar es Salaam alone accounted for 53%. However, this is not a surprising observation, since most of the privatised manufacturing companies are located in Dar es Salaam while most mining activities are concentrated in Mwanza, Arusha and Shinyanga. Also, Dar es Salaam is more advantaged than other regions due to its being the main commercial centre, its diverse social structure and more advanced economic infrastructure which is more conducive for business activities compared to other areas in Tanzania. Other regions that have attracted substantial amount of FDI are Arusha, Morogoro, Kilimanjaro, Mara and Iringa regions while Pwani, Dodoma and Ruvuma have the lowest concentrations of FDI. These are the regions with poorer infrastructure and least endowed with natural resources. Unfortunately, there are little if any production and economic linkages between the regions with most FDI and those with the least FDI. Government efforts to attract FDI into the country should go concomitant to the improvement of the rural infrastructure and productive utilities. However, little FDI involvement in agriculture seems typical of a general "LDC" experience rather than a special experience of Tanzania.

Table 7.7 Stock and flow of FDI by Region, 1998 - 2001 (US$ million)

Region	1998*	1999	2000	2001	Total	% of Total
Dar es Salaam	649.8	358.2	175.0	343.0	1526	52.69
Shinyanga	111.2	84.5	0.0	24.2	219.9	7.59
Arusha	159.2	23.6	17.1	12.7	212.6	7.34
Mwanza	327.4	21.4	5.0	15.5	369.3	12.75
Kilimanjaro	25.3	13.9	42.4	12.4	94	3.25
Morogoro	119.3	12.0	31.9	30.7	193.9	6.69
Mara	66.7	11.5	1.2	0.0	79.4	3.25
Tanga	50.3	5.8	0.7	9.5	66.3	2.29
Iringa	88.9	4.7	0.1	0.5	94.2	3.25
Mbeya	10.9	0.3	0.0	0.1	11.3	0.39
Pwani	1.9	0.1	0.3	0.1	2.4	0.18
Dodoma	5.3	0.0	0.0	0.0	5.3	0.18
Tabora	21.7	0.0	0.0	0.0	21.7	0.75
Ruvuma	0.0	0.0	0.0	0.0	0	0.00

*Figures for 1998 are FDI in Stock; *Source*: Tanzania Investment Report, 2001 & TIC

7.4.3 The Impact of FDI on Poverty

We have observed that the flow of FDI to Tanzania has been growing rapidly, especially in the late 1990s. The stock of FDI as a percentage of GDP grew from 2% in 1990 to 36% in 2002. Also, the share of FDI inflow to total capital formation increased from 0.5% in 1991 to 13% in 2002. The overall impact of FDI performance on poverty reduction has however been limited due to its concentration on a few sectors and regions and the fact that these sectors have low linkages with or multiplier effects on the rest of the economy (see Kweka, *et al* 2003). For instance, while agricultural projects accounted for only 5 percent of the total value of investment approved by the TIC between 1999 and 2000, they were the most efficient projects in creating employment (which is estimated to be 37% - see chart 7.4). This is not to imply that FDI going to other sectors are not important for poverty reduction. In fact, FDI into manufacturing sector has huge prospects of reducing poverty through the creation of employment and backward linkages into other sectors of the economy. The later impact will spur entrepreneurship and increase the employment multiplier in the economy. In general, sectors differ in the extent to which an additional investment will reduce poverty directly depending on the linkage effect with the rest of sectors (especially agriculture) and employment generation capacity.

While FDI can have much potential for reducing poverty, it is the actual conditions in a particular sector/economy that will determine the eventual outcome. In this case, the poverty challenge (mostly a rural phenomenon) and existing conditions in the rural agricultural sectors (unfavourable business environment, unskilled labour force) in Tanzania does not permit a significant impact of FDI on poverty reduction.

Anecdotal evidence finds that some Kenyan firms have established in Tanzania as a result of regional integration. More importantly, given South Africa's accession into the SADC bloc, Tanzania has witnessed a lot of South African investments in Tanzania with measured economic benefits such as skills, employment, technology, tax revenue, trade and entrepreneurship. A study by George Kabelwa (2004) found out that South African companies have a significant potential to improve the country's low technological base, thereby contributing to entrepreneurship and industrial development.

There is also a spatial aspect of the FDI-poverty nexus. Regions with a better investment climate because of infrastructure and natural resource endowment have performed better in terms of trade and investment, and are also less poverty stricken. As mentioned earlier, the distribution of FDI in Tanzania is skewed towards a few regions with Dar es Salaam and Mwanza attracting the highest level of FDI inflows (above US$ 500m each in 1999, about 57% of total FDI inflows in 1999), leaving only 43% for the remaining regions. With this kind of distribution, a very small section of the country has benefited directly from the improved performance in FDI inflows. Column three of table 7.8 reflects regional achievements in three dimensions of human development: long and healthy life, knowledge and decent standard of living. It is interesting to note that the regions with relatively higher concentration of FDI also have highest performance in terms of HDI. However, although Mwanza and Shinyanga are among the worst HDI performers, the two regions have rich mineral deposits (gold) and are among the top five with the highest stock of FDI. This implies that FDI inflows to the mining sector have so far had a limited impact on poverty reduction.

Table 7.8 Regional Distributions of FDI, Trade and Poverty

Region	FDI	HDI	CC exports
Arusha	◙◙◙	¤¤¤	◊◊
Coast	◙	¤¤	-
Dar es Salaam	◙◙◙◙	¤¤¤	-
Dodoma	◙	¤¤	-
Iringa	◙◙	¤¤¤	◊◊
Kagera	◙	¤	◊◊◊
Kigoma	◙	¤¤	-
Kilimanjaro	◙	¤¤¤	◊◊◊
Lindi	◙	¤	-
Mafia	◙	¤¤	-
Mara	◙◙◙	¤¤	-
Mbeya	◙	¤¤¤	◊◊
Morogoro	◙◙◙	¤¤	-
Mtwara	◙	¤¤	◊◊◊
Mwanza	◙◙◙◙	¤	◊◊◊
Pemba	◙	¤¤	-
Rukwa	◙	¤	-
Ruvuma	◙	¤¤	◊
Shinyanga	◙◙◙	¤	◊◊
Singida	◙	¤¤	-
Tabora	◙◙	¤¤	◊
Tanga	◙◙	¤¤	◊◊
Zanzibar	◙	¤¤	-

Key

FDI =Foreign Direct Investment
◙◙◙◙ $501m and above
◙◙◙ $101m - 500m
◙◙ $11m - 100m
◙ $0m - 10m

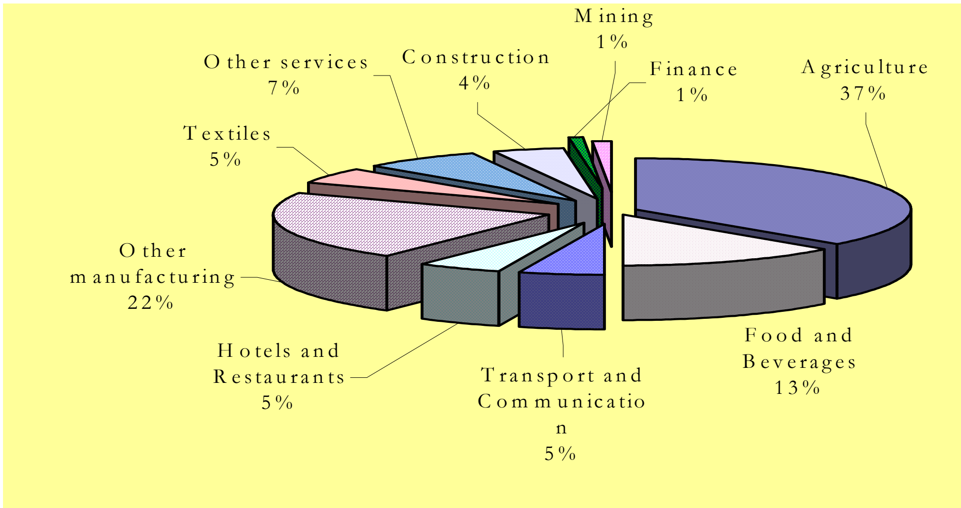
HDI= Human Development Index
¤¤¤ High HDI
¤¤ Medium HDI
¤ Low HDI
- Missing Data

CC exports = share of cash crops available
◊◊◊ 50%-100%
◊◊ 10% -50%
◊ Below 10%
- No cash crop for export

Source:FDI – Tanzania Investment Report, 2001; HDI – Poverty and Human Development Report, 2002; CC – Mkenda (2003)

The important role of domestic investment is acknowledged but not analysed here. One question is whether regional integration increases FDI inflows to a member country such as Tanzania, another question which we address here is whether FDI will affect poverty reduction generally.

Chart 7.4 Employment of approved FDI in Tanzania by sector, 1999–2000



Source: Tanzania Investment Centre (Various years)

Chart 7.5 FDI Share of GDP and primary school enrolment rate, 1990-2002

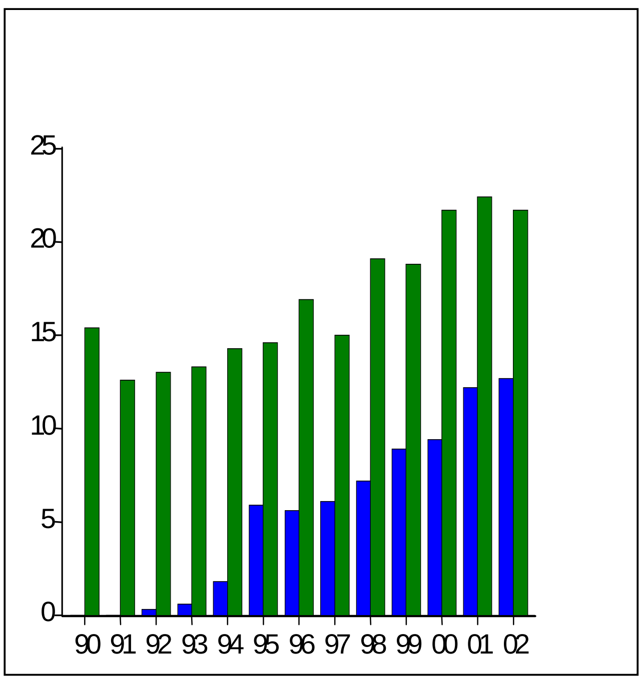
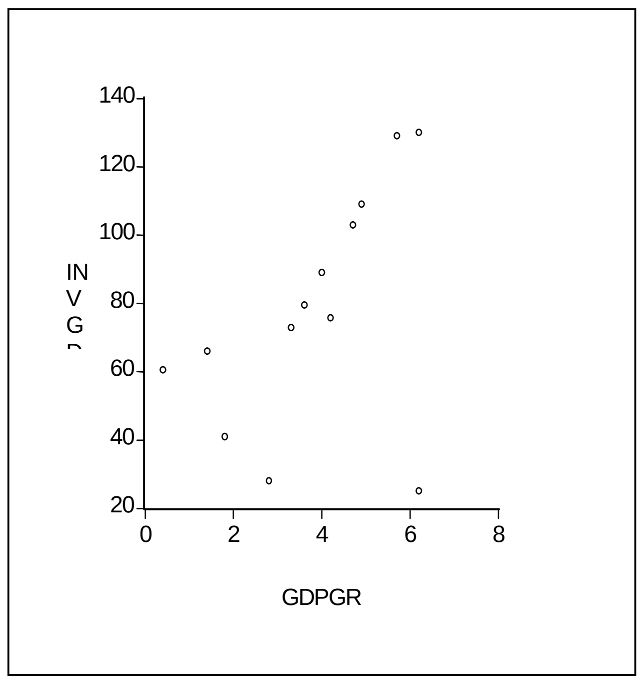


Chart 7.6 GDP growth and investment share of GDP, 1990-2002



As shown in chart 7.5, we observe a clear correlation between the FDI share of GDP and the primary school enrolment rate suggesting a possible positive impact of FDI on poverty. Similarly, using chart 7.6 one notes a positive relationship between investment and GDP growth signifying a positive association between investment and growth (or vice versa).

7.5 Regional integration and poverty reduction through trade

One of the key benefits and expectations of a RIA is to increase trade performance of the participating member countries. The literature has tended to examine whether RI is trade creating or diverting or estimate the impact of RI on the economy of the member country, particularly the implications for the loss of government revenue. In contrast, our focus will be to assess the efficacy of regional trade on poverty reduction in Tanzania.

Given the various trade provisions (such as those under custom union for EAC, the Trade Protocol for SADC and other Trade Preferences), the first question we investigate is whether Regional Integration has led to increased trade performance for Tanzanian. Regional markets are considered important remedies for the LDC's failure to achieve significant market access in the global economy because market access conditions are expected to be easier because of lower transport costs due to proximity of market, favourable rules of origin and joint promotional measures for investment and trade. In addition, regional markets may be considered useful stepping-stones to gaining competitiveness needed for LDCs to access global market. Secondly, we aim to assess the poverty focus of regional trade so as to estimate the extent to which regionalisation has or will contribute to poverty reduction. This is analysed by examining the trend and share of agriculture exports to regional markets given the importance of agriculture sector in poverty reduction and the multiplier effects it has on the economy. Thirdly, the impact of trade on poverty reduction is examined by linking trade performance to a set of poverty indicators over time (to demonstrate the likely effect of regionalisation) and by regions. Finally, we discuss the factors limiting the poverty-focus of trade and the stumbling blocks for poor to benefit from increased trade performance.

7.5.1 Regional Trade Performance in Tanzania

Examination of the trend and structure of Tanzania's trade performance in the last decade shows three interesting features. First, total exports have been increasing, especially due to the rising share of non-traditional exports (mainly exports of minerals, fish and tourism services). Second, imports have grown faster (with a negative trade balance) although at a decreasing rate in the recent years signifying potential for improvement in the trade balance. Finally and more importantly, trade (export in particular) to the regional markets is picking up fast with the progress in regional integration. Clearly this indicates better prospects for some of Tanzania's non-traditional exports to the regional markets, a favourable change to a trade regime that is dominated by traditional export of agriculture raw materials to the traditional markets.

For instance, total exports to the regional markets increased to US$ 125 million in 2002 from US$ 43 million in 1995; over the same period, the regional share of total exports increased to 14% from 6% of total exports. This reveals Tanzania's exports to the regional markets are growing faster than that of extra-regional exports (see chart 7.7). Notable variation in the performance of Tanzania's exports among regional blocs exists as can be seen in chart 7.8

The rise in export performance indicates that certain export products have increased in value and/or volume as a result of regional integration. For instance, most of the informal cross border trade in cereals and other agricultural/food crops has been formalised following the lift on the ban to export food crops in 1999, and 'opening up' of the borders as part of the process of regional integration. Both SADC and EAC have accounted for over 80% of Tanzania's regional exports, and almost all of Tanzania's regional imports. Chart 7.8 demonstrates two striking features of Tanzania's regional trade. First, after netting out the overlapping membership with SADC and EAC, COMESA's trade with Tanzania has been insignificant and in favour of EAC and SADC since Tanzania's withdrawal in 2000. Clearly the regional trade provisions have affected trade performance with the region. Secondly, although the pace of trade integration is faster in EAC, the SADC share of Tanzania's trade is peaking faster, mainly due to the entrance of South Africa in the region in 1994. The two points clearly show that Tanzania does not lose as much as feared by withdrawing from COMESA as long as the SADC and EAC blocs exist. A follows-up question (not analysed here) is whether trade provisions in COMESA are necessarily better/more effective than those of EAC or SADC.

Chart 7.7 Growth of Regional and Non-Regional exports (1995-2002)

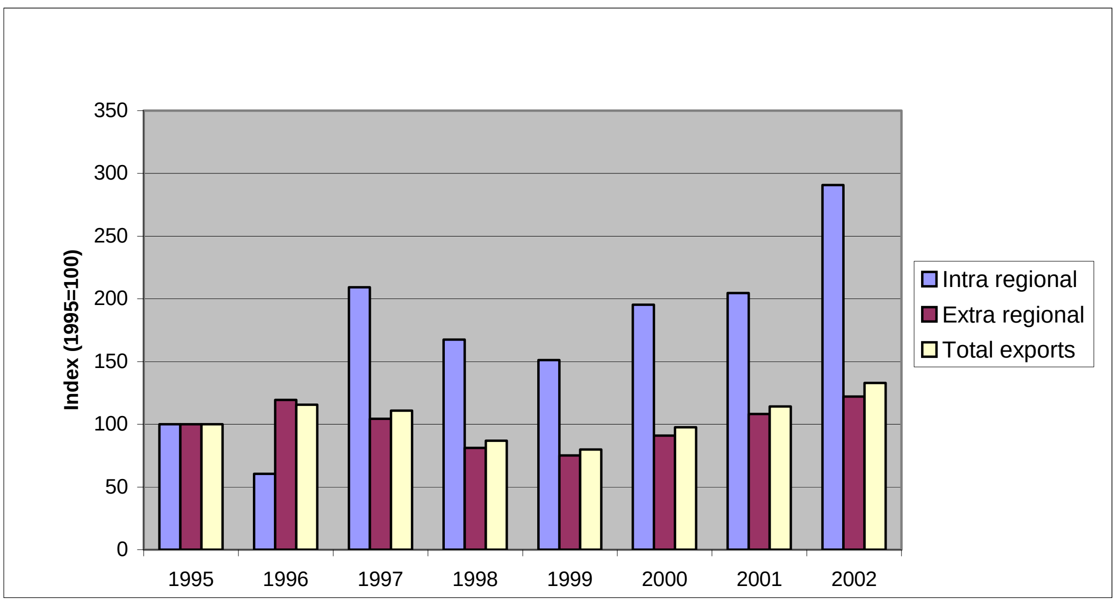
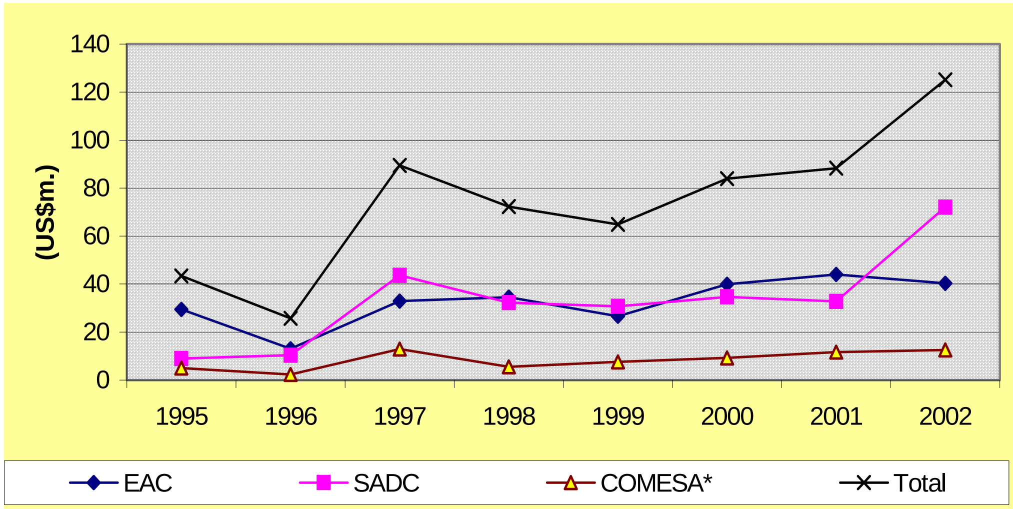
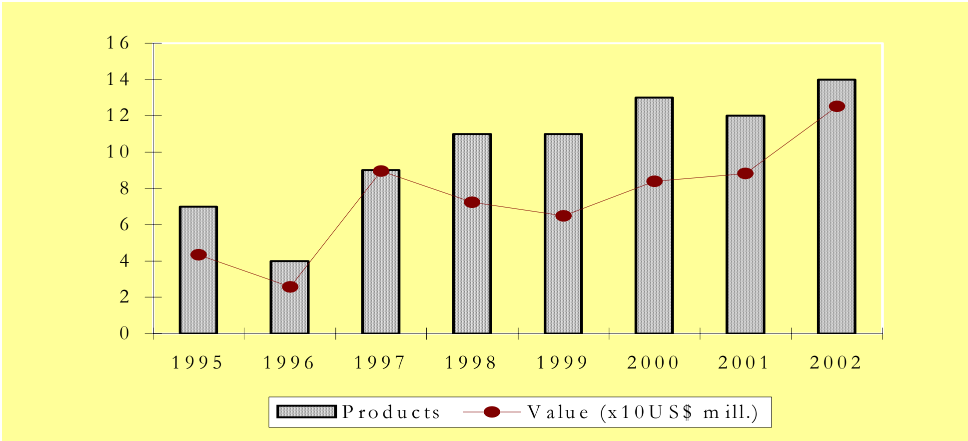


Chart 7.8 Tanzania's Exports by Regions (1995 – 2002)



Tanzania has also achieved a reasonable diversification of her exports. Chart 7.9 shows that the number of products exported by Tanzania to her regional markets has increased in parallel with the value of exports. The types of products range from natural resources (bee wax, honey, wild life), new cash crops (such as vanilla, spices, paprika and horticulture – cut flower) to manufacture and articles of art (textiles, electrical equipments) etc. For instance, the AGOA scheme has led to the establishment of new textile and garment mills. The main trading partners have been South Africa and Kenya for the SADC and EAC regional markets respectively. The two countries accounted for over 40% of all Tanzania's exports to the three regions in 2002. Although the balance of payments between Tanzania and the other countries in the region have been generally unfavourable it has improved from a deficit of US$ 223 million in 1995 to US$ 67 million by June 2003.

Chart 7.9 Range and Value of products exported to the Regional Markets



Source: Author's computation using export data from Tanzania Revenue Authority (TRA)

Chart 7.10 shows that Tanzania's imports from the regional markets have increased slightly faster than imports from non-regional markets. Regional variation in terms of growth of imports to Tanzania is shown in chart 7.11. The share of Tanzania's imports from COMESA, SADC and EAC in total imports has increased from 17% in 1995 to 18% in 2002 (appendix 7.4.2). Like regional exports, most regional imports come from South Africa and Kenya with the share of the two countries in total regional imports increasing from 70% in 1995 to over 90% in 2002. Imports from South Africa alone are almost half of the total regional imports for Tanzania. Unlike exports, the share of regional imports in total imports of agricultural products has stabilised at about 10% of total imports.

Chart 7.10 Growth of Regional and Non-Regional Imports (1995-2002

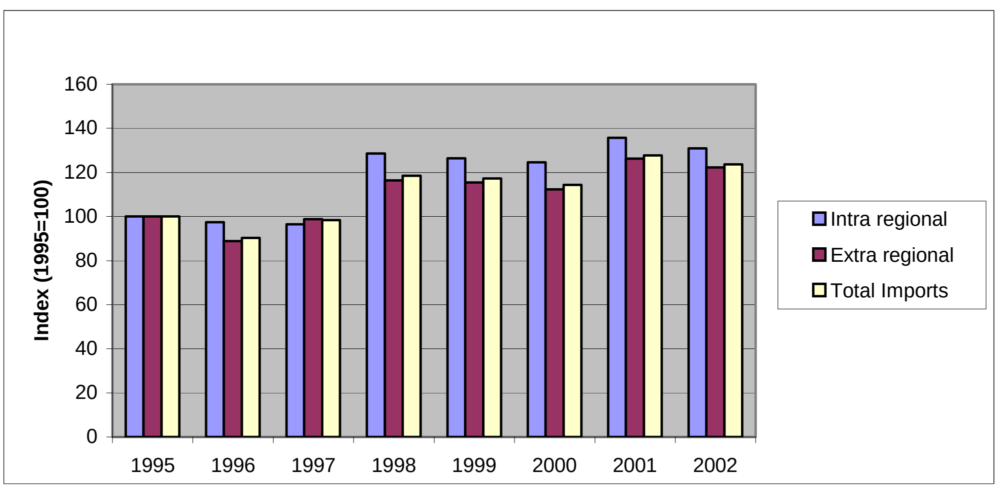
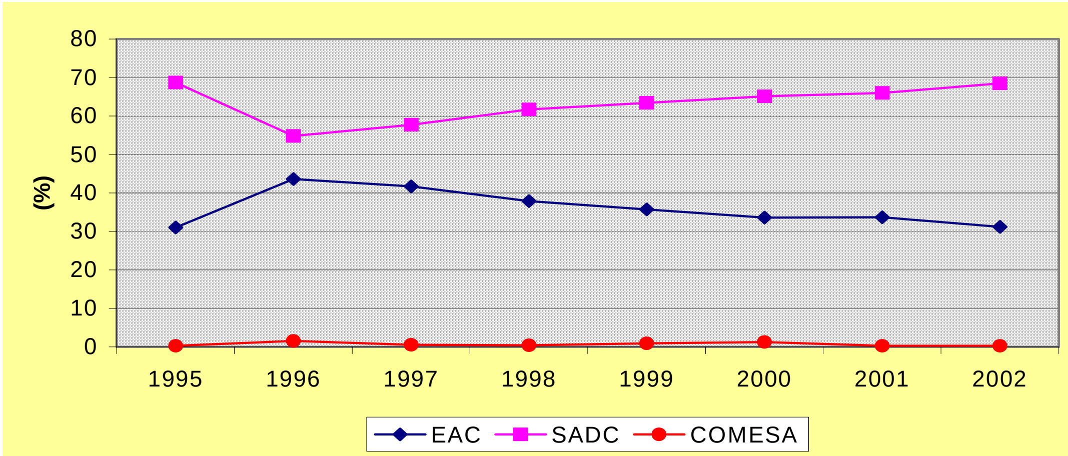


Chart 7.11 Tanzania's Imports from the Regional Market (% of regional imports)



7.5.2 Poverty Focus of Regional Trade

Regional integration can affect poverty if its provisions change the poverty focus of trade. One way to examine the poverty focus of trade (or investment) in regional integration is to discuss the share of the agriculture sector in regional trade. This is because of the role that this sector can play in poverty alleviation directly or indirectly through the high linkage it has with the rest of the economy. As noted earlier, emphasising trade in agriculture goods does not demean the importance of trade in other sectors such as manufacturing and services in alleviating poverty. Instead, we emphasise the two points. First, Tanzania's comparative advantage continues to exist in the agriculture sector, despite the country's notable failure to transform this comparative advantage into a competitive one (reasons for this failure is beyond the scope of this study). Associated with this failure is the slow (if any) strategic transformation of this sector for growth and poverty reduction. Second, poverty in Tanzania is basically a rural phenomenon. This has been especially so after the implementation of economic reforms and adoption of market economy that obliged the government to abandon most of the state led agriculture activities. Unfortunately, the expected takeover by the private sector has not been forthcoming given the little amount (and interest) of FDI in this sector. Given these two points, agriculture trade play an important role in reducing poverty relative to trade in other goods/sectors.

Tanzania's regional exports of agricultural and agro processed products (mainly food products) in total regional exports for Tanzania increased from 50% in 1995 to 60% in June 2003. Unlike most of her neighbours, Tanzania has low food shortages due to its diverse and favourable agro-ecological climates, contributing to positive trade balance as shown in table 7.9. Chart 7.12 (see also Appendix 7.4.3) shows the share of the value of Agriculture/Agro-processed products in total exports distinguishing between exports to and outside regional markets. It is found that the share of the value of agriculture products in total intra-regional exports has been increasing, while that of extra regional and total exports has been declining steadily from 1999 onwards. This is a good sign that the process of regional integration bears significant potential for agricultural exports and hence increases in the welfare of those in the rural sector[44].

Chart 7.12 Share of Agriculture in the Value of Exports (1995-2002)

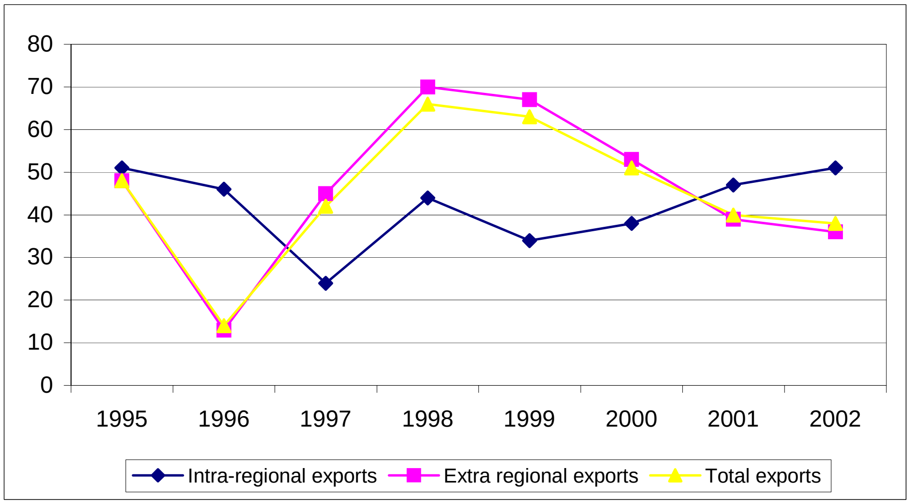


Chart 7.13 shows trends in the value of agricultural exports to the regional markets, while chart 7.14 shows that the share of agriculture in total regional exports by region. Both the value and share of agricultural exports has been increasing consistently for the EAC market. Between 2001-2, the share of agriculture in total exports to the SADC region has increased sharply along side that of total (overall) exports, while total exports to EAC declined slightly. The sharp increase in the case of SADC market may reflect the impact of South Africa's imports of agro-raw materials from Tanzania, but more importantly the massive exports of cereals from Tanzania following the famine in the neighbouring SADC countries (especially DR Congo, Zambia and Malawi).

[44] According to interviews conducted for this study with various stakeholders, there has been a significant increase in the export of food crops (including cereals) to the neighbouring countries of Kenya, Uganda, DR Congo, Zambia and Malawi. This positive move is a response to the government decision to lift the export ban for cereals/food products, but also to the regional trade agreements that alleviated most other non-tariff barriers to trade.

Chart 7.13 Exports of Agricultural products to the Regional Markets (US$ m.)

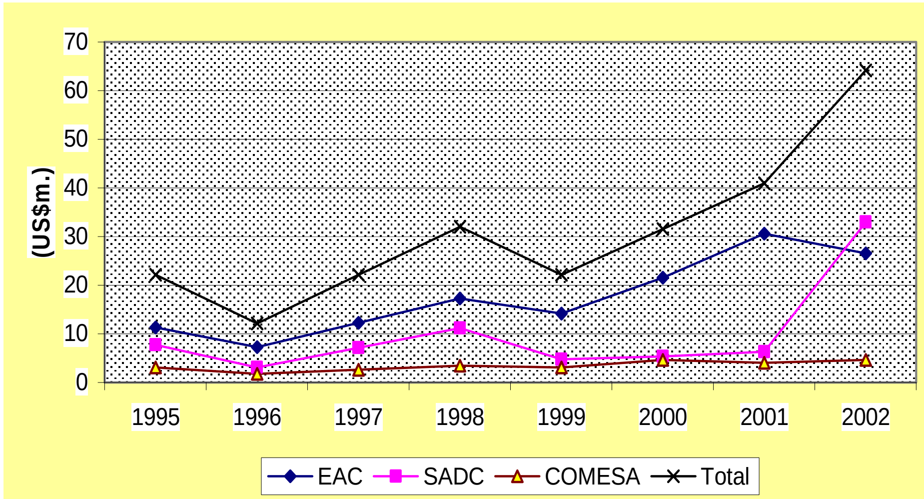
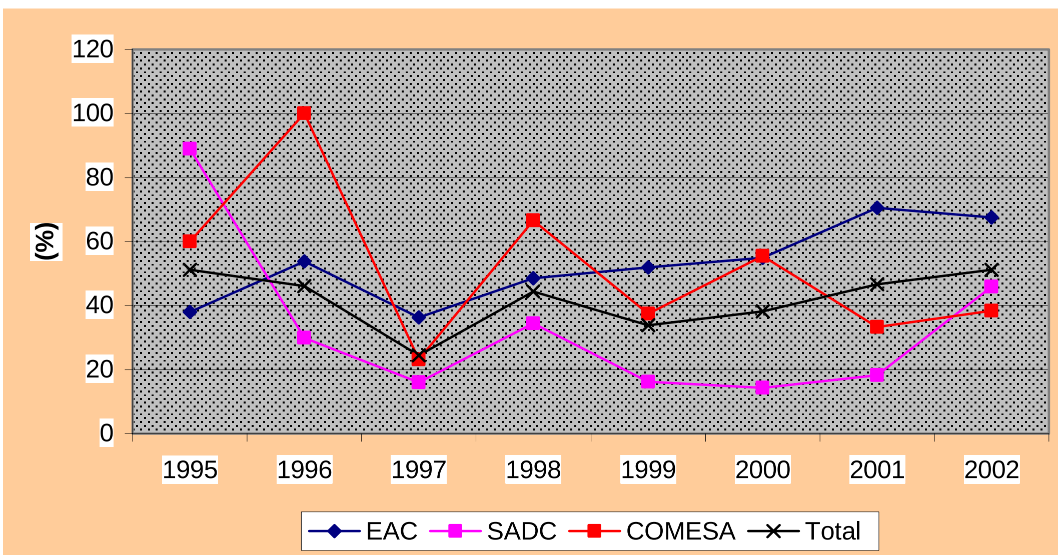


Chart 7.14 Share of Agriculture in total Regional Exports (%)



Source: Own computation based on Data from Customs Department.

Furthermore, regional trade bears significant potential for Tanzania to improve her trade account. Although the trade deficit has increased for total trade, that for regional trade has declined, particularly due to the positive trade balance in agriculture trade. Notably, the agricultural trade balance with regional markets improved from a deficit of US$ 5 million to a surplus of US$ 27 million. However, the trade balance with the main trading partners in the region (Kenya and South Africa) is still negative although the South African market shows greater prospects for increased exports compared to the Kenyan market. As shown in table 7.9, most imports come from SADC especially from South Africa whose exports to Tanzania has markedly since South Africa's accession to SADC.

Table 7.9 Trade balance between Tanzania and Regional Members

Year Indicator	1995			2002		
	X	**M**	**B**	**X**	**M**	**B**
Total Trade	679	1340	-661	903	1658	-755
Extra Regional Trade	641	1114	-473	790	1362	-572
Intra Regional Trade	38	226	-188	113	296	-183
o/w Agriculture Products	19	24	-5	60	33	27
o/w South Africa (SADC)	0.5	97	-97	35	177	-142
o/w Kenya (EAC)	24	70	-46	16	90	-74

Note: X = exports; M = Imports; B = Trade Balance; o/w = Out of which
Source: Calculated from Tanzania Customs Data.

7.5.3 Relating Trade to Poverty Indicators

According to table 7.8, there is a close association between the distribution of poverty by regions and distribution of cash crops (indicator of availability of tradable crops). Regions producing cash crops for export also have a lower level of poverty (higher HDI score) suggesting that trade in agriculture products is likely to be poverty reducing. Plots of trade and poverty indicators suggest a close positive relation. For instance, chart 7.15 shows a positive link between the exports share of GDP and the primary school net enrolment rate (PSNER). The correlation between terms of trade and PSNER is positive albeit less significant. One may require additional econometric analysis to find out the causality between the two, but even for this “rough and ready” indicators it is clear that trade performance and poverty reduction are not contradictory in the case of Tanzania.

Chart 7.15 Export Share of GDP and primary school enrolment rate, 1990-2002

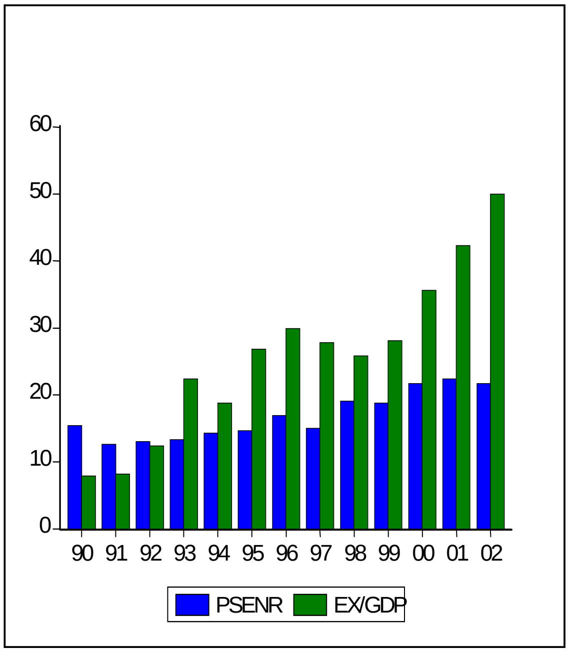
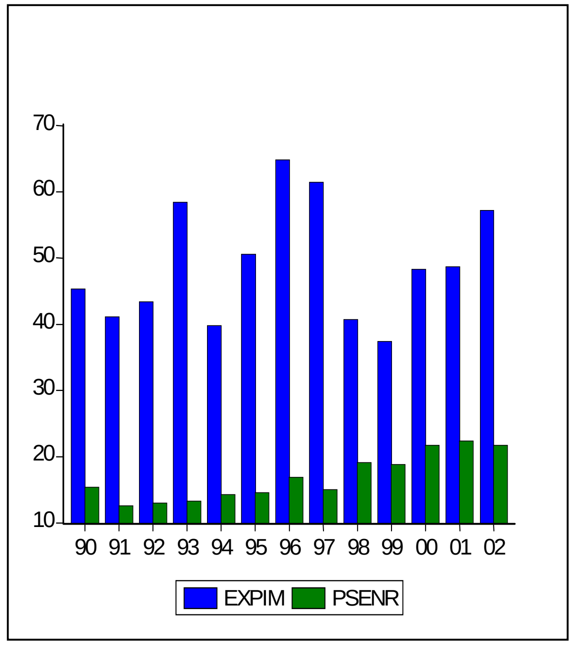


Chart 7.16 Export Import Ratio and investment share of GDP, 1990-2002



7.5.4 Constraints to Trade and Investment-Poverty Link

In a recent study by Booth and Kweka (2004) it was noted that the potential for trade-oriented economic development to reduce poverty in Tanzania is considerable, and that this potential is being seriously undermined. The study highlighted lack of competition in internal agriculture marketing and inadequate assets available to farmers as the most critical challenges for Tanzania's trade to reduce poverty:

> "…..the poverty profile and production structure of Tanzania create large opportunities for poverty to be reduced through trade-related economic growth. However, this would require rapid agricultural growth oriented towards exports, where the direct impacts and income multipliers would be particularly strong. That has not occurred: Tanzania's agricultural exports have performed very much worse in aggregate than those of Ethiopia, Kenya and Uganda – countries that that have a crop mix and natural environment comparable to Tanzania's. This helps to explain why rural poverty rates did not decline significantly during the 1990s, and sets a big challenge to policy makers who hope to do better for the country's poor in the present decade*…" Booth and Kweka, 2004:iv).*

To get a better understanding of how firms are coping with a number of constraints to increased trade performance at a regional level and prospects for poverty reduction, we surveyed a few exporting and non-exporting firms to evaluate their prospects for increased regional trade. In this section we report the results of this survey. Although the number of interviewed firms is quite small by research standards, they revealed important information that will supplement our understanding of challenges limiting the poverty-impact of regional integration in Tanzania[45]. In addition, we considered it necessary to solicit industry perspectives on how Tanzania can effectively realise the benefits of regional integration, given the serious supply side constraints faced by the productive sectors. We therefore surveyed 30 firms to examine information on production, regional trade/market, employment, and training and skills development issues.

The sampled firms were equally sourced from the three major industrial regions of Tanzania (numbers in brackets), i.e. Dar es Salaam (10), Mwanza (11) and Arusha (9). As noted earlier in the introduction, these firms were carefully selected to target the production sectors that are considered key for growth (e.g. manufacturing and agriculture) and also have high (and a few that do no have) export potential to the regional markets. All sectors are privately owned, but varied to include foreign owned firms (19%), domestic firms (41%), and joint ventures (37%)[46]. Most firms fall between medium sized and large enterprises, covering manufacturing, agriculture and fishing sectors. Although we cannot state with certainty the differences in behaviour between regional and non-regional firms, we can make rather general conclusions about the domestic versus foreign firms[47].

Export Potential to the Regional Markets

Almost half of the interviewed firms also export to the regional markets of COMESA, EAC and SADC (in addition to exporting to abroad). About 30% export mainly to the regional market, 15% to Europe and America, 11% to Japan and Australia, 8% to Asia including India, 14% to the rest of the world while 22% sell mostly to the domestic market (see chart 7.17).

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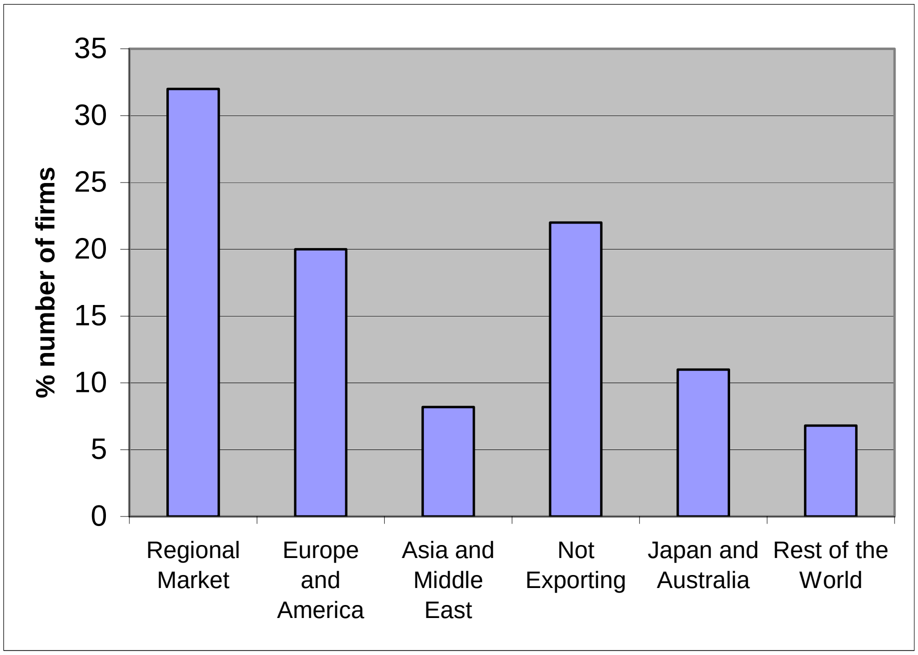
[45] The information revealed by the interviewed firms is, in most cases and based on the recent World Bank-ESRF Investment Climate (RPED) Survey (see World Bank, 2004), consistent with the national average behaviour and concerns of Tanzanian manufacturing firms in the selected sub-sectors.

[46] Throughout the text, the percentages may not add to 100 due to missing values.

[47] Given our limited sample, it was not possible to distinguish between firms supplying in or originating from the regional markets from those supplying or originating from outside the regional markets. However, the important distinction in the context of Tanzania is between behaviours and type of constraints facing the exporting and non-exporting firms (see chart 7.20).

Chart 7.17 Export Destination for the Selected firms

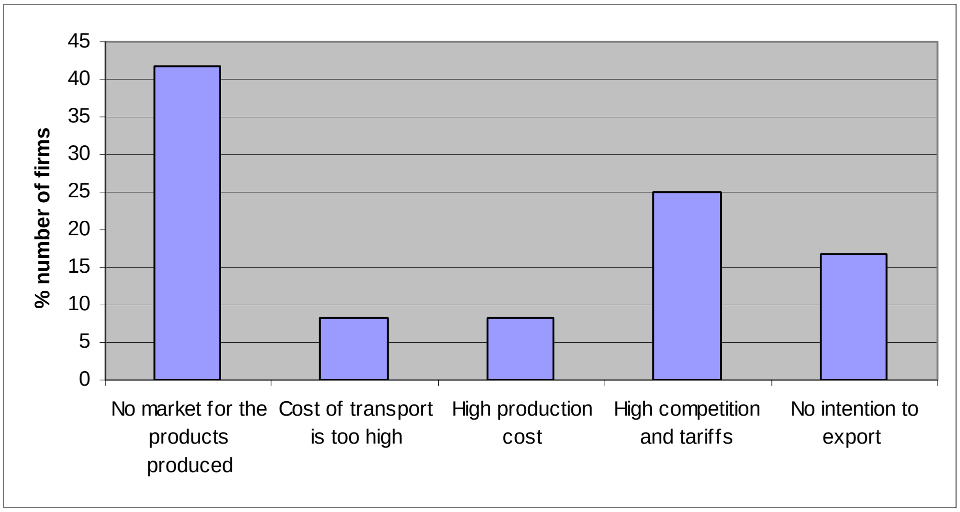


Source: Computed based on Data from Selected firms

Chart 7.18 reports the reasons why some of the firms do not export to the regional market. About 50% of the selected firms do not target this market because they think that the type of products they produce have no demand in the regional market (for instance fish fillets), and fear high competition and protective tariffs in the importing countries of the regions. This may suggest that firms have failed to diversify their production structure to exploit regional market due to a perception gap. For instance, although demand for fish fillet is small in the EAC/SADC, there could be a market for products such as sausages etc. Second, some firms seem unaware of regional trade policy changes. Finally, a number of non-exporting firms are implicitly lacking confidence or an entrepreneurship zeal to venture into regional export market. However, as shown in chart 7.19, exporting to the regional market is not unfeasible. Close to 50% of the firms exporting to the region do not face any substantial barriers to exporting to the regional market. Clearly, this implies that, confidence building and entrepreneurship capacity building by the regional body can make a big difference, and should be one of the appropriate interventions to promote regional exports.

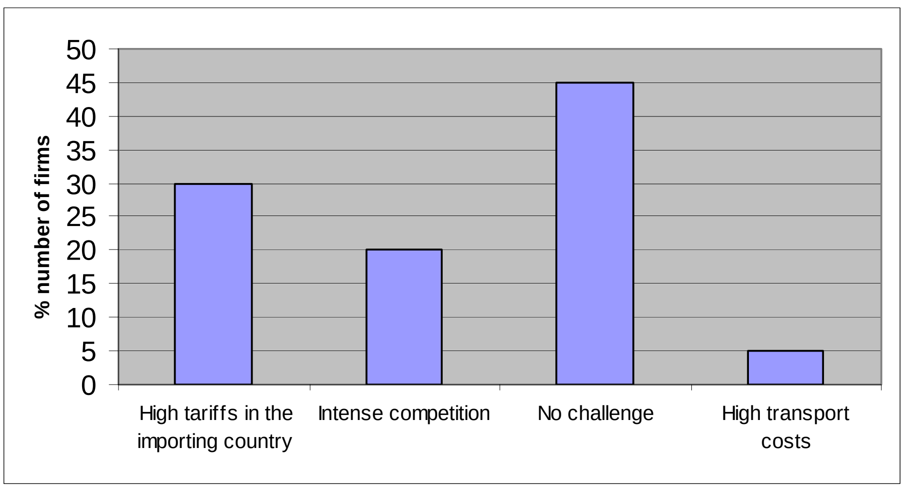
Given the infancy of regional integration, firms are yet to realise the impact of the trade reforms arising from regionalisation. Over 50% of the selected firms responded that they have not been affected in any way through the signing of the Custom Union for EAC, but most hope that it is likely to increase production if tariffs are harmonised. The only advantage cited by exporting firms in the regional market is the proximity to the market. When asked whether Tanzanian products can compete with imports from the regional markets of EAC and SADC after fully-fledged integration, firms were ambivalent –52% are affirmative and 48% sceptical. For the latter category, high production and energy costs (also see Musonda, 2000), bureaucracy in implementing trade agreements and infrastructure limitations were cited as most important factors (also see chart 7.20).

Chart 7.18 Reasons for not exporting in the Regional Market



Source: Own computation based on Data from Selected firms

Chart 7.19 Challenges faced by Firms in Exporting to the Regional Market



Source: Own computation based on Data from Selected firms

Foreign firms are relatively better placed to reap the trade opportunity of liberalisation compared to domestically oriented firms. Overall, only 45% of the selected firms regard regional integration as beneficial to increased export trade, while 55% (most of them domestic) are cynical about the trade benefit of regionalisation. Over 80% of the firms that regard regional integration as a trade opportunity are foreign and joint venture companies. This raises a challenge in that policy makers have not adequately encouraged the wider business community to realise the inherent opportunities in the regional integration. Perhaps there is an ingrained mindset that business community regard export market outside their neighbours as more important (Amani *et al*, 2003).

Potential Impact from Regional FDI

One of the ways in which FDI can be useful for poverty reduction is through its impact on incomes by creating jobs directly and indirectly so by their spill-over effects on skill and technology transfer. We investigated the orientation in training, skill development and capacity for technology transfer of the interviewed firms. In general, the selected firms (almost all) were optimistic that they have sufficient capacity to absorb technology embodied in FDI. This reflects their quest for technology and skill acquisition as a means of enhancing quality and competitiveness. Associated with this quest, most firms (over 90%) offer regular training to their employees, most of which is done in-house (on the job training). Over time, firms have increasingly demanded skilled labour to support their adherence to quality and modern technology. As shown in table 7.10, the number of skilled and unskilled workers declined between 1998-2001 but picked up in the later years while that of semi-skilled workers increased consistently throughout. Clearly, as trade liberalisation increases (with the process of regionalisation), firms strive to be more competitive although some (particularly domestic) firms find it a challenge to sustain their output levels and productivity.

To examine the trend in productivity of the selected regional exporting firms, we computed the output per labourer (volume of production/total number of employees) expressed as indices (1998=100) and shown in table 7.11. The indices show that productivity increased by about 50% from 1998 to 2001 but declined in 2002 – 2003 owing to a faster increase in number of employees relative to output. Presumably, over the recent years, increase in competition from imports due to liberalisation has negatively affected the rate at which firms' output increases.

Table 7.10 Number of Employees in the sampled firms by Skill Levels (1998=100)

Year	Skilled	Semi-skilled	Unskilled
1998	100	100	100
1999	100	106	104
2000	106	117	94
2001	92	120	112
2002	196	218	170
2003	260	277	252

Source: Computed based on data from selected firms

Table 7.11 Productivity Index
(Output per Worker, 1998=100)

Year	Production (Volume)	Total No. of employees	Productivity
1998	100	100	100
1999	114	104	110
2000	162	108	150
2001	168	116	145
2002	175	186	94
2003	185	264	70

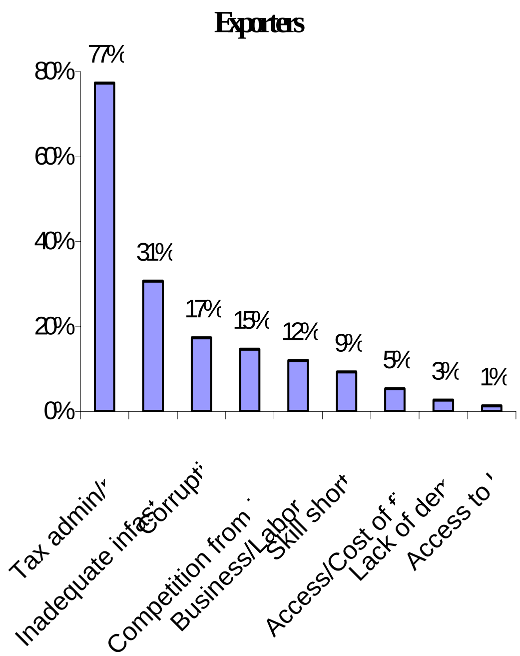
Source: Computed based on data from selected firms

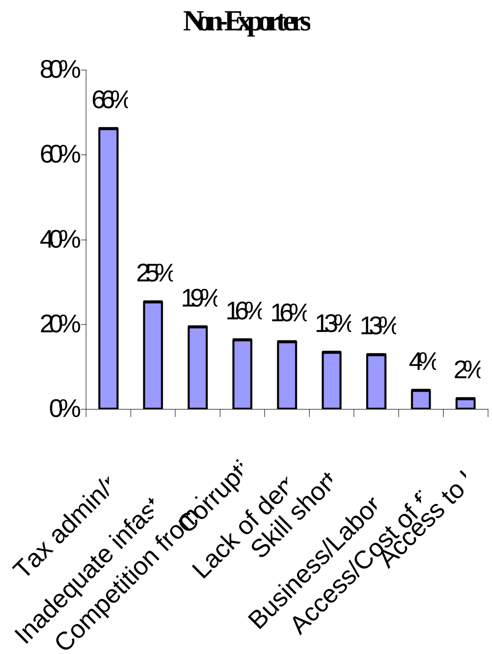
Comparative strength of Tanzania as FDI destination

Information from various policy documents and interviews with a number of selected foreign firms suggests three main factors attract FDI to Tanzania relative to its peers in EAC and SADC. These are political stability, commitment to reforms and endowment of untapped natural resources. We asked the selected firms to identify the three most important factors motivating their investment in Tanzania. Over 40% of them consider political stability as a prime factor for their investment in Tanzania, while 45% considered trade opportunity (the various trade concessions available for Tanzania) as the second most important factor; and finally, 65% named incentives from TIC as the third most important factor. Only a few firms (less than 12%) think that the regional export market was a strategic reason for their investment in Tanzania. In addition, many firms in Tanzania are neither informed nor convinced that there are regional-specific incentives for attracting investment – compared to those from the investment centres such as TIC. Eighty five percent of the firms reported that there is no incentive from either EAC or SADC to support their investment. Such scepticism may be expected since most of the incentives associated with regional integration (for instance flow of factors of production across the boundaries) are yet to be implemented.

Tanzania has probably one of the lowest productivity and competitiveness indicators in the region. It will be difficult to evaluate all the factors limiting productivity and competitiveness given the scope of this study. The World Bank Report (2004) on the Survey of Investment Climate Assessment for Tanzania shows a number of constraints faced by exporting (and non-exporting) firms in Tanzania (see chart 7.20). The highest-ranked constraint is taxation, followed by inadequate infrastructure, corruption and competition from imports. Tanzanian enterprises pay a myriad of taxes – sometimes at exorbitant rates that discourage compliance and enforce rent-seeking behaviour. Although harmonisation of fiscal policies is being done within EAC, Tanzania has the highest VAT rate of 20% compared to 17% in Kenya and 16% in Uganda. In addition, local taxes by local government form another huddle for exporters.

Chart 7.20 Constraints to exporters and non-exporters





7.6 Other regional co-operation for poverty reduction

As noted in section 3, the focus and orientation of integration process of Regional Integration Arrangements may follow a market integration model or a development cooperation model or a combination of the two. In Africa (perhaps in the developing world in general) development cooperation has been a primary objective in many RIAs given their various development challenges other than trade integration. One such development challenge is poverty reduction. This section reviews the link between RI and poverty in Tanzania via development cooperation. Our concern is to identify regional cooperation programmes for EAC and SADC that are likely to have an important impact on poverty; and then evaluate their efficacy using case examples.

For the purpose of simplicity, we can categorise two ways in which development cooperation takes place: development programmes or projects, and development (management) policy on a particular issue/sector of common interest. The former demonstrates the need for the regional members to pull resources together to meet a particular development objective (e.g. provision of public goods such as infrastructure development). The later includes the non-trade and non-investment regional policy. We will review some cases of regional development cooperation that have notable implication for poverty in both EAC and SADC. However, given the scattered nature of the various programmes/projects, it is not easy to access and evaluate all the regional projects/programmes. For instance, in the case of SADC, the organisation of most programmes is not centralised, but usually put under the custodianship of the relevant government ministry/department, which may not always be willing to share such information. In the case of EAC, many programmes are still in the pipeline and are yet to take place.

7.6.1 Socio-economic Programmes in EAC

Several non-trade/investment initiatives have been undertaken by the EAC that have important bearing on poverty reduction. Due to unforeseen circumstances in the regional organisations in Africa, many of the programs set by many RIAs were never followed by the member states, posing the challenge of lack of credibility (Musonda, 2004:61). One of the most successful projects is the East African Development Bank, which mobilises resources to finance various social economic projects in the region. Box 7.2 provides a case study to show how the East African Development Bank has strengthened trade and investment relations between the EAC member states and its potential for poverty reduction. As explained in Box 7.2, the bank has played an important role in long-term lending for productive sectors of the economy such as manufacturing, agriculture and energy development. This is particularly important for Tanzania where commercial lending in the rural sector is severely absent.

Box 7.2 The East African Development Bank (EADB)

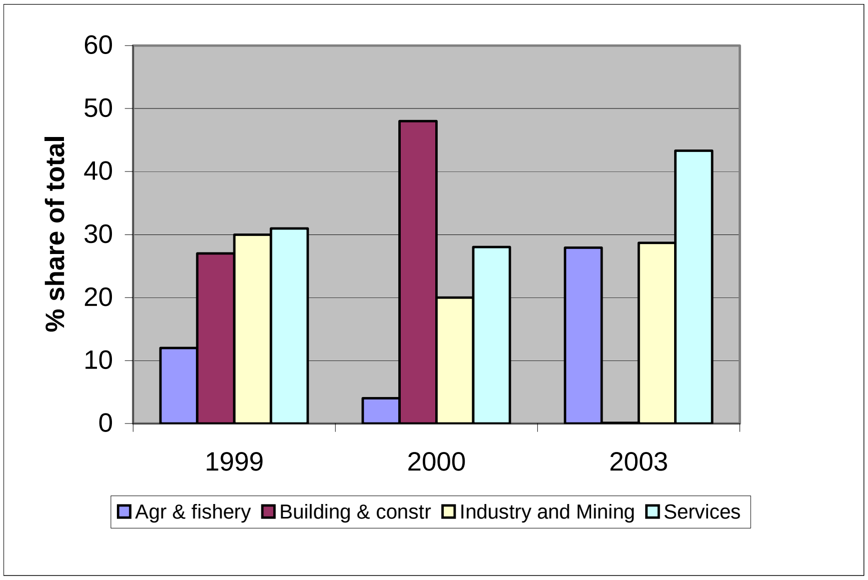
The EADB started operations in 1967 following the establishment of EAC. The bank did not collapse with the community in 1977 because the assets of the bank belonged to various shareholders. The ownership structure of EADB is as follows. EAC – 72.21%; FMO (Netherlands), – 10% DEG (German) – 2.7%. The supervision of credit allocation is controlled by the bank's management and is purely on a commercial basis. The main objective of the bank is to encourage industrial balance by advancing loans to key sectors of growth that are not attractive to lending by commercial banks. The bank's main focus is to finance projects that are regional in nature. The bank is currently involved in the regional energy and fishing projects. It has also started issuing bonds to the capital markets of the three member states.

The bank has the capacity to mobilise substantial amounts of resources from other partners and development banks to finance regional projects. The bank loans range from US$20,000 – US$10,000,000 and can be short term (less than two years), medium term (1-5 years) and long term (up to 25 years). Most loans have been directed to the manufacturing sector. The loans are awarded in accordance with the commercial viability of a specific project. The bank is comparatively well-placed to reduce poverty as it accords priority to value adding and agriculture-based projects, with a low interest rate (14%) compared to most commercial banks. However, a practice of extending relatively fewer loans to the agriculture sector emanates from the lack of collateral to support loan application. This lack of collateral it in is due to the practice, until recently, of not accepting land as collateral., The government addressed this constraint by amending the Land Act in 2002 to allow land to have a commercial value for investment. The governments of the three states have not provided a good environment conducive for bankers to extend credits to poor farmers. The bank is nevertheless trying to work with the Small Industry Development Organisations (SIDO) and micro-finance institutions to help farmers and SMEs get financing since these institutions have the infrastructure to reach the poor in the rural areas.

Source: EADB Annual Report, 2003

The sectoral distribution of the approved projects (for 1999-2003) is shown in chart 7.21. The share of agriculture has increased from 25% in 1999 to over 40% in 2003. Interviews with EADB officials confirmed their focus on Agriculture and fishery (due to EAC's lake Victoria), which reflects the Bank and EAC's commitment to poverty reduction. Another important recipient of EADB loans is the services sector, notably the financial sector (a couple of banks) and tourism. Currently, the Bank does not lend to the construction companies. The share of the manufacturing sector has also increased over time.

Chart 7.21 EADB sector distribution of investment approvals



7.6.1.1 Lake Victoria Development Project

Lake Victoria is one of the biggest lakes in Africa covering an area of 68,800 sq. km. The lake is the most important source of livelihood for many people in EAC as it has the cleanest water for human consumption and is a source of *Nile perch*, one of the most popular fish in the world, hence an important source of export revenue for the EAC countries. In this sub-section, we describe Lake Victoria Development Projects as an important instrument for regional integration in EAC and examine its effectiveness in poverty reduction.

The lake is a source of food (fish), safe drinking water, means of transport (marine) and a good climate that enables the region to grow a variety of food and cash crops. As a shared resource, it is instrumental for the regional integration prospects of the EAC, but one with a number of managerial challenges. First, it presumes existence of capable regional institutions to oversee its utilisation and regulation. Second, it has some environmental effects that need to be alleviated/ tamed. Thirdly, given the fact that the fish stock level is subject to depletion, the regional body will require substantial resources for ensuring sustainability of the benefits from the lake including investment in aqua culture, marine research and infrastructure. Finally, it requires harmonisation of social and economic policies and regulation for governing/promoting investments in the lake or exploitation of its downstream benefits. To obtain answers to these issues, the study team visited a couple of institutions and stakeholders responsible for the management of the Lake including the Lake Victoria Environmental Management Project – LVEMP (see box 7.3).

Interviews and a review of documents indicate that most of the organisations involved in different aspects of the management of Lake Victoria have adopted a regional approach and as such, the existence of a shared resource has deepened further the need for regional cooperation and harmonisation of policies. This has increased the potential use of the Lake for poverty reduction that would otherwise have been difficult. However, although poverty reduction is identified as a key objective, regional integration framework is not yet implemented sufficiently to benefit the poor. This is because most of the regional institutions are too infant and under resourced to implement poverty-reducing programmes. The LVEMP is geared towards regulating fishing methods to ensure a sustainable fishing stock. These tasks have resource implications that will be too difficult to meet by a single (poor) country such as Tanzania. Pooling resources and capacity at the regional level will reduce the burden of a single country and ensure sustainable use of the Lake. Conversely, the possibility for joint intervention in the management and exploitation of the Lake may be held back by the pace in which the integration process is taking place. For instance, while LVEMP has successfully gone through its first phase of operation, the EAC has not yet secured resources necessary to sustain the LVEMP despite the fact that it is scheduled to assume management responsibility for the organisation.

Income-Generating Capacity of the Lake

Lake Victoria's role in poverty reduction can be analysed by examining the income and employment impact of artisan fishing. Interviews with various stakeholders revealed that there are some factors that limit the extent to which the Lake can be used as a tool for fighting poverty with or without the regional institutions. The artisan fishermen have a weak position in the fishing value-addition chain, they lack self-organisation and negotiation capacity which has limited the price of their produce. Large-scale fishermen have dominated some fishing sites often limiting any possible opportunity for artisan fishermen. Also, artisan fishermen have been victims of burglary and piracy in the Lake. Some of them have been caught in the interlocking contracts, while the fish processing factories supply nets and other fishing facilities on condition to sell their total catch to the factories at pre-set prices. Over-dependence on fishing as a sole source of income/employment is yet another setback. Factories have in the last 2 years been cutting jobs as a result of declining catch/fish stock. In total, the number of people employed in the fishing industry increased from 300,000 in 2000 to 500,000 in 2002 most of which include fishermen, traders and factory workers. The lake has also brought with it a number of regional NGOs that address the poverty reduction aspects although their collaboration is somewhat inconsistent and in some cases institutional conflicts exist, limiting the effects for the beneficiaries. For instance, there are notable conflicts between the LVEMP and some smaller watchdog type NGOs, especially EcoVic, both of which claim to be concerned with the common good's interests in the Lake and its sustainability.

Marine Transport in the Lake and Intra-regional Trade.

Lake Victoria offers an effective means of transporting cargo and passengers across the three countries. The main service provided by the Marine Company (MSCL) is to transport transit cargo between the three countries through Lake Victoria. This makes Lake Victoria and the MSCL strategic tools for enhancing intra-regional trade in East Africa. There is a tripartite cooperation between the railway companies in the three countries. The tripartite agreement is meant to allow the three countries to cooperate in transporting transit goods across the lake irrespective of whether the cargo originates in or is destined for the respective member country.

A few problems limit the significant role of marine transport in the Lake. These include (i) lack of adequate rail wagons compared to Kenya, denying Tanzania much business opportunity, (ii) increased competition from road transport, (iii) discrimination and undue nationalist attitude by Kenya against Tanzanian business people (for instance, Kenyan customs giving preferential duty rates to fellow Kenyan businesses) and finally, (iv) the soaring oil prices which have reduced competitiveness of Tanzania compared to Kenya's. The EAC is keen to cooperate more effectively in infrastructure development and has vowed to maintain cooperation in marine environmental management through the LVEMP.

Performance of the Fishery Sector

Fishing in Lake Victoria is principally a private sector activity and a number of export-processing firms have been established around the Lake. These firms export processed fish largely to the EU, USA, Australia, Middle East, Central and Northern America. Tanzania has taken fishery more seriously than the other countries in the region and has therefore greater potential for poverty eradication (e.g. development of fish beach communities, fishery research and quality, sustainable fishing, export ban of traditional species for domestic consumption, ban of fish trolleys). Tanzania was also the first to go on List 1 of EU quality certification. The country's fish fillet is of high quality due to the adherence to international (EU) quality standards[48]. However, the government fishery department is concerned with growing fishing levels as this may compromise the sustainability of the fishing stock. Much of the current government efforts are directed towards seeking alternative value adding industry within the fishery sector to discourage over-reliance on fish exports and promote down stream benefits.

Fish Export Royalty

Tanzania is the only of the three EAC countries that charges a royalty on fish exports (20 $ cents). Coupled with higher petrol and power prices, this additional tax on exports has made Tanzanian fish fillet less competitive. An interview with the Fishery department reveals that, the royalty was used to develop the fishing sector including the fish beach, fishery division, Research, landing sites etc. So far there has been lots of improvement in these aspects. Firms complain of the size and multiplicity of taxes including the royalty issue because they hardly see any tangible benefit of the taxes they are paying. The collected tax is not restricted for expenditure in the local area only but also because some other benefits derived from such taxes are not easily visible or tangible to the firms.

7.6.1.2 Agriculture and Environmental Programs

A study to develop a comprehensive East African Agricultural and Rural Development Strategy has been undertaken by the EAC secretariat. A committee on Agriculture and Food security has been formed and has prepared reports on policy for Agriculture and Rural Development policy and Sanitary and Phytosanitary measures

[48] Tanzania lost its market significantly in 1998 following an EU ban on imports of Nile Perch due to the occurrence of dead bodies in Lake Victoria in 1994, the outbreak of cholera in Uganda and the traces (in Spain) of salmonella in the fish fillet in 1997. After the lift of the fish export ban to EU in 2000, the export volume and value nearly doubled and this increased the fishing effort to nearly 100% of the 1999 level.

as well as guidelines for farm inputs. The report is due to be presented to the Council of Ministers in late 2004 for approval. Also a joint project for the control of trans-boundary livestock diseases and trade in livestock and livestock products is being developed by the secretariat. As a basis for these programmes, a Memorandum of Understanding on environmental management and cooperation was signed on 22 October 1998 by the three states. Subsequently, the development of a Protocol on Environment and Natural Resource Management has commenced. Currently, the Secretariat is facilitating study on the importation, manufacture, utilisation, disposal and re-cycling of polyethylene material in the region.

7.6.1.3 Social Affairs and Human Development Programs

Tanzania and Uganda are on the process of issuing national identity cards in order to enhance security control in the region and facilitate the implementation of decisions relating to free movement of people in the region. On gender issues, Regional Gender and Community Development Strategy and Programme have been developed. The East African integrated Disease Surveillance Network (EAIDSNet) will facilitate disease surveillance and collaboration in health research in communicable diseases. Funding has been secured from the Rockefeller Foundation to finance a three-year health project. In line with this, a regional programme for the control of cholera, yellow fever and HIV/AIDS have been developed.

Box 7.3 Lake Victoria Environmental Management Project (LVEMP)

The LVEMP was established in 1997 in Tanzania for the three countries as one of the projects to implement the 1992 Rio Conference supported by a grant from the World Bank and Global Environmental Facility (GEF) to the tune of $70 million for the three east African countries. Out of this, Kenya and Uganda are receiving US$24.3 and US$25.3 million respectively while Tanzania is receiving US$20.4 million.

The Philosophy of LVEMP is to avoid establishment of parallel institutions. One of the initial tasks of the project was to control the sea weed that posed a serious environmental problem to the Lake and which limited the use of the Lake (it makes water treatment too costly, limits penetration of light in the lake and obstruct movement in the water). The fishing aspect of the project addresses the regulation of fishing methods and guards against illegal fishing techniques. However, enforcement is still a challenging problem as there is a smaller workforce in Tanzania (193 people) compared to 611 employees in Kenya. Furthermore the project establishes fishing sites and Beach Management Units (BMUs); regulates deforestation, conducts/supports fishery research (to increase the fishing stock and maintain aqua culture). So far the LVEMP has managed to establish over 500 BMUs across Lake Victoria, and the government is keen to maintain and strengthen them. In fact, the EAC has embraced the idea of developing the BMUs. In addition, the project undertook soil and water conservation and micro-projects that address priority needs of the communities surrounding the lake zone. Finally the project undertakes water quality management, and supports fishery departments of the Riparian Universities as well as Capacity Building initiatives.

Some of the project's achievements include the following: About 90% of the area covered by the weed has been controlled (Most of the remaining part is that which belongs to Burundi and Rwandan part of the Lake. There is a lack of government commitment from that end), fish quality and safety assurance substantially improved, the law enforcement mechanism to curb illegal fishing has been strengthened, new species of fish feared extinct have been discovered and strategies to conserve them have been developed, Many more initiatives aimed at conserving biodiversity and genetic resources in the lake for the benefit of the riparian and the global community.

The project was scheduled to fall under the total management of EAC. The role of EAC will be to coordinate activities of LVEMP and solicit for funds and provide institutional support. It should be noted that LVEMP is a government project, which is owned by the three governments. Before establishment of the EAC the project was managed under a tripartite agreement with no legal framework, hence the regional integration has helped to consolidate the regional effort. This poses a big challenge in the sustainability of the project, as EAC does not yet have resources for funding the project's second phase. The Phase 2 of the project, scheduled for 10-15 years is still in the design stage and is likely to concentrate on environmental aspects of the Lake, applied fishery research, water movement due to climatic changes, and regulation of water quality. Therefore Phase 2 is likely to be less ambitious and smaller in focus compared to Phase 1, implying that some of the established programs (such as micro-project, capacity building, soil conservation and forestry) may cease or receive little attention. However, in the future, cooperation with other neighbouring countries of Rwanda and Burundi is essential to enhance effectiveness of the LVEMP project.

7.6.2 Socio-economic Programs/Projects in SADC

Due to a lack of detailed and good case studies of projects and cooperation programmes in SADC, we provide a short annotated list of projects for which information was made available.

Maintenance of Peace and Conflict resolution

Maintaining peace and security in the region is one of the basic SADC objectives. Various initiatives have been made; including an end of armed conflicts in Angola and DRC Congo. In addition SADC has a memorandum of understanding with UNHCR for solving refugee problems within the member states.

Disaster Management and Humanitarian Crisis

SADC and the UN have launched an appeal amounting to US$611 million to avert food crises in Zambia, Zimbabwe, Malawi, Lesotho, Swaziland and Mozambique. The member states are also working to carefully manage the Genetically Modified (GMO) food grains supplied to them by donors (in response to their appeal) in order to safeguard cultural and health considerations associated with consumption of GMO foods. These concerns are critical for poverty alleviation in the region. A strategy to systematically address the problems of floods and drought in the region was developed and approved by a Council of ministers in 2001. Six SADC member countries, namely Angola, Namibia, DRC, Mozambique, Zambia and Zimbabwe, have landmine problems, which have exacerbated poverty situations. The cost of mine removal is very high and these countries face constraints in financing such operations. SADC has responded to this problem by creating a regional Mine Action Programme for devising strategies for mutual assistance. The Regional Mine Action Database linking the affected states has been created to assist in resource mobilisation from potential donors.

Crop, Livestock and Natural Resource Development

The most pressing problems facing the agrarian sector in the region include loss of genetic biodiversity, insufficient inputs, poor technology, inadequate control and containment of plant diseases and pests. The SADC, though the Food, Agriculture and Resource Development Unit (FANR), is developing regional programmes to promote crop production, plant protection, processing, storage and monitoring plant diseases including migratory pests such as Larger Grain Borer. The SADC Seed Security Network has also developed a five-year action plan to ensure availability of quality seeds to smallholders in the region. Livestock products also play an important role in poverty reduction and food security in the region. Having recognised this, Farm Animal Genetic Resource Network Programme (FANGR) aims to support the member states at regional and national level to develop sustainable use and management of indigenous and local breeds in order to improve income generation and household food security. To ensure animal health in the region, SADC Animal Health Surveillance Network (SADC- AHSN) has been formed with staff specialists in veterinary epidemiology, animal disease outbreak investigations, and food inspection and research. These programmes will focus on policies related to food safety for domestic consumption and export, control of Transboundary Animal Diseases (TADs), and adoption of legislation that stipulate the role of the public sector in food safety.

The Protocol on Forestry was signed in October 2002. The protocol emphasises the development of an appropriate forestry industry and trade within the SADC region. The project's objective is to improve rural livelihoods through the sustainable utilisation of selected indigenous tree fruits in the semi-arid areas of the SADC region. Also, the SADC heads of state signed a Protocol on Wildlife Conservation and Law Enforcement in 1999, which seeks to establish common approaches to the conservation and sustainable use of wildlife resources. However, the Protocol is yet to be rectified by all member states.

SADC has also instituted a strategy for environmental protection and sustainable development, aiming to accelerate economic growth of the poor majority and ensure equitable and sustainable use of natural resources. Furthermore, the SADC Protocol on Environment that will commit the member states to co-operation on all issues relating to environmental protection and sustainable use of natural resources is being developed. In 1995, SADC developed a Protocol on a Shared Watercourse System whose goal is to develop, and manage shared watercourses in the region. SADC Fishery Protocol came into force in September 2003 to stimulate action by SADC member state to use monitoring, control, and surveillance tools to address Illegal Unreported and Unregulated (IUU) fishing, to address the negative effects of IUU fishing in their national Exclusive Economic Zones (EEZ).

Social and Human Development Programmes

A number of initiatives are also being pursued in the area of Social and Human Development. In order to combat high illiteracy rates in the SADC, the Protocol on Education and Training has been signed. In addition, SADC is considering the establishment of a Regional Centre that specialises in lifelong learning to address the illiteracy problem among older people. A regional proposal is being prepared to solicit funds from the Global Fund to Fight AIDS, TB and Malaria to fight pandemics of these three diseases. Other initiatives fight against these diseases including the launching of the SADC Malaria Strategy by three SADC health ministers in South Africa, and SADC's revision and strengthening of its Multi-sectoral HIV/AIDS Strategic Framework and Programme of Action 2003-2007. The latter programme aims at intensifying measures to tackle the destructive impact of the HIV/AIDS pandemic in a comprehensive manner in order to promote sustainable human development of its member states. The SADC region is facing a problem of illicit drug trafficking and abuses which are usually associated with spread of infectious diseases, corruption, and money laundering. In reaction to this, a Protocol on Combating Illicit Drugs has been signed. SADC drug committees have been formed where member states exchange drug related information. SADC provide funding and technical advice for these strategies.

7.7 Conclusions

While regional integration arrangements have existed in many parts of the world for a long time, their efficacy in changing the nature of the integration of the developing countries in the global economy and subsequently, their impact in reducing poverty has become an important subject of analysis and policy in the last decade. In most parts of Africa, a new wave of regionalisation is taking place. Whereas some regional arrangements are expanding, and others are being strengthened, new ones are also being formed. In this report, we present a case study of Tanzania as part of the larger study that aimed to identify the linkages between regionalisation and poverty either directly or indirectly through trade, investment or development cooperation channels.

While the overall conclusion is that regional integration is useful for enhancing trade performance, it should be noted that the process of regional integration in the case of Tanzania is in most cases at its initial stages (there is little evidence to attribute most of the post-regionalisation trade and investment performance to the respective regional provisions). EAC was re-established recently (Custom Union signed in March 2004), the SADC trade protocol ratified in 2000 with Tanzania withdrawing from a much older COMESA in the same year. Hence, only broad conclusions are made on the impact of regional integration on poverty in Tanzania.

The findings show that Regional Integration has increased intra-regional trade for Tanzania but not inward FDI. Regional Integration can reduce poverty particularly through increased exports of agriculture products. While regional blocs (SADC and EAC) have not been a significant source of FDI to Tanzania, generally, the efficacy of FDI in poverty reduction has been limited, among other factors, by its concentration on sectors that have few linkages to the rest of the economy (particularly FDI in the mining sector). Regional integration can also address poverty reduction through Regional cooperation on development projects/programmes, which we find to have a significant impact on poverty but limited in scope.

The limited impact of Regional Integration on poverty can be explained, among others, by the infancy of the integration process, and the fact that the Poverty challenge in Tanzania transcends the role of regional integration *per se*. For instance, since poverty in Tanzania is basically a rural phenomenon, the unfavourable economic conditions of the rural sector (lack of functioning markets, low level of skills and reliance on subsistence agriculture with constrained tradable crops) limit the benefits of regional integration to the poor. Nevertheless, the realisation of the potential for Regional integration to reduce poverty depends much on how the above conditions are addressed, more than the efforts to hasten regional integration progress.

Tanzania has a notable comparative advantage over the neighbours in the exports of food and agriculture products but a competitive advantage is required in order to maintain the current positive trends. The economy-wide competitiveness can be achieved as a combination of various initiatives, including measures to improve taxation, infrastructure, reduce high-energy tariffs and bureaucracy, and speeding up of the establishment of and compliance to quality standards. The private sector should be made conversant about the modalities and opportunities of regionalisation, as part of government's measures (if any) to support export entrepreneurship.

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Appendix 7.1: Some Investment-related Policy Reforms implemented by Tanzania since mid 1990s

NATURE OF ACTIVITIES IMPLEMENTED	FINANCIAL YEAR
The National Investment Protection and Promotion Act 1990 was reviewed to grant tax exemption upon commencement of production.	1994-1995
Minimum qualifying investment ceiling for any venture set at 10 million US dollars.	1995-1996
Investment Promotion Policy and Act 1992 were reviewed to eliminate bottlenecks hampering stead flow of investments.	1996-1997
Government promote local/foreign investors through provision of conducive investment environment.	1996-1997
Agreement reached by EAC to promote East Africa as a single Investment Centre destination.	1996-1997
Harmonize investment incentives in East Africa	1997-1998
Investors in petroleum and gas exploration not to be charged customs duty and sales tax on machinery and equipment used for oil exploration.	1997-1998
Investors in agriculture, infrastructure construction, telecommunication and human resource development be charged a small rate of 5% customs duty and 5% sales tax.	1997-1998
Investors in all other sector other than above shall be charged 10% sales tax/Customs duty.	1997-1998
Investment Act 1997 transfers tax exemption administration to TRA to enhance efficiency.	1998-1999
Investment Promotion Centre changed to Tanzania Investment Centre.	1998-1999
Tanzania grants 100% deduction on investment costs to be at par with Kenya/Uganda	1998-1999
Harmonize income tax regime for investors with TIC certificates and investors without any by allowing full capital expensing when computing tax relief.	1999-2000
Establishment and review of SADC protocol on trade to spearhead harmonization and cooperation of member states in investment and trade sectors.	2000-2001
Harmonize withholding tax rate on dividends at 10% for TIC and non-TIC certificate holders.	2000-2001
Harmonize withholding tax rates on interest at 15% for TIC and non-TIC certificate holders.	2000-2001
Limitation of the 15% Capital Allowances to mining companies on unredeemed expenditure to the existing investors only.	2001/2002
Limit the deferment of royalty to existing investors only.	2001/2002
Harmonize Immigration Act and Business Licensing Act to facilitate investors and speed up activities	2001/2002

Source: ESRF (2001)

Appendix 7.2: Some Important Trade Policy Measures implemented in Tanzania since mid 1990s

NATURE OF ACITIVITIES IMPLEMENTED	FINANCIAL YEAR
Government committed to trade liberalisation by providing a conducive environment for security bank credit.	1994-1995
Government through BOT starts buying gold and counter smuggling of minerals.	1994-1995
Export of traditional crops by private sector allowed.	1994-1995
To encourage export trade government advises the introduction of hire purchase schemes.	1995-1996
Government authorizes reciprocal arrangements for Kenya and Uganda businesses to set local agencies in Tanzania.	1995-1996
Consensus for enhancing cooperation amongst East African countries reached by agreeing on intra-regional trade and removal of barriers to easy cross-border trade.	1996-1997
Presidents from Kenya, Uganda and Tanzania signed Treaty for revival of the East African Cooperation.	1996-1997
Government pledges to enhance trade liberalisation by further lowering of tariff rates while protecting the country from becoming dumping ground of substandard and harmful commodities.	1996-1997
Local beer industry accorded protection to stimulate production volumes and employment. COMESA beer tariffs rose.	1997-1998
Polished and cut mineral stones will not be charged royalty.	1997-1998
Duty drawback scheme set up “special account” for deposit of Exporters funds. Exporters to be refunded from this account.	1998-1999
Export of scrap metal re-introduced.	1998-1999
A number of measures introduced for protection of industries.	1998-1999
Pre-shipment Inspection extended to cover Zanzibar imports.	1998-1999
Promote external sector and Export strategy devised targeting agriculture, tourism, minerals and fisheries.	1996-1997
Government abolished export-tax on traditional agricultural goods, e.g. cotton, coffee, tea, sisal, cashew nuts, pyrethrum and tobacco.	1999-2000
Tanzania effective September 2000 resigned from COMESA membership.	2000-2001
Export tax on scrap metals abolished with effect from 1 July 2000.	2000-2001
To encourage cross-border trade within East African member states, import duties between the member countries will be reduced substantially.	2001/2002
Government has abolished all taxes for drugs used by those affected by HIV/AIDS, Malaria and TB.	2001/2002
Abolish stamp duty on sale proceeds from agricultural produce.	2001/2002
District Councils to register and licence small-scale traders.	2001/2002
Maximum stamp duty on lease agreement to be at lower rate of 0.96% on Tshs. 10 millions.	2001/2002
Importation of powdered milk banned.	2001/2002

Source: ESRF (2001)

*Appendix 7.3: Flow of FDI by Country of Origin: 1998 - 2001(US$ Mill. except **)*

ORIGIN	1998*	1999	2000	2001	Total	% of Total**
EAC						
Kenya	53.7	21.1	6.5	12.5	93.8	3.2
Uganda	0.4	1.8	0.4	0	2.6	0.1
Sub-Total	*54.1*	*22.9*	*6.9*	*12.5*	*96.4*	*3.3*
SADC						
South Africa	32.4	44.3	133.5	174.5	384.7	13.2
Mauritius	70.4	16.5	4.6	3.7	95.3	3.3
Swaziland	0.2	8	1.2	2.8	12.2	0.4
Malawi	10.5	1.1	0	0	11.6	0.4
Zambia	8.6	0.6	0	0	9.2	0.3
Sub-Total	*122.1*	*70.5*	*139.3*	*181*	*513*	*17.6*
America and Australia						
Canada	96.7	78.9	0	20.6	196.2	6.8
USA	122.2	24	27.6	27.6	201.4	6.9
Australia	106.3	48.5	4	3.9	162.7	5.6
Sub-Total	*325.2*	*151.4*	*31.6*	*52.1*	*560.3*	*19.3*
Europe						
United Kingdom	313.8	30.7	24.4	82.2	451.2	15.5
France	30.2	13.1	2.3	2.2	47.8	1.6
Switzerland	28.3	9	30.8	23.8	91.9	3.2
Germany	35.1	8.5	12.2	1.2	56.9	2.0
Denmark	24	6.3	0.4	0.1	30.8	1.1
Norway	31.5	5.5	1.6	4.6	43.2	1.5
Netherlands	106.4	5.5	1.7	58.5	172.2	5.9
Italy	68.1	3.5	1.5	1.2	74.3	2.6
Sweden	24.5	3.5	4.1	5.4	37.5	1.3
Luxembourg	16.5	0.6	0	2.4	19.4	0.7
Japan	6.5	0.4	16.8	0	23.7	0.8
Isle of Man	13	0.1	0	1.6	14.7	0.5
Sub-Total	*697.9*	*86.7*	*95.8*	*183.2*	*1063.6*	*36.7*
Rest of Africa and World						
Ghana	265.1	162.7	0	1.5	429.3	14.8
Lebanon	1	6.4	0	0.9	8.3	0.3
Saudi Arabia	4.1	6.1	0	0	10.2	0.4
Bermuda	61.2	5.3	0	0	66.5	2.3
Foreign-Not Specified	3.7	4.1	0.2	1.3	9.3	0.3
Malaysia	40.5	3.7	0.1	1	45.4	1.6
Panama	1	2.4	0	5	8.4	0.3
China	9.9	0.8	1.9	1.5	14.2	0.5
United Arab Emirates	2.2	0.6	2.2	0.3	5.4	0.2
India	4.7	0.5	1.5	1.8	8.5	0.3
Sub-Total	*393.4*	*192.6*	*5.9*	*13.3*	*605.5*	*21.0*
Grand Total	**1592.7**	**524.1**	**279.5**	**442.1**	**2838.8**	**97.9**

* 1998 represent FDI stock, and the subsequent years are flows. ** Total does not add up because of rounding-off errors and omission of countries with insignificant value of FDI.

Source: Tanzania Investment Report & TIC (2002)

Appendix 7.4.1: Exports to COMESA, SADC and EAC countries: 1995 - 2002 (US$ mill.)

Country	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
Angola	0.04	0.00	0.16	0.03	0.23	0.35	0.51	1.38
Botswana	0.02	0.03	0.07	0.27	0.21	0.09	0.23	0.04
Burundi	0.03	0.58	0.85	0.34	3.88	6.24	6.75	6.92
Comoros	0.00	0.01	0.00	0.05	0.01	0.05	0.02	0.35
DRC	3.32	4.12	8.75	4.69	8.10	4.87	8.66	15.64
Eritrea	0.00	0.00	0.40	0.00	0.00	0.03	0.34	0.23
Ethiopia	0.24	0.00	3.77	0.51	0.38	0.39	0.73	0.37
Kenya	23.47	8.99	25.49	27.96	21.59	31.53	38.41	34.90
Lesotho	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Madagascar	0.01	0.01	0.04	0.00	0.04	0.10	0.67	0.68
Malawi	0.01	1.51	5.53	3.54	7.65	7.52	5.87	17.54
Mauritius	0.40	0.11	1.37	0.00	0.16	0.20	0.33	0.29
Mozambique	0.12	0.01	0.29	0.13	0.74	1.51	1.50	1.61
Namibia	0.01	0.00	0.01	0.06	0.35	0.15	0.04	0.03
Rwanda	3.93	1.48	6.25	4.23	3.15	2.10	2.85	3.82
Seychelles	0.00	0.00	0.00	0.58	0.03	0.05	0.03	0.28
South Africa	0.51	2.10	8.38	6.23	6.75	11.52	8.95	16.32
Sudan	0.78	0.20	1.60	0.34	0.17	0.29	0.24	0.27
Swaziland	0.00	0.06	0.24	0.03	0.20	0.21	0.00	0.37
Uganda	5.94	4.04	7.38	6.59	5.00	8.39	5.64	5.42
Zambia	4.12	1.50	2.17	3.62	3.45	5.59	6.09	17.23
Zimbabwe	0.47	0.93	16.71	13.06	2.80	2.68	0.44	1.39
Total	43.44	25.70	89.47	72.26	64.88	83.84	88.29	125.08
Over all exports*	**679.20**	**785.20**	**752.50**	**588.50**	**543.20**	**663.20**	**776.40**	**902.50**

Source: Own computation based on Customs data from Tanzania Revenue Authority (various years).

Appendix 7.4.2: Imports from COMESA, SADC and EAC countries: 1998 - 2002 (US$ mill.)

Country	1995	1996	1997	1998	1999	2000	2001	2002
Angola	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Botswana	0.33	0.10	0.05	0.22	0.18	0.70	0.16	0.26
Burundi	0.26	1.91	0.55	0.05	0.02	0.01	0.01	0.01
Comoros	0.00	0.01	0.00	0.00	0.00	0.00	0.00	0.00
DRC	0.00	0.00	0.00	0.47	0.14	0.11	0.21	0.37
Eritrea	0.00	0.00	0.00	0.01	0.02	0.19	0.14	0.06
Ethiopia	0.13	1.21	0.26	0.81	0.87	3.12	0.54	0.68
Kenya	69.91	92.82	89.42	108.20	102.93	89.49	92.63	90.08
Lesotho	0.01	0.21	0.23	0.38	0.03	0.00	0.00	0.00
Madagascar	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00
Malawi	2.50	2.85	2.06	2.30	3.73	1.80	2.04	1.44
Mauritius	0.64	3.00	0.48	0.74	3.31	2.43	3.14	1.73
Mozambique	6.48	10.10	3.77	5.41	0.03	0.13	0.43	0.03
Namibia	0.00	0.03	0.13	0.18	0.26	0.20	0.19	0.62
Rwanda	0.07	0.52	0.39	0.29	0.01	0.14	0.08	0.04
Seychelles	23.08	20.65	17.28	0.02	0.10	0.01	0.01	0.00
South Africa	96.80	71.56	85.19	127.35	189.68	159.42	180.16	177.17
Sudan	0.01	0.00	0.03	0.17	0.02	0.34	0.05	0.11
Swaziland	0.40	1.64	8.95	11.44	12.89	12.74	12.68	15.48
Uganda	0.33	3.65	2.02	2.17	8.12	5.52	11.34	2.38
Zambia	7.68	8.94	4.07	16.97	7.57	2.39	1.60	4.30
Zimbabwe	17.82	2.08	4.12	14.43	6.33	4.22	3.00	1.99
Total	226.46	221.31	219.01	291.63	336.25	282.96	308.42	296.75
Overall imports	**1340.95**	**1210.95**	**1320.30**	**1588.70**	**1572.80**	**1533.90**	**1714.40**	**1658.40**

Source: Own computation based on Customs data from Tanzania Revenue Authority (various years).

Appendix 7.4.3: Trends in Intra and Extra Regional Exports (1995 – 2002)

Year	1995	1996	1997	1998	1999	2000	2001	2002
(A) Value of Total Exports (US$ mill.)								
Intra-regional exports	43	26	90	72	65	84	88	125
Extra regional exports	636	760	663	516	478	579	688	777
Total exports	*679*	*785*	*753*	*589*	*543*	*663*	*776*	*903*
(B) Share of the Value of Total Exports (%)								
Intra-regional exports	6	3	12	12	12	13	11	14
Extra regional exports	94	97	88	88	88	87	89	86
Total exports	*100*	*100*	*100*	*100*	*100*	*100*	*100*	*100*
(C) Value of Agricultural exports (US$ mill.)								
Total Intra Regional agric. exports	22	12	22	32	22	32	41	64
Extra Regional Agric. exports	303	99	296	359	318	309	270	280
Total Agriculture export	*325*	*111*	*318*	*391*	*340*	*341*	*311*	*344*
(D) Share of agriculture products in Total exports (%)								
Intra-regional exports	51	46	24	44	34	38	47	51
Extra regional exports	48	13	45	70	67	53	39	36
Total exports	*48*	*14*	*42*	*66*	*63*	*51*	*40*	*38*

Source: Own computation based on Customs data from Tanzania Revenue Authority (various years).

Chapter 8 Conclusions

Dirk Willem te Velde

Regional integration can affect poverty in a variety of ways (see chart 1.1). In order to assess how regional integration (RI) affects poverty, Te Velde, Page and Morrissey presented a theoretical framework in part I. The starting point of this was that trade, investment, migration and other provisions can each affect trade, investment and migration.

RI can affect poverty at country level a number of ways:

- *Route 1* through the volume and poverty focus of trade
- *Route 2* through the volume and poverty focus of investment
- *Route 3* through the volume and poverty focus of migration
- *Route 4* through other routes

We found there were four basic steps to assess each route:

- *Step 1* Identify relevant provisions on trade, investment and migration
- *Step 2* Identify the effect on the volume and poverty focus of trade, investment and migration
- *Step 3* Identify how this change in volume and poverty focus maps onto poverty
- *Step 4* Identify how complementary conditions affect the relationship between the change in volume and poverty focus and poverty

There are a number of expected and sometimes actual effects for the above links which provides a better understanding of how regional integration affects poverty. Empirical findings from the literature included:

- RTAs boost intra-regional trade through tariff reductions; several studies find that many regions are trade creating, but regions such as the EU and EFTA may have been trade diverting.
- Standards and very strict rules of origin may decrease intra-regional trade because the region may not have the appropriate processing capacity or tariff preference take-up because it may be costly to obtain relevant certificates. Overlapping membership of more than one region may add to the confusion. Effects can also interact: Rules of origin are likely to be more relevant if intra-regional tariff rates are substantially lower than extra-regional tariffs.
- RTAs are likely to lead to increased FDI from outside the region; various RTAs have led to net investment creation.
- The effects of increased trade and FDI depend on complementary conditions such as provision of education.
- Despite these positive indications, any effect through trade, investment and migration provisions in developing country regions is likely to be small in the aggregate for various reasons. This is because share of intra-regional trade in total trade in developing regions is small (e.g. 15%) and trade (average of

export and imports) is usually not more than 30% of GDP. So regional trade is only around 5% of GDP. In addition, of the 21 percentage point cuts in average weighted tariffs of all developing countries between 1983 and 2003, unilateral reforms accounted for the majority followed by multilateral commitments leaving just 2 percentage points (10% of the 21 percentage points) due to regional agreements.

- Similarly, intra-regional inward FDI is low; although it is 'only' 25% in SADC, several SADC countries depend for more than 50% of FDI from South Africa. While intra-regional migration as a share can be high in MERCOSUR (26%) or ANDEAN (53%), migration as such is usually (except for small 'migration countries') low and less than 1% of the population.
- On the other hand, there can be non-static effects. Increased trade and investment can lead to faster economic growth and poverty reduction particularly when trade lead not only to increased allocative efficiency but also increased competition and productivity in the long-run. These dynamic effects of regional integration are difficult to measure, but equally should not be assumed away. There is some limited evidence that trade and investment induced by regions boost productivity (e.g. regional exporters pay higher wages than domestic firms in Tanzania) and product variety and availability (e.g. in times of country specific droughts). While such dynamic effects are more likely when liberalising multilaterally, to the extent that regional integration drive up productivity, regional integration might help firms to prepare for multilateral liberalisation.

The regional integration effects through merchandise trade are thus likely to remain limited in regions amongst poor countries with similar production structures, so expectations that this would lead to large development benefits should be tempered. While there may well be dynamic effects and these can be more important than static effects, the evidence of this remains hitherto limited, and it needs to be shown whether dynamic effects from regional integration support dynamic effects from multilateral integration.

The chapter by Te Velde and Fahnbulleh in Part II shows that regions differ in two fundamental respects:

- *Over time* when one region can change or add investment related provisions
- *Across regions* when investment related provisions differ at one single point in time

Evidence shows that investment related provisions in key regions differ significantly, including differences in

- Extent of regional tariff preferences
- Restrictiveness of Rules of Origin
- Investment rules, including national treatment for pre and post establishment and presence of effective dispute settlement mechanisms
- Regional co-ordination on investment
- Type of membership: North-North, South-South, North-South, South-South-North.

The effects of regional integration on investment (from outside the region) are positive, but the benefits are likely to be distributed unequally across the region. The poverty effects through trade and investment do not only depend on the depth of the integration process, but more likely on the complementary conditions that countries put in place.

Case studies of Bolivia and Tanzania in part III tested the mapping structure set out in part I, moving beyond effects at regional level to poverty effects at country level. For Bolivia, new evidence by Nina and Andersen shows that regional integration has affected the trade composition of Bolivia, geographically towards more trade with ANDEAN and MERCOSUR, and sectorally from minerals towards vegetable fats, food and beverages. However, total trade as % of GDP has not increased mainly due to supply constraints in Bolivia, so that capacities to trade are important in benefiting from regional integration. This shows the importance of complementary conditions. Lower regional tariffs have led to cheaper imports, but since just 8% of the consumption by the poorest part of the population are imported goods (and some of this is not from the region) the impact on poverty through a trade price effect has been weak. To the contrary, data on the pattern of employment across sectors and over time support the idea that regional integration may have hurt domestic producers. This is because a large proportion of imports from ANDEAN and MERCOSUR competes with local producers. On the other hand, while increased exports may not have led to higher wages in manufacturing sectors, it did raise incomes in the mining, hydrocarbon and modern agriculture sectors.

Kweka and Mboya aregued in Chapter 7 that regional integration has increased trade in Tanzania. Regional trade has a better poverty focus than other trade, i.e. it comprises products that involve the poor more directly. RI may not have affected FDI, but conversely FDI may actually have affected regional integration processes: Tanzania is part of SADC, not COMESA, and has important commercial links with South Africa. The effects of RI on poverty through trade and investment have been limited. This is not necessarily due to limited progress in the regional integration process, but rather due to capacity constraints particularly in areas where the poor live. On the other hand, The East African Development Bank has provided regional public goods including socio-economic projects and environmental projects related to Lake Victoria. These projects reduce poverty, but while the initiatives are significant they remain limited in scope. While it is too early to evaluate fully such initiatives, it is an encouraging sign that regional integration can benefit the country through non-trade/investment/migration routes.

In conclusion, while this book remains cautious about the first three routes to how poverty could be affected (trade, investment and migration), there might be important effects in the fourth route (direct route from regional integration to poverty – the curved arrow in chart 1.1). Regional integration can affect poverty by including regional socio-economic projects and other types of integration, e.g. in providing infrastructure or generally regional public goods. Regions seem also well placed to tackle liberalisation of sensitive services sectors. In this sense, the type and scope of the regional integration process may matter a lot for poverty reduction. Several regions have widened the scope beyond trade and investment. SADC, for instance, has created a Southern Africa Transport and Communications Commission to implement its transport protocol.

A final note of caution relates to negotiating capacities and incentives to engage in multilateral liberalisation. Regional integration processes affect the incentives to engage in multilateral integration (particularly N-S, but also S-S). When some countries have acquired tariff preferences they would like to keep these, and perhaps understandably may prevent further multilateral liberalisation which would erode the preference margin. More attention should therefore focus on what areas fall within the competencies of regions (e.g. regional public goods) and how to ensure a country does commit to and benefit from regional integration in a way that does not oppose multilateral trade liberalisation later. Regional integration processes, just as other integration processes, require government capacities. Normally, national policy is more important than any trade policy in development, so countries should avoid being diverted excessively to trade, especially to a small portion of total trade, as in most developing country regions. Thus there needs to be a better understanding of which negotiating capacities are transferable and useful for both regional and multilateral (e.g. national baselines of services liberalisation as proposed by COMESA) and which are not (e.g. time spent in meetings).

INDEX (to be done)