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EAST AFRICAN ECONOMIC UNION:
AN EVALUATION AND SOME
IMPLICATIONS FOR POLICY

Benton F. Massell
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PREFACE

This study is part of a program of research supported by The RAND Corporation on the problems of economic growth in newly developing countries. It examines the gains from East African economic integration in terms of the present performance of the East African common market as well as in terms of a course of action that East African states might choose to adopt.

Parts of the study were made available in preliminary form as a background paper for the Conference on Public Policy, held in Nairobi, Kenya in November 1963. In addition, the material in Section II was presented to the Technical Assistance Seminar at the California Institute of Technology, and the material in Section III was presented at the October 1963 meetings of the African Studies Association in San Francisco.

The field work for this research was undertaken by the author during a one-year visit to East and Central Africa. The author is indebted to A. L. Adu, former Secretary-General of the East African Common Services Organization (EACSO), and to L. W. Clarke, former Director of the East African Statistical Department, for their cooperation and for their kindness in making available to him the facilities of EACSO. He is indebted also to the many other officials in EACSO and in the three East African states who gave generously of their time.

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SUMMARY

An East African common market, composed of Kenya, Uganda, and Tanganyika, has been in existence since 1922. In the present study, an attempt is made to (1) assess the gains and losses resulting from the operation of this common market, both from the point of view of East Africa as a whole and that of the three participant economies individually; (2) consider the gains likely to result from continuation of the common market, in either its present or an expanded form; and (3) evaluate several measures that might improve the performance of the common market and suggest a course of action the East African governments might follow.

The common market has resulted in net gains to East Africa because of trade creation, factor mobility, economies of scale, and external economies. These gains have offset any losses that may have arisen as a result of trade diversion. Economies of scale have probably been of especial importance in East Africa and have undoubtedly contributed to the inflow of foreign capital and to the rise in interterritorial trade that has characterized recent East African development.

Kenya has realized a large share of the gains from the economic union and will doubtless continue to gain in relation to Uganda and Tanganyika in the near future. But if Kenya is prepared to compensate Uganda and Tanganyika, then all three countries will be able to derive significant economic gains from continuing the common market arrangements. From an economic standpoint, it would be better for this compensation to take the form of fiscal redistribution and to be integrated with over-all economic planning in the area.

To realize the full potential of the common market, it is important to take deliberate policy measures to promote increased trade based on specialization of production. Towards this end, it would be useful if the East African countries could achieve a greater coordination of their economic policies. It would be especially desirable to establish a regional planning authority, perhaps building
on the structure already provided by the East African Common Services Organization. A regional organization charged with responsibility for planning development on an East African basis could have a tremendous impact on the region's rate of economic growth.

A Greater East African common market -- one including, in addition to East Africa, several of the contiguous countries -- would offer only marginal short-run gains, but would possibly make a great deal of sense in the long run. One prerequisite is a systematic improvement of the transport network connecting East Africa with the neighboring states. The objection to enlarging the common market is the danger that this might dilute, and thus weaken, the present group. It would be preferable to enter into specific economic ventures with the nearby countries and at some later date try to incorporate these countries into an East African common market.
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I. INTRODUCTION

An East African common market, composed of Kenya, Uganda, and Tanganyika, has existed since 1922. Although most Kenya government officials have strongly favored the continuation of the common market during this period, many officials in Uganda and Tanganyika have been decidedly less enthusiastic about its continuation.

Those who argue in favor of maintaining economic union in East Africa base their argument largely on the expansion in the market for manufactures and the increased economic well-being brought about by economic union. Opponents tend to argue that, although Kenya has doubtless derived substantial economic gain from the present arrangements, it is less clear that Uganda and Tanganyika have come out ahead. Perhaps either or both of these countries, it is suggested, might achieve more rapid economic development by denying Kenya free access to their markets.

Although the debate over the gains from the East African common market continues, another debate has recently arisen: If the common market is continued, should it also be expanded to include some of the neighboring countries? Northern Rhodesia, Congo, Zanzibar, 

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1In 1917, Kenya and Uganda formed a common market into which Tanganyika was gradually introduced between 1922 and 1927.

2The terms "common market" and "economic union" are used interchangeably in this study, and "economic integration" is used to denote the formation of a common market.


Ethiopia, and others have been mentioned as possible new members. During 1963 there have been several discussions between political leaders in East Africa and in several of the contiguous states concerning possible measures for economic integration of these countries with East Africa. Again, the argument for such a move relates largely to the expanded market for manufactures which would result.\footnote{There has also been public discussion on the possible formation of an East African political federation. This point will be considered briefly in Section VI.}

The present study attempts to (1) assess the gains and losses that have resulted from the East African common market, both from the point of view of East Africa as a whole and from that of the three participant economies individually;\footnote{For other discussions of economic union in East Africa, see the Reisman Report, \textit{op. cit.}; T. A. Kennedy, the works cited above; W. A. Jalango-Ogumi, \textit{Some Unsettled Questions on the Economics of Integration in East Africa}, Harvard University Honor's Thesis, 1962; I. C. Stewart, "Customs Union in East and Central Africa," \textit{Scottish Journal of Political Economy}, February 1962, pp. 65-72; A. J. Brown, "Economic Separatism versus a Common Market in Developing Countries," Parts I and II, \textit{Yorkshire Bulletin of Economic and Social Research}, May and November 1961, pp. 33-40 and 88-96, respectively; P. K. Lomas, "The Report of the East Africa Economic and Fiscal Commission" (Review Article), \textit{The East African Economics Review}, Vol. 8, No. 1, June 1961, pp. 14-23; K. G. V. Krishna, "Some Economic Aspects of an East African Federation," \textit{The East African Economics Review}, Vol. 8, No. 2, December 1961, pp. 99-110; and "Planning and Economic Development," \textit{The East African Economics Review}, Vol. 9, No. 1, June 1962, pp. 48-52; \textit{The Economic Development of Uganda}, \textit{op. cit.}, pp. 82-95 and 295-296.} (2) consider the gains likely to result from continuation of the common market, in either its present or an expanded form; (3) outline several measures that might improve the performance of the common market. Where relevant data were available, I have tried to make inferences from these data concerning the effect of economic union on the level and utilization of resources in East Africa. Where such data were not available, the focus has been instead structuring on the problem to bring the relevant issues more clearly to mind.

By removing some impediments to trade among two or more countries, a common market alters the set of relative prices facing both consumers
and producers in the common market area.\(^1\) As a result, a change in
the patterns of both consumption and production can generally be
expected. Although the change in the consumption pattern in East
Africa may be inconsequential, the alteration in production is likely
to be of considerable consequence.

Governmental production decisions, because they do not reflect
the operation of market forces, are unaffected by the common market.
Strictly speaking, the common market per se affects resource alloca-
tion, and hence economic welfare, only to the extent that it is per-
mitted to influence the investment decisions (including decisions to
disinvest) that determine the pattern of production in the area.
Since market forces typically influence investment decisions in the
private sector, but not (at least not to the same extent) in the
government sector, a common market is likely to have a more profound
effect on resource allocation in an economy with a relatively large
private sector.

Even within the private sector, only a limited class of invest-
ment decisions is affected by economic integration. For example,
investment in an enterprise that is intended to produce largely or
entirely for export may not be affected.\(^2\) With respect to an indus-
try producing for the local market, if the effective barriers to trade
are not those eliminated by the common market, then clearly the common
market will have no effect. The effect of economic integration on
the allocation of resources will depend, then, not only on the impor-
tance of the private sector, but also on the extent to which new
investment is geared to production for local consumption, and on the
effectiveness of the constraints removed by economic integration.
It follows that economic integration can be increased in effectiveness

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\(^1\)A relatively complete bibliography on the subject of economic
unions appears in Bela Balassa, Economic Integration, Irwin, 1961,
Homewood, Illinois. See also the bibliography at the end of this
study.

\(^2\)Even if a firm produces solely for export, however, its costs of
production may be lowered by the external economies resulting from
economic integration.
if it is accompanied by an appropriate set of government policy measures that reinforce rather than conflict with the operation of the common market. In this study a distinction will be made between the gains arising from the common market per se and those arising from policies aimed at supplementing the operation of the common market. This study will refer to the latter class of forces as the institutional environment in which investment decisions are taken in East Africa.

Discussion will be limited to the effect of economic union on investment in manufacturing. This is not because of an assumed unimportance of the agricultural and mining sectors, nor because economic development is identified with industrial development. Rather, the development of the primary producing sectors in East Africa is assumed not to have been (and not likely to be) significantly affected by the existence of an East African common market. The common market will exert some effect on the allocation of resources in agriculture and mining, but this effect will probably not be of great importance, because these sectors are geared largely to production for markets abroad, which will not be affected by economic integration in East Africa. It may be true that some of the resources released from manufacturing may be used in part in the agricultural or mining sector; but this result, if it occurs at all, is likely to be unimportant in East Africa.

Excluding the public sector, agriculture, and mining, industry producing for export, and industries that are otherwise unaffected by the existence of an economic union, leaves a very small proportion of East African economic activity directly affected by the common market. Nevertheless, the common market may have indirect effects of equal or greater magnitude than its direct effects. If, for example, there is substantial unemployment in East Africa, then there

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1 Similarly, commerce, finance, construction, and utilities are unlikely to be significantly and directly affected by economic integration, although there may be indirect effects of some importance.

2 For example, industries that produce at their least cost output in the market of a single country may not be affected by economic integration.
may be secondary, or derived, benefits from economic integration that affect industry, agriculture, and commerce, as well as government revenue.

In evaluating the relative advantages and disadvantages of continuing the East African common market, it is important to consider the gains provided by the common market for East Africa as a whole and the distribution of these gains among the three participants. Section II considers the area as a whole, and finds that economic integration in East Africa has resulted in gains that have not been offset by comparable losses. Moreover, evidence suggests that this situation will continue if the common market is maintained.

Section III considers the distribution of the gains among the three member states. The findings of this section suggest that Kenya has gained in relation to Uganda and Tanganyika. Whether and to what extent Uganda and Tanganyika are better off economically as a result of the common market resolves, then, into a question of whether the gains to the area as a whole are sufficiently great to offset the relative loss that economic integration may mean to these two countries. Although the analysis presented in Section III is not conclusive, it does suggest that the gains to Uganda and Tanganyika from continued association with Kenya are likely to be only marginal. This tentative conclusion is based only on a consideration of the common market per se; a redistribution by the three governments of the gains from economic integration can redress the balance in favor of Uganda and Tanganyika.

Section IV deals with the policy issues confronting the East African governments relating to the need to find a set of measures that will effect a satisfactory trade-off between the equally important objectives of increasing the gains from economic integration to the area as a whole and ensuring that the gains to each participant state are sufficiently great to make economic union an attractive alternative to autarky. Kenya must devise an appropriate scheme for compensating Uganda and Tanganyika to persuade them to continue the
common market arrangements and to adopt the policies that will make economic union a success.

Section V considers the issues involved in extending the East African common market to include one or more of the neighboring countries. The analysis suggests that the gains from enlarging the common market at the present time may be outweighed by the costs of doing so. However, there may well be scope for such a move at a later date.

Finally, Section VI brings together the results of the preceding analysis, summarizes the conclusions supported by this analysis, and presents some policy suggestions.
II. THE GAINS FROM ECONOMIC UNION

INTRODUCTION

In his classic survey of customs union theory, R. G. Lipsey distinguishes among five ways in which a customs union can affect the welfare of the participating nations: "(1) specialization of production according to comparative advantage ...; (2) economies of scale; (3) changes in the terms of trade; (4) forced changes in efficiency due to increased foreign competition; and (5) a change in the rate of economic growth."¹

With respect to East Africa, (3) and (4) are unlikely to be of much significance. Both (1) and (2) are important, however, and will be discussed below. Lipsey does not expand upon (5), and it is therefore unclear what he intends this to relate to. It is likely, however, that (5) relates to the inflow of foreign capital stimulated by the formation of a customs union, and this point will also be considered below, as part of the discussion of economies of scale.

A common market is distinguished from a customs union by the provision for free factor mobility. Consequently factor mobility will be discussed in addition to the three points mentioned above. Finally, there will be a brief discussion of external economies.

SPECIALIZATION OF PRODUCTION

As noted above, the formation of a common market may, by altering the pattern of incentives governing investment decisions, affect the allocation of resources within the region. Two countries with different resource endowments and correspondingly different patterns of comparative costs are likely to benefit from trade based on inter-country specialization. However, in the presence of artificial restrictions on trade, such as tariffs, trade may not occur. The

elimination of some of the artificial restrictions on trade permits the development of specialization and, as a consequence, may result in a more efficient pattern of resource utilization. Formation of a common market may enable a greater quantity of goods to be produced with the given resources of the area.

As an illustration, consider the formation of a common market between Countries A and B. As a result of the elimination of tariffs on trade between the two countries, Country B may find that some commodities that it previously manufactured itself can be obtained more cheaply from Country A. From the point of view of the two countries considered together, it is more economic for B to let A produce these goods for both countries, thereby releasing resources in B for other, more economic, uses. Country B may find that it has a comparative advantage in the production of other commodities, which it, in turn, can provide for the entire common market area. Or B may expand its exports to Country C (not in the common market), enabling A, in turn, to increase its imports from Country C. In either case, the common market area as a whole gains as a result of the participant economies' exploiting opportunities for specialization of production based on comparative advantages -- opportunities previously denied by virtue of the tariff barriers to trade. This phenomenon is termed "trade creation" and constitutes one important source of gain from economic integration.

On the other hand, a common market may also bring about "trade diversion." This occurs if the economic union results in the uneconomic substitution of locally produced goods for products that, in the absence of the common market, would be imported from a lower cost source. For example, consider a commodity produced in Country A for $50 but in Country C for $45. Without a common market, Country B imposes a $10 tariff on imports of the product from either A or C. It is consequently cheaper for consumers in B to buy the good from C. But if A and B form a common market, consumers in B can then purchase the product from A for the $50 cost of production, whereas the same
product imported from C would cost $55 ($45 cost of production plus $10 import duty). In this example, B buys the product from A instead of from the lower cost supplier outside of the common market.

In general, it is impossible to evaluate the welfare effects of a common market, because shifts in production are likely to be accompanied by shifts in consumption. Or, put differently, although trade creation and trade diversion can be regarded as intercountry substitution (for example, substitution of Country B's products for those of Country C), there may also be intercommodity substitution.\footnote{Ibid.} Because economic integration changes relative prices, consumers may substitute a product whose price declines for one whose price rises. When both consumption and production effects are considered, it becomes impossible to say in general whether the welfare effects of economic integration are likely to be positive or negative.

In the case of East Africa, it seems reasonable to regard intercommodity substitution as of secondary importance at most; and, in the absence of intercommodity substitution, trade creation has been shown to be beneficial and trade diversion to be harmful.\footnote{Ibid., pp. 496-499, and the works cited therein.} As noted above, trade creation results in a more efficient use of the area's resources, whereas trade diversion results in a waste of resources and, consequently, a net loss to the common market area.

This argument assumes that the inputs used in the production of the commodity in question have an opportunity cost that is accurately reflected by the factor prices, whereas in many underdeveloped countries -- and notably in East Africa -- this is not the case. In East Africa, the social opportunity cost of labor may in some cases be zero, or nearly zero, even though relative factor prices may fail to reflect this fact. In this situation, some trade diversion may be less uneconomic than suggested by a consideration of factor prices. Although Uganda may pay more for products from Kenya than from overseas,
employment in Kenya may receive a boost, thereby offsetting (at least, in part) the higher cost of the product. By the same token, with unemployed labor, the gains from trade creation are reduced. Nevertheless, it seems reasonable to regard trade creation as being on balance beneficial to East Africa and trade diversion as providing a loss. This is particularly true if one considers the long term impact of economic integration on the area. This long term effect is likely to be of the greatest consequence to the region.

According to established theory, trade creation (and thus a gain in welfare) is more likely "the greater is the degree of overlapping between the class of commodities produced under tariff protection in the ... countries (forming the common market)." According to this criterion, the East African common market has made and continues to make a great deal of sense. It is true there was little local industry in East Africa at the time the common market was formed. But it does not necessarily follow that the growth of trade within East Africa during this period has been trade diverting. The distinction to be made is between the situation that obtained when the common market was formed and the one that would have obtained now in the absence of a common market. Although only the former can be observed, the latter is relevant to the distinction between trade creation and trade diversion.

It is reasonable to suppose that some industry would have been formed in the three East African countries even in the absence of economic union. Without a common market there would have been less trade among the three countries, and more local industry would have been geared to the market of a single country. To the extent that new investment in East Africa has substituted for investment that would have occurred at any rate, but that would have served only a single national market, this investment must be classed as trade creation. As the three East African states began with essentially similar

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1Ibid., p. 499.
resource endowments, there is a presumption that production would have followed roughly the same lines in all three, and that the common market has therefore resulted in a net gain, a rough indication of which is the growth of interterritorial trade during this period.\(^1\)

With respect to the future prospects of the common market, again one would suspect that trade creation would be more important than trade diversion. The process of economic development in this area is certain to bring about an expansion in the industrial sector. In the absence of a common market, the East African countries are likely to develop the same industries, notably light consumer goods manufactures. But with an effective common market, there is greater scope for establishing industries within the area according to comparative advantage, and developing trade based on specialization.\(^2\)

The prospective gains from trade creation, however, are not likely to be large in East Africa. It has been demonstrated that, given a net gain from common market operations (that is, the gains from trade creation outweigh the loss from trade diversion), "... the more the economies differ the greater the gain from Union."\(^3\) Although trade creation is more likely than trade diversion in East Africa, the gains from trade creation are likely to be limited in view of the basic

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\(^1\)What differences in resource endowments do exist result in large measure from the externalities that industrialization in Kenya has provided for that country. It is true, however, that the presence of a larger European population in Kenya has contributed to Kenya's having a somewhat different pattern of demand, but this is likely to be of much less significance in the future than it has been to date. The growth of interterritorial trade may also reflect the presence of economies of scale, discussed below, in which case it will provide a gain a fortiori. See Table 5, below, for figures on interterritorial trade.

\(^2\)Even with the common market, there has been a great deal of duplication among countries. But with a coordinated economic policy, East Africa can reduce or eliminate this duplication. It can also eliminate trade diversion. These points are discussed in Section IV.

similarity in resource endowments of the three countries. With respect to this aspect of economic integration in the East African case the best that can be concluded is that the East African common market has resulted in some gains, and is likely to continue to do so, but these gains are probably not of great quantitative consequence. A significant growth in interterritorial trade (that is, trade within East Africa) may in fact reflect only marginal improvements in the efficiency of resource use. At a later date, however, trade creation may offer substantially larger gains.

FACTOR MOBILITY

Another possible consequence of economic integration, also resulting in a greater efficiency of resource use, is factor mobility. For example, if the wage rate is higher in Country A than in Country B, migration from B to A will tend to equalize the returns to labor in the two countries, creating a net gain to the area as a whole. From the point of view of the area as a whole this effect must be beneficial.

There are few restrictions on labor mobility across national boundaries in East Africa, so economic integration is unlikely to affect resource use appreciably in this respect. Moreover, the gains from labor migration are reduced as a result of the existence of underemployed labor in all three East African economies. But a common market also affects the mobility of capital and, in this sense, may be expected to contribute to a more efficient allocation of the region's resources. East Africa may benefit from mobility of capital from Uganda and Tanganyika into Kenya, but this has not been an important factor in the development of the area thus far.

ECONOMIES OF SCALE

The arguments thus far have been based on some discrepancy in comparative costs among the countries forming an economic union. If the resource endowments of these countries are identical, then neither
trade creation nor factor mobility will provide a gain.\textsuperscript{1} But, even in this case, economic integration may give rise to economies of scale which may, in turn, result in an increased inflow of foreign capital; and these factors are likely to provide a gain to the area.

Economies of scale arise from the presence of an inverse relationship between the average cost of production and the scale of operations in some industries, or in firms within an industry, and are manifested in one of three ways: Industrial consolidation, industrial expansion, and new industries.

\textbf{Type 1 -- Industrial Consolidation Economy of Scale}

Consider a common market formed by two countries. Economic integration may enable an industry operating in both countries to consolidate operations in one plant, which then supplies the markets of both countries, and consequently operates at a larger scale of output than either plant did before. If the establishment has a declining cost curve in the relevant range, the average cost of producing the commodity declines as a result of the consolidation. This type of economy of scale may look like trade creation, but there is an essential difference. In the case of economies of scale, there are gains even when comparative costs in the two countries are identical; it is arbitrary which country produces the commodity -- the gains result from production being concentrated in either country. Of course, this type of economy of scale and trade creation may go hand in hand, in which case the gains are compounded. This situation would arise if trade creation occurred in an industry that also has a declining cost curve.

\textbf{Type 2 -- Industrial Expansion Economy of Scale}

An industry previously existing only in Country A, and not selling in Country B's market, may, as a result of economic integration,

\footnotesize{\textsuperscript{1}There may still be what one can term "dynamic trade creation" -- that is, the development of economies along complementary lines based on an emerging pattern of interdependence. Moreover, as noted above, there may be gains if the countries have different preference patterns.}
expand its operations and supply the markets of both countries. In the absence of a declining cost curve, this would merely be trade diversion. With a declining cost curve, however, this amounts to an economy of scale possibly (but not necessarily) compounded with trade diversion. A pure case of this type of economy of scale would arise if the gains from the new pattern of trade more than offset the cost of Country B's purchasing the commodity from the higher cost producer, Country A. Country A can never produce the commodity cheaper than Country C (the previous supplier), for, were this the case, A would be supplying B's market even without an economic union. But it is possible that the increased cost to Country B is more than offset by the reduced cost to Country A.¹ A mixture of type 2 economy of scale and trade diversion could involve a net loss to the common market area, with the gains from economies of scale only partially offsetting the costs of trade diversion.

Type 3 -- New Industries Economy of Scale

If an industry cannot operate economically in the market of a single economy but can operate economically in the integrated market, then formation of an economic union may well lead to the establishment of this industry in the area. Whether, and to what extent, the common market area benefits from the new industry depends on the income generated by the new investment and on the higher price (if any) the area must pay for the locally produced commodity.

Indivisibilities

The reason industries exhibit economies of scale can be summed up in the single word, "indivisibilities." Because of indivisibilities, opportunities for specialization begin to appear as the scale of operations of a process expands, and this specialization may result

¹If the industry could charge a lower price to consumers in B than to those in A (that is, price discrimination), then it would be able to increase its profits by selling in both markets even without a common market.
in a lower cost of operation. When an industry has a relatively large, homogeneous demand for its products, it can often adopt methods that make use of standardization of parts, specialization in the manufacture of components and accessories, and specialized maintenance and other services; but with a small market for its products, the industry may be unable to exploit opportunities for specialization, and the average cost of production may consequently be higher.

In the East African common market, one might expect economies of scale to be a more important phenomenon than either trade creation or factor mobility in providing benefits to the area. This is partly because, as noted above, trade creation provides smaller gains when the factor endowments of the countries involved are similar. Furthermore, the relative gains from an enlargement of the market are likely to be greater, the smaller the base from which one starts. Thus, opportunities for specialization would presumably be of greater significance to East Africa than, say, to the European Economic Community (although, of course, this cannot be stated with any certainty).

The significance of the gains from economies of scale will depend on the extent to which economic integration enlarges the market for locally produced goods, the number of industries affected by the market expansion, the elasticity of the cost curves in these industries with respect to changes in the quantity produced, and the extent to which decreased industry costs are translated into rises in East African income. The following subsections consider the effect of economic integration on the size of the market for locally produced goods and the implications of this market expansion.

Size of the Market

Table 1 presents several measures of the size of the market in the three East African countries and in East Africa as a whole. The three countries have approximately the same number of people, so the common market is roughly triple the population of each country considered individually.
Table 1
THE SIZE OF THE EAST AFRICAN MARKET

<table>
<thead>
<tr>
<th>Country</th>
<th>Population(^a) (thousands)</th>
<th>Income(^c) (£ millions)</th>
<th>Money Income(^b) (£ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td>8,576</td>
<td>629</td>
<td>477</td>
</tr>
<tr>
<td>Tanganyika</td>
<td>9,560</td>
<td>523</td>
<td>346</td>
</tr>
<tr>
<td>Uganda</td>
<td>7,016</td>
<td>437</td>
<td>315</td>
</tr>
<tr>
<td>TOTAL</td>
<td>25,252</td>
<td>1,589</td>
<td>1,138</td>
</tr>
</tbody>
</table>

Notes:
\(^a\) Estimated population, 1962.
\(^b\) Gross domestic product, 1961.
\(^c\) Gross domestic product in 1961 multiplied by ratio of money income to total income in 1959.

Sources:
Income tells us more than population about market size, in the sense of effective demand. Table 1 shows that total income in East Africa is just over 1.5 billion U.S. dollars. Of this, Kenya accounts for 40 per cent of the total, Tanganyika for 33 per cent, and Uganda for 27 per cent. Thus, although the combined market is 2.5 times the size of the Kenya market alone, it is 3.7 times as big as Uganda’s market.

Much of the income in East Africa consists of subsistence production that does not enter the market. Thus, to assess the size of the market, it is more realistic to subtract subsistence production and focus only on cash income. As can be seen from Table 1, East African money income is only $1.1 billion; of this, Kenya’s share is 42 per cent, Tanganyika’s share is 30 per cent, and Uganda’s share is 28 per cent. Although Kenya has only 34 per cent of the area’s population, it has 40 per cent of East African income, and 42 per cent of money income. Consequently, economic union constitutes a smaller proportionate increase in the market from Kenya’s point of view than from that of either Uganda or Tanganyika.

Table 2 shows imports into Kenya, Uganda, and Tanganyika from outside East Africa. Two points emerge from the table. First, Kenya’s imports are greater than 50 per cent of the East African total. Second, and of equal importance, nearly half of the imports of manufactured goods (Standard Industrial Trade Classification [SITC] groups 5, 6, 7, and 8) are destined for Kenya.

All the measures of market size presented in Tables 1 and 2 have some relevance, and all suggest that for Uganda or Tanganyika, the integrated East African market represents a substantially larger market for industrial goods than the market of either country alone. For Kenya, too, the East African market offers some gains, although it

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1 All income and trade figures are expressed in current U.S. dollars.

2 A corollary of this is that per capita income is low -- less than $100 in all three East African states (see Table 3).
Table 2
EAST AFRICAN NET IMPORTS\(^n\) BY CUSC GROUP, 1961
(Thousands of dollars)

<table>
<thead>
<tr>
<th>Section</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Tanganyika</th>
<th>East Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>0. Food</td>
<td>19,145</td>
<td>2,782</td>
<td>10,288</td>
<td>32,242</td>
</tr>
<tr>
<td>1. Beverages and tobacco</td>
<td>2,072</td>
<td>689</td>
<td>816</td>
<td>4,375</td>
</tr>
<tr>
<td>2. Crude materials, inedible (except fuels)</td>
<td>2,996</td>
<td>520</td>
<td>393</td>
<td>3,909</td>
</tr>
<tr>
<td>3. Mineral fuels, lubricants, and related</td>
<td>21,235</td>
<td>5,867</td>
<td>9,993</td>
<td>37,094</td>
</tr>
<tr>
<td>materials</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Animal and vegetable oils and fats</td>
<td>2,167</td>
<td>1,039</td>
<td>922</td>
<td>3,328</td>
</tr>
<tr>
<td>5. Chemicals</td>
<td>14,441</td>
<td>5,076</td>
<td>6,653</td>
<td>26,992</td>
</tr>
<tr>
<td>6. Manufactured goods classified chiefly by</td>
<td>53,597</td>
<td>28,541</td>
<td>41,324</td>
<td>123,961</td>
</tr>
<tr>
<td>material</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Machinery and transport equipment</td>
<td>51,377</td>
<td>18,707</td>
<td>20,731</td>
<td>99,515</td>
</tr>
<tr>
<td>8. Miscellaneous manufactured articles</td>
<td>18,541</td>
<td>7,218</td>
<td>8,330</td>
<td>34,099</td>
</tr>
<tr>
<td>9. Miscellaneous transactions and</td>
<td>10,073</td>
<td>3,029</td>
<td>3,412</td>
<td>16,515</td>
</tr>
<tr>
<td>commodities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total imports of manufactured goods (STC</td>
<td>(134,535)</td>
<td>(69,434)</td>
<td>(85,598)</td>
<td>(280,567)</td>
</tr>
<tr>
<td>groups 5, 6, 7, 8)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>$193,023</td>
<td>$74,330</td>
<td>$111,122</td>
<td></td>
</tr>
</tbody>
</table>

Note:
\(^{n}\)Imports less goods traded interterritorially.

Source:
would appear that the Kenya market is substantially greater than that of the other two East African states.

Probably the best measure of the effective enlargement of the demand for manufactures brought about by the East African common market is the quantities of manufactured goods imported. The pattern of imports into East Africa gives some notion of the existing demand for a fairly wide class of products. In the long run the entire pattern of demand will doubtless change dramatically, but in the short run industrial development is likely to come about largely through import substitution. ¹ Whether any particular industry can be economically established, either in a single East African country or in a grouping of these countries, will depend, of course, on the demand for the products of this particular industry. But, by adding together the quantities each country imports of a variety of products, a reasonably accurate assessment can be formed of the market of the individual countries and of the countries combined for industrial goods in the present and near future.

Transport Costs

The effect of economic integration on the enlargement of the market must be qualified by a consideration of transport costs. Economic integration does not imply squeezing more people or greater purchasing power into a given area; rather, it simply means enlarging the area an industry can serve without certain artificial restrictions on trade. But serving a larger area may imply an increased cost of transporting the product from the producer to the consumers. If cost per unit distance of shipping a product is sufficiently high, the cost of serving the more remote parts of the enlarged area may be so great

¹It may appear I am arguing for trade diversion, but this is not the case. Import substitution is likely to play a major role in the economic development of East Africa, with or without the common market. With the common market, there is an opportunity, through trade creation and economies of scale, to put import substitution on a more rational basis. Trade diversion is not regarded here as of much significance in East Africa.
that potential consumers in these areas elect either not to consume the product or else to purchase it elsewhere. To what extent increased transport costs limit the effective expansion in the market for the products of a particular firm (or prospective firm) will depend on the elasticity of demand for these products, and this in turn will depend on the relative cost of near substitutes.

In some cases, it will be cheaper to supply a product to one part of a common market from overseas than from elsewhere in the common market. It has been said for example that it may be cheaper to ship goods to Dar es Salaam from India than from Uganda.\(^1\) It follows that aggregate purchasing power in the common market, compared with that in an individual country, exaggerates the effective expansion of demand resulting from economic integration.

If the transport costs are high relative to the gains from scale, then it simply does not pay to supply the entire market from the same factory and each of several population centers may establish its own firm. Then the advantages of economic union are lost; it cannot be argued that a common market provides a net gain because of the opportunities it affords for establishing new industries if, in fact, each participant country in the common market ends up with its own plant in each industry. If the natural obstacles to trade among the countries outweigh the gains from the larger scale of operations, then, even in the absence of tariff restrictions, trade will not occur.\(^2\) Put more simply, a common market may under some circumstances merely signify the relaxation of restrictions that were, in any case, ineffective.

The size of the effective local market for the product of a single firm is determined both by the aggregate demand for the product and by transport costs. Transport costs, in turn, are a function of


\(^2\)In Section IV another reason is given for the possible failure of a common market to expand trade among participating economies.
the kind of transport facilities available, and of the distances involved in getting the product to the consumers. As the area served by a single firm expands, the average cost of supplying consumers will rise.

An index of the extent to which aggregate purchasing power exaggerates the enlargement in market size is purchasing power density (PPD), defined as the ratio of the market's aggregate income to its land area. In Table 3, population density, per capita income, and PPD are shown for the East African countries, as well as for several industrial nations. Although the income of East Africa is more than triple that of Uganda, PPD in East Africa is actually less. Moreover, the table indicates that PPD in East Africa is only 1.6 per cent that of the United States and .3 per cent that of Germany. Use of this measure must be highly qualified, but it does serve to suggest that East Africa must serve a greater area to obtain a market of given size than richer, more highly industrialized nations.¹

Given the PPD of an area together with the area's income, the effective size of the market for a particular product will be related to the unit mileage cost of shipping the product; and this, in turn, depends on the adequacy of the transport system. In East Africa the transport system is not sufficiently comprehensive to enable a great deal of specialization within the area without entailing a high transport cost. The East African railway does offer a relatively cheap means of shipping goods between points located on the line of rail, but once one leaves the railway, transport costs rise appreciably. The relatively poor road system and the absence of sufficient feeder lines to the railway limit the effectiveness of transport.²

¹It may be argued that in the 19th century PPD in the United States was not very large either. But world conditions were probably more favorable to a newcomer then than now. And, too, industrialization in the United States was not achieved overnight.
PPD will tend to be low in a sparsely settled area or an area that has a low per capita income; East Africa has both.
²This is not to argue that a more highly developed rail system would necessarily be economic in East Africa. While the railway is
<table>
<thead>
<tr>
<th>Country</th>
<th>Per capita income a (U.S. dollars)</th>
<th>Population density (inhabitants per square mile)</th>
<th>Purchasing power density (thousands $ GNP per square mile)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>2,900</td>
<td>50.5</td>
<td>144</td>
</tr>
<tr>
<td>Germany</td>
<td>1,381</td>
<td>585.5</td>
<td>817</td>
</tr>
<tr>
<td>France</td>
<td>1,356</td>
<td>193.4</td>
<td>298</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1,418</td>
<td>557.3</td>
<td>786</td>
</tr>
<tr>
<td>Kenya</td>
<td>72</td>
<td>32.4</td>
<td>2.8</td>
</tr>
<tr>
<td>Uganda</td>
<td>62</td>
<td>72.8</td>
<td>5.6</td>
</tr>
<tr>
<td>Tanganyika</td>
<td>55</td>
<td>36.5</td>
<td>1.5</td>
</tr>
<tr>
<td>East Africa</td>
<td>63</td>
<td>37.1</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Note:

aIncome refers to gross domestic product for East African countries, gross national product for other countries.

Sources:


Population (Kenya, Uganda, Tanganyika), see Table 1; (other countries), United Nations, Statistical Yearbook, 1962, New York, 1963.

Income (Kenya, Uganda, Tanganyika), see Table 1; (other countries), United Nations, Statistical Yearbook, 1962.
The low PPD and high costs of transport in East Africa strongly qualify the effective increase in the size of the market resulting from a common market. Although purchasing power is larger, both in the aggregate and with respect to most individual products, the distribution of purchasing power over the land area is low; and the latter is an important determinant of effective market size.

Although the discussion of this subsection qualifies the earlier argument, it does not negate it. High transport costs may mean that the effective enlargement of the market is greatly overstated by an inspection of aggregate income or purchasing power figures. But surely there is some expansion resulting from economic integration, and perhaps a fairly large expansion for the products of certain industries. This is particularly true to the extent that the demand for manufactures tends to be clustered in large population centers that are interconnected by reasonably effective transport links. In East Africa, the common market has linked up Kampala, Nairobi, and Dar es Salaam, all of which are served by the East African railway. One might hazard a guess that the demand for manufactures originating in cities and towns on the rail line is some 90 per cent of the total demand for these products. In this respect, the common market does provide some effective enlargement of the market for at least some industries.¹

Prospects for Industrial Expansion

The Raisman Report states that "there are a limited number of manufacturing industries in which the whole East African market could support several establishments of efficient size, a probably larger

necessary to ship primary products to the sea for export to Europe, it is probably much less essential for intra-African trade. For shipment of light manufactures, for example, air freight and roads may provide adequate transport facilities.

¹As incomes in East Africa rise and population expands, PPD will rise also. Moreover, a large part of the increase in income will doubtless be clustered in the urban centers, because of migration from the agricultural areas and higher labor productivity in the cities.
number in which it could just about support one or two such establish-
ments, and a large number in which it could not yet absorb the output
of one . . ."  
Professor A. J. Brown, who served on the Raisman Com-
mmission, has expanded on this statement, presenting the model behind
these figures in a recent publication. For each of several indus-
tries in the United Kingdom, Professor Brown compares total employment
in the industry with employment in the median plant, and regards this
ratio as a crude index of the number of "typical" (which he seems to
identify with "efficient") plants in the industry. If this number
exceeds the ratio of the U.K. market to the East African market, then
Professor Brown would argue that the industry can be economically
established in East Africa, but otherwise not. On the basis of this
model, he presents a list of industries that he believes could be
supported by the East African market. This list is reproduced in
Table 4. In his study, Professor Brown classified the industries
appearing in the table on the basis of the relationship between U.K.
employment in the industry and the median plant size. His results
have been interpreted here in terms of the suitability (on the basis
of scale of operation) of the industry for establishment in East
Africa, assuming the East African market to be 1/50 to 1/100 the size
of the U.K. market for the product in question, and assuming the
Uganda market to be roughly 1/3 the size of the total East African
market.

Although Professor Brown's analysis is an interesting first
attempt to quantify certain aspects of the relationship between market
size and industrial potential, caution must be used in accepting his
results. One difficulty, in particular, derives from the ambiguity
involved in defining -- and hence, in measuring -- an industry.
Typically, an industry does not consist of a group of firms, all
producing identically the same products; rather, there is often some

\footnote{Raisman Report, op. cit., p. 16. I refer to this analysis
because of the impact the Raisman Report has had on East African
thinking, and because this particular point deserves reconsideration.}

\footnote{A. J. Brown, op. cit., Part I.}
### Table 4

CLASSIFICATION OF INDUSTRIES ON THE BASIS OF MEDIAN PLANT SIZE

<table>
<thead>
<tr>
<th>Relationship of Median Plant in the United Kingdom to:</th>
<th>East African market</th>
<th>Uganda market</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Larger</td>
<td>Larger</td>
<td></td>
<td>Blast furnaces, butter and margarine, corsets, electric cooking and heating apparatus, machine tools, railway wagon and carriage, soap, wholesale bespoke tailoring, electric valves, iron and steel tubes, aircraft, biscuits, cables, linoleum, marine engineering, prime movers, rubber, silk, tobacco and cigarettes, wireless, cattle food, batteries, dyes, explosives, sugar refining, tin box, tin plate, cement.</td>
</tr>
<tr>
<td>2. Possibly no larger</td>
<td>Larger</td>
<td></td>
<td>Carriage, packing, umbrella, glove, aluminum rolling and smelting, coke and by-products, jute, wholesale tailoring, wire, chemicals (other), cocoa and sugar confectionery, glass, electrical machinery, sports goods.</td>
</tr>
<tr>
<td>3. No larger</td>
<td>Larger</td>
<td></td>
<td>Canvas, flock and rag, fur, lace, oil and tallow, saddlery, wood crates, mackintosh, paper, scientific instruments, tool, hat and cap, newspaper, iron and steel rolling and smelting, motors and cycles, shipbuilding, aprons and overalls, grain-milling, paint, linen.</td>
</tr>
<tr>
<td>4. No larger</td>
<td>Possibly no larger</td>
<td></td>
<td>Fish curing, bottling (wholesale), brass (finished), building materials, tanning, chain mail and screw, china and earthenware, constructional engineering, shirt, gas, bacon curing, cardboard box, plate and jewelry.</td>
</tr>
<tr>
<td>5. No larger</td>
<td>No larger</td>
<td></td>
<td>Bread and cakes, furniture, motor repairing, retail bespoke tailoring, shoe repairing, timber, brick, cotton spinning, cotton weaving, woollen and worsted, hardware, millinery.</td>
</tr>
</tbody>
</table>

**Source:**

complementarity among firms, one firm perhaps providing others with
spare parts or components. In an industry consisting of three small
firms, it might prove impossible for the industry to operate with a
single firm unless this firm performs the functions currently under-
taken by the three; hence a single firm might have to be much larger
than any of the smaller ones. This is particularly true if one con-
siders the more complete specialization of services that is typically
found in larger economies. According to Jewkes the relevant question
corns not the optimal size of firms in an industry but the optimal
distribution of sizes.

Professor Brown may have overstated both the number of firms
that could operate economically in East Africa as a whole and the
number that could operate efficiently in a single East African coun-
try. But an empirical examination of the East African industrial
sector reveals that some of the industries in Professor Brown's Cate-
gory 1 do in fact exist in East Africa, despite the apparent need of
these industries for a larger market. In particular, there are three
cigarette factories in East Africa (one in each country) and three
cement plants, with a fourth about to be built. To some extent this
may be explained by exports of these products, a factor Professor
Brown did not take into account. But a more complete explanation
must certainly take into account the possibility of an industry's
adapting its methods to differences in the economic environment.
Even if it is assumed that the scale of operations of the typical
plant is indeed also the minimum economic scale for plants in the
United Kingdom, there is no presumption that this will also be the

1Other difficulties arise from product differentiation, the
existence of regional markets, and so on.

2Such as maintenance and distribution. Also factories may have
to be larger in East Africa to be able to afford the large inventories
of raw materials and spare parts necessitated by their isolation from
sources of supply.

3J. Jewkes, "Are the Economies of Scale Unlimited?", E. A. G.
Robinson (ed.), Economic Consequences of the Size of Nations, St.
minimum economic plant size in East Africa, which has a greatly different resource and market picture.

The elasticity of the industry cost curves is also relevant. An industry with a relatively flat cost curve might be able to operate at any output within a fairly wide range without an appreciable rise in cost, whereas an industry with a less elastic cost curve is constrained to a more narrow output range. If the industry cost curve is relatively flat, then the scale of operations will be more strongly influenced by transport costs. In East Africa, with its relatively low purchasing power density, the industry would tend to operate at a lower scale than in the United Kingdom, with its much higher PPD.

In sum, a comparison of the East African and British markets provides little guide in an evaluation of the impact of economic integration on the prospects for industrial development in East Africa. It makes more sense to compare the East African market with the markets of other countries at a more nearly comparable stage of development. In this respect, India, Argentina, and South Africa all may have important lessons for East Africa.

Finally, Professor Brown's analysis relates only to the capacity of the East African market, vis-à-vis that of the individual country markets, to support establishments of efficient size. As the earlier analysis revealed, this is an oversimplification of the problem. Many industries are likely to set up in the East African countries whether they can operate at minimum average cost or not. The maintenance of a tariff will permit the establishment of uneconomic as well as economic industries. The question remains whether the formation of an economic union will make these industries economic (or less uneconomic).²

¹Of course, many of these industries, while superficially uneconomic, or uneconomic in the short run, may be justified on the basis of the external economies to which they give rise, or on the basis of the "infant industry" argument.

²In the industrial consolidation and industrial expansion types of economies of scale, although economic integration results in a
Although it is difficult, if not impossible, to estimate the number of firms likely to be affected by a given increase in the size of the market, it is nevertheless of some interest to look at the relative rates of growth of interterritorial trade and external trade.¹ There is no quantitative evidence on the extent that interterritorial trade reflects trade creation, trade diversion, and economies of scale. But there is a strong presumption, based on the analysis above, that this trade is a manifestation largely of a mixture of trade creation and economies of scale. Table 5 shows the growth of total external trade (exports plus imports) and of interterritorial trade during the period 1950-1961. External trade during the period increased by 80 per cent, whereas interterritorial trade expanded by 190 per cent, or more than one and one-half times as fast as external trade. This seems to suggest that, for whatever reason, the common market has been effective in bringing about some measure of specialization in production.²

The Impact of Economies of Scale

East African interests should not be identified with either a reduction in average costs of production or an inflow of new industry. Either of these may contribute to economic well-being in East Africa, but not necessarily.

In a discussion of the impact of economies of scale, a distinction should be made between national (or regional) income and domestic more efficient use of resources (or at least does not result in a more inefficient use of resources), this is not necessarily true with respect to new industry economies of scale. For example, an industry that may be uneconomic even with tariff protection in the market of a single country, may, in the combined integrated market, be economic only as a result of the tariff protection. If this industry were established because of economic integration, there would be a waste of resources comparable to that occasioned by trade diversion.

¹Interterritorial trade is defined here as trade among the three East African countries.

²The increased interterritorial trade may be due to other factors as well. See the discussion in Section V.
Table 5

EAST AFRICAN EXTERNAL TRADE (EXPORTS PLUS IMPORTS) AND
INTERTERRITORIAL TRADE, 1950-1951
(thousands of dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>External trade</th>
<th>Interterritorial trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>413,087</td>
<td>24,601</td>
</tr>
<tr>
<td>1951</td>
<td>613,981</td>
<td>25,725</td>
</tr>
<tr>
<td>1952</td>
<td>628,554</td>
<td>30,377</td>
</tr>
<tr>
<td>1953</td>
<td>554,423</td>
<td>37,744</td>
</tr>
<tr>
<td>1954</td>
<td>613,371</td>
<td>40,320</td>
</tr>
<tr>
<td>1955</td>
<td>710,959</td>
<td>49,705</td>
</tr>
<tr>
<td>1956</td>
<td>710,492</td>
<td>46,456</td>
</tr>
<tr>
<td>1957</td>
<td>723,803</td>
<td>52,830</td>
</tr>
<tr>
<td>1958</td>
<td>683,407</td>
<td>50,856</td>
</tr>
<tr>
<td>1959</td>
<td>607,593</td>
<td>56,274</td>
</tr>
<tr>
<td>1960</td>
<td>752,831</td>
<td>63,809</td>
</tr>
<tr>
<td>1961</td>
<td>748,622</td>
<td>69,191</td>
</tr>
</tbody>
</table>

Note: a Years before 1958 not strictly comparable to subsequent years.

Source:


1956-1957: Ibid., No. 1, pp. 52 and 55.


product. Domestic product refers to goods and services produced within the national (regional) boundaries of a country (group of countries). National (regional) income refers, on the other hand, to income earned by the nationals of the country (region), and in general is different from domestic product. In an underdeveloped country, domestic product may consist partly of income on foreign-owned assets, which is excluded from national income; in this case, national income is less than domestic product by the amount of these factor payments to foreign nationals.

Since we are concerned here with the rise in incomes of the nationals of East Africa, it appears appropriate to relate the gains from economies of scale to East African regional income. Increases in factor payments abroad are excluded, notably, increased profits on foreign-owned enterprises.

Economies of scale may result in an increased efficiency in the utilization of the region's resources and thereby in the release of resources for other uses. Alternatively, economies of scale may create an augmentation of the region's resources, that is, an inflow of capital and, possibly, managerial and technical skills. But the region gains only if the released or augmented resources can be translated into an increase in regional income.

An industry has three points of contact with the economy in which it is located. First, the industry may sell its products in the local market. Second, the industry may use local resources and factors of production as inputs. Third, the industry may pay profits (and other) taxes to the local government. Economies of scale may impinge on any of these three points of contact.

The industrial consolidation economies of scale may result in a reduction in the price at which a product is sold. The effect of a given increase in market size (given degree of consolidation) on the product price will depend on the elasticity of the cost curve.

\[\text{We are concerned here only with industries that do.}\]
in the establishment in which production is consolidated, on the
elasticity of the demand for the product, and on the industry's pric-
ing policy. If the cost curve is highly inelastic (that is, relatively
steep), then an increase in output has a pronounced effect on the
average cost of production; but if the cost curve is relatively elastic
(or flat), the reduction in cost will be smaller. In this type of
economy of scale, there will be some reduction in average cost by
definition.

Whether or not the reduced cost is passed on to the users of the
product in the form of a lower price will depend on other factors.
By definition, the industry in question is a monopoly (although pos-
sibly a regulated monopoly), so that the price is undoubtedly higher
than the average cost of production, and output less than under com-
petitive conditions. If the reduction in the average cost of production
is in part reflected in a lower product price, there will be a further
expansion in output, the magnitude of which will depend on the elasti-
cities of the demand and supply curves. But quite likely, the price
will decline little, if at all.

Consider the situation depicted in Fig. 1. BD is the local demand
curve for a locally produced item. A comparable import is available
at price OA, and consumers are completely indifferent between the
imported and locally produced good. Consequently, the local firm
cannot charge above OA if it wishes to make any sales in the local
market. At price OA, however, the firm can sell OM of the product.

Since the firm is a monopoly, it will sell at the point where
the marginal revenue equals marginal cost. As the effective demand
curve, ACD, is kinked, the marginal revenue curve is discontinuous;
this is shown as AC and EF. If the marginal cost curve cuts the
dotted line CM at any point between C and D, the industry will sell
exactly OM at price OA; it will sell greater than OM, and at a lower
price, only if the marginal cost curve cuts DF to the right of D.

Now consider a situation in which a monopolist, in the absence
of economic integration, operates an establishment in each of two
Fig. 1 — Demand and marginal revenue curves facing typical East African producer
countries. With the formation of a common market, the industry consolidates its output in one plant. If the demand situation is initially like that shown in Fig. 1 with regard to each country market, then the economic union is likely not to result in either a lower price or an expanded output. The price will be maintained just under that of the comparable import (including the import duty), and the output for the area as a whole will be unchanged. All the gains from economies of scale go to the monopolist in the form of increased profits. Although the case illustrated in Fig. 1 is admittedly extreme, this or a similar situation is certainly not unlikely to arise in East Africa, with respect to some industries. Any industry controlled by a profit-maximizing monopolist, and faced with a relatively inelastic demand curve, will tend to maintain price and restrict output as average cost declines. In this case, the reduced cost of production is not passed on to the consumers; it serves instead to increase the monopolist's profits. Even in this case, East Africa may derive some gain. If the industry is locally owned, the increase in the monopolist's profits constitutes a rise in East African income. But, if the industry is foreign owned, the increase in profits raises factor payments abroad, and thus does not enter into East African income. Of course, the industry will pay a higher profits tax, and this does constitute a gain to East Africa.

With respect to the saving of resources, reflected in the declining cost curve, whether or not East Africa gains depends on the nature of this saving. If capital is saved, and if this capital is reinvested elsewhere in East Africa, there is a gain. But if the declining cost curve of the industry reflects a reduction in wages and salaries paid to East African nationals, there is a reduction in regional income. The extent of this reduction depends on the opportunity cost of the resources. If the industry reduces its employment of labor, and this labor is otherwise unemployed, then, with respect to this industry, East Africa may suffer a net loss from economic integration. More specifically, East Africa will lose if: the product price is not reduced; there is initially some unemployment in the area; economic
integration results in a reduction in the wage bill in the industry in question; and the resulting decline in wage payments is less than fully offset by a rise in other factor payments and in taxes.

The industrial consolidation type of economy of scale is more likely to result in a rise in regional income if the monopolist can be forced to share his gains with the region. A price regulatory policy might accomplish this objective by forcing the industry to reduce its price in line with any reductions in average cost of production. Or, a high marginal profits tax rate might be effective. If an expansion in monopoly profits can be taxed away, it provides an excellent source of "forced savings" for the area by placing additional resources in the hands of the government. But either regulation or taxation poses the danger that it might provide a disincentive for capitalists to invest in East Africa. This type of economy of scale is likely to be especially beneficial to East Africa at a later date, when disguised unemployment will have disappeared, and when the opportunity cost of labor will be substantially higher.

New industry economies of scale present quite a different picture. They are likely to result in a higher product price to the consumer and, on this account, a loss to the area. The new industry will tend to charge a price equal to the price of a comparable import, including the import duty. As a result, although the consumer may pay no more, the government loses the revenue otherwise collected on the imported substitute. In this respect, new industry economies of scale create a loss to East Africa, the extent of which depends on the size of the tariff and on the pricing policy of the industry.

In addition, if the industry is established with local capital that is withdrawn from some alternative use, the area stands to gain little from the reallocation of resources; the other use may or may not represent a better use of the capital from an East African point of view. However, if the industry is established with new foreign capital, then East Africa may gain from the increased employment (resulting in increased factor payments) arising from the new foreign
investment, as well as from the rise in profits taxes. It is impossible to predict in which cases new industry economies of scale will provide a net gain. It is probably the most important type of economy of scale at the present time, because of the presence of underemployed labor in East Africa. At a later date, it will doubtless become less important just as industrial consolidation economies of scale become more significant.

Industrial expansion economies of scale fall in between the two cases discussed above. They are likely to result in a higher price in Country B (the country that initially purchased the product from abroad), though possibly a lower price in Country A. With monopoly pricing and an inelastic demand curve, the price reduction in A is likely to be less than the price increase in B. If the industry is locally owned, there may be gains in the form of profits and profits taxes. If it is foreign owned, the beneficial effects will arise from the new capital brought into the area.

On balance, one is tempted to believe that economies of scale do provide a net gain to East Africa, primarily as a result of the income generated by the inflow of capital that results from industrial expansion and, especially, new industry economies of scale. The preceding discussion suggests, however, that the gains are far from automatic; the policies adopted by the East African governments will determine in part the extent of these gains.

EXTERNAL ECONOMIES

Related to economies of scale is another phenomenon: external economies, or externalities. For the same kinds of reasons that an industry average cost curve may slope downward, the cost of production in one industry may be reduced as output in other industries expands. An increase in output for an entire industrial complex enables some specialization of functions to develop among industries. Perhaps a specialized maintenance service, which would be uneconomic to service an area with a small industrial output, becomes economic beyond some critical point, enabling gains to the group of industries
as a whole. Similarly, the existence of a trained labor force, or of a group of highly skilled specialists and technicians, will contribute to lowering industry costs. It is probably fair to say that industrial development tends to feed upon itself; the movement into an area of each new firm is likely to increase the attractiveness of the area to other prospective investors, at least up to a point. This, of course, accounts for the clustering of economic activity that is observable throughout the world.

To some extent, the industrialization of an area like East Africa receives justification in terms of the external economies generated by industries that may otherwise appear uneconomic. If this is the case, then economic integration results in gains insofar as it enables industrial expansion and concentration. Neither trade creation nor industrial consolidation economies of scale are likely to result in significant external economies, for although these factors tend to build up one part of the common market area, they do so at the expense of other parts. However, industrial expansion and new industry economies of scale, by resulting in an expansion of local industry possibly accompanied by the inflow of new capital resources, may have a profound effect on the profitability of other enterprises, and may consequently result in substantial gains to East Africa.

**CONCLUDING REMARKS**

The factors suggesting that the East African common market has provided a net gain to the area also suggest the gains to be reaped from continuing the common market. As both population and income levels continue to rise in East Africa, the market will expand. Moreover, possible improvements in transportation will serve to integrate the market more fully. These developments will provide an incentive for an increasing number of industries to set up in East Africa -- not overnight, but during the next few decades. So long as East Africa continues to expand, there will be further opportunities for economies of scale and further reason to continue the common market relationships.
One point, though, that has not yet been discussed, relates to the distribution of the gains among the three participants. Economic union has brought and will continue to bring gains to East Africa as a whole, but it may still be possible that one or two of the countries, considered individually, will be made absolutely worse off as a result of participation in the scheme. This point will be discussed in the following section.

Another point, of some importance, relates to the attempt by the East African countries to put national before regional objectives; and this, in turn, relates to interference by the governments of the three countries with market forces. It is clear that in East Africa decisions concerning the allocation of economic resources are not regulated by market forces to the same extent as in the United States or Great Britain. Governments are consciously pursuing policies aimed at rapid economic development and, in this way, their decisions necessarily affect resource allocation in a vital way. The institutional factors that govern these decisions are consequently highly relevant to an assessment of the gains from economic integration. This set of factors forms the subject of Section IV.
III. THE DISTRIBUTION OF GAINS

INTRODUCTION

In an evaluation of the impact of economic union in East Africa, it is both useful and relevant to focus attention on the interests of the individual states, because a consideration of these interests has an important bearing on whether the common market will be maintained. If one country is convinced that the common market results in a net loss to that country even though it may result in gains to East Africa as a whole, then the government of that country may decide to opt out.

In pondering the advisability of participation in a common market, a country is concerned with political as well as economic factors. Even if the country is worse off economically as a result of membership in the economic union, there may be offsetting political gains sufficiently important to persuade the country to continue its participation. Not that noneconomic factors are unimportant, but that economic factors are important. Although a country may, in the interests of Pan-Africanism, derive political gain from economic union with its neighbors, if the economic costs of its doing so are high enough, it may be dissuaded.

The distribution of gains within a common market will be affected both by factors intrinsic to the common market and factors not intrinsic to it. In particular, the distribution of gains will be influenced by nonmarket phenomena -- for example, government actions affecting the pattern of investment. Whatever the pattern of gains resulting from the common market as such, it is possible for the governments, by taking deliberate measures, to redistribute the gains in any way they see fit. Thus, if participants in a common market are worse off in absolute terms by participation, it is possible -- in principle, at least -- to compensate these countries so as to leave all participants better off, individually as well as jointly.

In Section IV we will consider the question of compensation, and in the present section we confine the discussion to the distribution
of gains that forming a common market brings about through the operation of market forces, assuming that resource allocation is governed solely by these forces. First, how the common market influences the distribution of investment activity in a common market area among individual countries; second, the effect of the distribution of investment activity on the incomes of the countries concerned. In the final subsection the results of the analysis will be applied to the East African common market.

**DISTRIBUTION OF INVESTMENT ACTIVITY**

The removal of some of the barriers to trade among the countries forming a common market will tend to produce a greater geographical concentration of industrial activity. In the absence of economic union, many industries would develop along parallel lines in two or more of the prospective participant countries, each industry serving a national market only. With economic integration, however, production will tend to be concentrated in a smaller number of centers -- perhaps only one -- each center serving a wider market than before. The production centers will very likely be those that have the most appropriate resource endowment for the establishment of the industry concerned. Even if the cost structures of the countries forming the economic union are identical, economies of scale will result in some concentration of economic activity, as noted in Section II. Some industries that would not have existed without economic union will now come into being, and activity within some of these industries, too, will depend on economies of scale and will thus be concentrated in one location.

In addition to the tendency for economic activity within an industry to become more highly concentrated, there will tend to be a clustering together of different industries, as a result of externalities. There are frequently large gains from an industry’s choosing a site with well developed ancillary industries, a trained labor force, and social overhead capital facilities. The presence of some firms in an area will enhance the area’s attractiveness to newcomers.
It is generally acknowledged that economic activity tends to cluster in those parts of an economy, or common market, that are growing most rapidly, or -- in the case of an underdeveloped economy -- in those areas that are most highly developed. An economy that manages to get a lead over its neighbors, perhaps for purely accidental reasons linked with the historical development of the area, is likely to retain this lead for some time and, possibly, even pull further ahead. This process will be further fed by the increased mobility of capital resulting from a common market. As capital is free to move across national borders, new investment will tend to flow to the most promising areas. As the rapidly growing industrial clusters will offer the advantages of externalities,\(^1\) then, in the absence of strong reasons to the contrary, it is logical for much new investment to be channeled into these areas. The same forces that are responsible for the gains from a common market -- trade creation, factor mobility, economies of scale, and external economies -- tend also to create a clustering of economic activity within the common market, and tend to make growth cumulative within these clusters.

One interesting question relates to the number of such clusters likely to arise in a common market. This will depend, of course, on the factors discussed in Section II: the size of the market, the elasticity of industry cost curves, and the relevant sets of transport costs. One would not expect all clusters to be equal size nor to grow at the same rate. In general one might expect the process of economic growth initially to favor the major industrial centers at the expense of the rest of the area. But beyond some critical point, economic development can be expected to become more diversified. The process of development both increases the market and, by resulting in the improvement of the transport network, reduces the cost of transport. For both reasons, a reduced concentration will develop in time. Although existing clusters will expand initially, new ones will develop later. Of course, this process may take many years.

\(^1\)In particular, the availability of technically trained and other highly skilled persons is likely to be greater in the industrial clusters.
RELATIVE GAINS FROM NEW INDUSTRY

For the purposes of this discussion the gains from the common market accruing to a particular economy will be defined as the increase or decrease in that country's national income resulting from common market as opposed to economic separation. According to this measure of the gains, noneconomic factors are ruled out. If a country attaches a considerable prestige value to a particular industry which is otherwise of only nominal economic value, the prestige element will not show up in these calculations.¹

There are two reasons why the area that receives the greatest share of new investment activity does not necessarily receive the greatest over-all benefit from the common market. First, in a common market there is free labor mobility among participating economies, with the result that investment in one country can be paid out as factor income to residents of other countries in the group. Thus there is some equalization of the gains from the movement of labor into areas that offer a higher wage rate. This brings about not only a greater efficiency of resource use for the common market as a whole but a more even distribution of gains among regions or countries comprising the common market.

Second, some of the new investment in a common market may be made by nationals of other countries in the common market or of countries outside the group. This is particularly true in an underdeveloped country, where a substantial part of the capital invested in new economic activity originates in the more advanced, industrial nations. Although this represents an increase in the domestic income of the recipient economy, it does not form part of that country's national income, and consequently does not count as part of the gains from

¹This means, of course, that the analysis presented here ignores noneconomic factors that may legitimately enter into a country's preference function. See Section IV, however.
economic union. Nevertheless, it seems highly likely that wage payments to nationals of the country in which the new industry locates will exceed wage payments to nationals of other countries of the common market. Land rent and royalties will also accrue to the country in which the new industry is located. Therefore, factor mobility will effect only a partial equalization of the gains from the common market. The country that gets the bulk of the industry will still benefit relative to the country that does not. The rise in income will be due largely to increased factor payments, and therefore can be expected to accrue in the main to the country in which the investment is located. In the absence of an institution serving to redistribute fiscal revenue, moreover, profit taxes will also accrue to the host country. In East Africa, this situation is offset in part by the operation of a redistributable revenue pool, and, if an East African federation is formed, some form of fiscal redistribution will presumably take place.

Professor A. J. Brown has argued that income spillover effects resulting from economic integration tend to equalize the gains from the concentration of industry and result in all participant economies deriving some absolute gain. He argues that the establishment of an industry in the more rapidly industrializing economy (Kenya, in his example) results in an increased income in the less rapidly industrializing economy (Uganda plus Tanganyika). This effect results from the relationship between demand in Kenya for the products of Uganda and Tanganyika on the one hand, and the growth of Kenya's income on the other hand. Kenya's relatively rapid growth is translated into a rising demand for Uganda and Tanganyika products and consequently stimulates growth in these countries as well.

1 See Section II above.
2 A. J. Brown, op. cit., Part II. Professor Brown's analysis presumably led to the conclusion by the Raise Commission that Uganda and Tanganyika derived a net benefit from economic union with Kenya.
Professor Brown's model considers only the demand side of the relationship between industrialization in one country and income growth in another. In other words, an increased demand for manufactured goods in Uganda is tantamount to the establishment of the industry to produce these goods. This ignores the crucial variable of supply of capital to build the new industries, whereas the scarcity of capital in East Africa constitutes one of the major obstacles to economic growth. Although demand should not be neglected in assessing the productivity of new capital, one must question the appropriateness of a model based wholly on demand in analyzing the prospects for economic development in East Africa.

It could be argued that a demand spillover model has relevance because of the effect of demand on the profitability of new investment and the effect of profitability considerations, in turn, on the likely availability of foreign capital. The rate of development in Uganda and Tanganyika may be affected by the rate of growth of income, and thus by the rate of industrialization, in Kenya. But Kenya is also competing with Uganda and Tanganyika for new industry. An increase in Kenya's national income may increase the demand for the products of Uganda industry, but it also increases the demand for goods manufactured in Kenya itself. The latter effect may be greater because of the lower transport costs involved in supplying the Kenya market from plants located within the country. Furthermore, the tendency of new industries to cluster, discussed above, reinforces the view that industrial development in one part of a common market tends to make that area relatively more attractive for additional prospective industries. Will the strength of the increased demand for Uganda's products be enough to offset the increased attractiveness of Kenya as a site for new industry?

The externalities generated by the new investment will also accrue in large measure to the area in which the investment takes place.

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1 In other words, what is relevant is the increased demand for Uganda and Tanganyika products relative to that for Kenya products.
For the reasons outlined above, the increasing attractiveness of a country for new investment will rise as a function of investment that has already been made in the area. In time the other parts of the common market may catch up, but this may take many years.

The advantage of Nairobi's becoming a large industrial center may, of course, provide some benefits to Uganda and Tanganyika as well as to Kenya. For example, the existence of skilled technicians and engineers and the availability of spare parts and components in Nairobi facilitates the establishment of new industry elsewhere in East Africa. However, the externalities are also stronger in Nairobi than elsewhere.

The increased flow of industry to the area will have to be large if places like Dar es Salaam and Kampala are to receive a net gain in absolute terms despite a declining relative share. Moreover, the external economies in question are not intrinsic to the concept of an economic union. Tanganyika and Uganda derive benefit from Kenya's development regardless of whether a common market exists. The common market enters the picture only insofar as it contributes to Nairobi's industrial development. Thus, from Tanganyika's point of view, the question is one of balancing a certain and direct loss from economic integration against an indirect and less certain gain.

Finally, a few words should be added concerning trade diversion. Trade diversion results in the substitution of relatively uneconomic production within the common market for production in a nonmember country. If the industry in question is operating under constant cost conditions, trade diversion results in a loss to the common market that may be offset by externalities generated by the industry. This loss consists of the higher price the purchasing country pays for the product, and may well take the form of customs revenue foregone. If the industry has a declining cost curve in the relevant

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1 Consider a situation in which Country B, in the absence of a common market, imports a product from abroad, at price P. Now, a common market is formed between A and B, and Country B proceeds to
range, the gains from the expansion in scale may partially or fully offset the direct cost of trade diversion. Moreover, if there is substantial unemployment in the common market, then the increased employment brought about by the industry represents a gain as well. In general, the country in which the industry is located does not share in the cost of trade diversion; for, as postulated, it would have had an "uneconomic" industry in any case. The other countries alone share the cost, but all countries share in the possible gains from economies of scale. Thus the host country gains relative to the others. Moreover, as in the examples discussed above, the externalities and other direct income gains accrue largely to the host country, which therefore tends to derive a net benefit from such a case, while the other countries either benefit less or actually lose.

Although trade diversion can result in the expansion of an industry in any member of a common market, this expansion is likely to occur predominantly in the economy that has the most industry. Trade diversion, therefore, reinforces the factors considered above, in tending to favor the more rapidly growing economy relative to others.

The above discussion seems to suggest that, if one country in the common market has a significant comparative advantage in the production of manufacturing goods, then new investment is likely to flow into this country, and the other members of the common market are likely to specialize in some other fields such as agricultural production. Even if the resource endowments of all countries in

buy the product instead from A, at a price equal to P + T, where T = import duty. Consumers in B pay what they paid before, but the government of B loses the customs revenue it previously collected on the import of the product.

Implicit in the discussion is the assumption that the gains from economic integration derive from investment in industry rather than in agriculture or mining. (Presumably services are not appreciably affected by the common market.) This assumption appears to be reasonably well justified with respect to East Africa, where most agricultural production is (and is likely to continue to be) exported to countries outside Africa. The impact of the East African common market has been most pronounced in the industrial sector.
the common market are roughly equal, then, for one reason or another, perhaps historical accident, a few industrial clusters will develop and, once having formed, will continue to develop, with present development being fed on past investment. This analysis suggests that, at least in its initial stages, economic development of an underdeveloped country is a cumulative process that feeds upon itself.

THE EAST AFRICAN COMMON MARKET

The figures in Table 6 give some indication of the growth of interterritorial trade from 1956 to 1962, and of the distribution of this trade among countries. During this period, Kenya's interterritorial exports expanded by 90 per cent, Uganda's by 60 per cent, and Tanganyika's by only 10 per cent. At the end of the period, Kenya's interterritorial exports accounted for 65 per cent of the total, Uganda's for 26 per cent, and Tanganyika's for only 9 per cent. Thus, on the basis of trade, it seems clear that Kenya has gained relative to the other two and now accounts for a larger proportion of interterritorial exports than Uganda and Tanganyika combined. Of course, this does not mean that these gains have resulted from the common market nor does it mean that the income gains to Kenya are proportionate to Kenya's share of trade.

Table 7 considers exports of manufactured goods by the three East African countries to each of the other two in 1962. Here the importance of Kenya's role is brought out even more dramatically. Kenya accounted for 76.4 per cent of interterritorial exports of manufactures in 1962, Uganda for 20.0 per cent, and Tanganyika for a mere 3.6 per cent. To the extent that this reflects the clustering of industry as a result of the common market, it is clear that Kenya has derived the greatest benefits.

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1 Perhaps there will be only one major industrial center.

2 For the present purposes, manufactured goods are defined to include all products in Standard Industrial Trade Classifications (SITC) 5, 6, 7, and 8, plus beer and cigarettes.
Table 6

EAST AFRICAN INTERTERRITORIAL EXPORTS, 1956-1962
(thousands of dollars)

<table>
<thead>
<tr>
<th>Origin of exported goods:</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Tanganyika</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Uganda</th>
</tr>
</thead>
<tbody>
<tr>
<td>Destination of exported goods:</td>
<td>Tanganyika</td>
<td></td>
<td></td>
<td>Kenya</td>
<td>Uganda</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year(^a)</td>
<td>12,342</td>
<td>12,793</td>
<td>4,248</td>
<td>1,596</td>
<td>7,042</td>
<td>5,435</td>
</tr>
<tr>
<td>1956</td>
<td>15,100</td>
<td>16,923</td>
<td>4,259</td>
<td>1,423</td>
<td>8,376</td>
<td>6,532</td>
</tr>
<tr>
<td>1957</td>
<td>15,303</td>
<td>14,283</td>
<td>4,245</td>
<td>3,013</td>
<td>9,411</td>
<td>4,102</td>
</tr>
<tr>
<td>1958</td>
<td>18,236</td>
<td>16,195</td>
<td>5,174</td>
<td>2,033</td>
<td>10,192</td>
<td>4,444</td>
</tr>
<tr>
<td>1959</td>
<td>21,302</td>
<td>17,256</td>
<td>5,250</td>
<td>1,260</td>
<td>14,336</td>
<td>4,407</td>
</tr>
<tr>
<td>1960</td>
<td>24,923</td>
<td>19,732</td>
<td>5,163</td>
<td>1,092</td>
<td>14,426</td>
<td>4,771</td>
</tr>
<tr>
<td>1961</td>
<td>28,048</td>
<td>20,216</td>
<td>5,471</td>
<td>1,224</td>
<td>15,081</td>
<td>4,673</td>
</tr>
</tbody>
</table>

Note:
\(^a\)Years before 1960 not strictly comparable to subsequent years.

Source:
East African Statistical Department, Economic and Statistical Review, No. 1 and 6.
### Table 7

**EAST AFRICAN INTERTERRITORIAL EXPORTS OF MANUFACTURED GOODS, 1962**

<table>
<thead>
<tr>
<th>Good</th>
<th>Kenya</th>
<th>Tanganyika</th>
<th>Uganda</th>
<th>East Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beer</td>
<td>1,834</td>
<td>-</td>
<td>227</td>
<td>2,061</td>
</tr>
<tr>
<td>Cigarettes</td>
<td>4,452</td>
<td>-</td>
<td>1,995</td>
<td>6,446</td>
</tr>
<tr>
<td>Chemicals</td>
<td>5,774</td>
<td>118</td>
<td>425</td>
<td>6,316</td>
</tr>
<tr>
<td>Cement</td>
<td>1,859</td>
<td>-</td>
<td>-</td>
<td>1,859</td>
</tr>
<tr>
<td>Corrugated steel plates</td>
<td>1,662</td>
<td>-</td>
<td>-</td>
<td>1,662</td>
</tr>
<tr>
<td>Clothing</td>
<td>3,115</td>
<td>-</td>
<td>-</td>
<td>3,115</td>
</tr>
<tr>
<td>Footwear</td>
<td>2,408</td>
<td>524</td>
<td>-</td>
<td>2,932</td>
</tr>
<tr>
<td>All other manufactured goods <em>a</em></td>
<td>10,427</td>
<td>840</td>
<td>5632</td>
<td>16,973</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>31,699</td>
<td>1,482</td>
<td>8,285</td>
<td>41,368</td>
</tr>
<tr>
<td><strong>Per cent</strong></td>
<td>76.4</td>
<td>3.6</td>
<td>20.0</td>
<td>100</td>
</tr>
</tbody>
</table>

**Note:**
- None.

*a* Excluding processed food products.

**Source:**
One must be careful to distinguish between two quite different questions concerning the distribution of industrial activity within East Africa. First, one can ask whether Kenya is likely to continue to get the lion's share of new industry moving into the area, or whether a larger percentage of economic activity will locate in either Uganda or Tanganyika. A more interesting question, though -- and a harder one to answer -- is whether the rate of growth of either Uganda or Tanganyika would be greater in the absence of the present common market.

Turning first to the easier of the two questions, it seems likely that, on the basis of a continuation of the present institutional structure, both Uganda and Tanganyika will continue to receive less new investment than Kenya, at least in the foreseeable future. The clustering of economic activity can be observed in recent developments in East Africa, where over 70 per cent of the total manufacturing activity in the area is now centered in Kenya, much of this in the Nairobi area. Partly because the climate in Nairobi was hospitable to European settlers, and partly for other reasons, Nairobi was established at a relatively early date as a center of European settlement and administration. This has doubtless been of considerable significance in the emergence of Nairobi as the industrial capital of East Africa. With the relatively small East African market, there is likely to be only one center in many of the industries that establish in East Africa, and certainly Nairobi now has a greater attraction for new industry than any other center. In time, no doubt, other centers will become more highly developed, and economic activity is likely to become more diffused; but at the moment, Nairobi has the edge. Whether or not Nairobi had a genuine comparative advantage in industrial production initially, it has developed such an advantage during the past few decades.

For the purpose of deciding between continued economic integration and autarky, the relevant question concerns the effect that

1In principle, these are not the only alternatives; free trade would be another, but this is not likely to be seriously considered.
continued participation in the common market will have on economic growth of the three East African states. Is common market preferable to economic separatism from Uganda's or Tanganyika's point of view?

This issue turns on two points. First, does the common market per se reduce Uganda's and Tanganyika's shares relative to that of Kenya? And, if so, is this offset by the gains to the area as a whole?

The first question depends both on how the common market has affected the location of economic activity in East Africa and how this is reflected in the distribution of income. Even though Kenya accounts for the major part of interterritorial trade in manufactures, it cannot be established conclusively that this trade is a direct result of the common market, although there is a strong presumption that much of it is. Most of the industries that serve only the market of a single state or that produce primarily for export would presumably have set up equally well without the common market.\(^1\) At least part of those industries that account for most of interterritorial trade would, in the absence of a common market, either set up parallel plants in two or more East African states or else not establish in East Africa at all. These correspond to trade creating and trade diverting industries respectively.\(^2\) The fact that these industries have located largely in Kenya suggests that this economy has had a stronger attraction for industry as a result of the common market. The particularly small role which Tanganyika plays as a supplier of manufactured goods in interterritorial trade seems to indicate that Tanganyika has benefited particularly little -- at least, in this regard -- from the common market.

\(^1\) External economies may have influenced investment in these industries.

\(^2\) Much interterritorial trade is undoubtedly due also to economies of scale, although this is likely to be combined with either trade creation or trade diversion.
Whether the redistributional effects have been sufficiently great to compensate Uganda and, especially, Tanganyika, for the uneven distribution of industry is much harder to say. There has been some factor mobility, both labor and capital, from Uganda and Tanganyika into Kenya, although it would seem that Kenya industry has served largely to increase Kenya incomes. Taxes, until recently, accrued exclusively to Kenya, but now there is a redistributable pool which offsets this in part.

The economies of scale and externalities are still harder to estimate. The fact that prices of goods traded interterritorially tend to be not much below the prices of comparable imports, including the import duty, suggests small gains from declining costs, at least thus far. Whether this is explained by inefficiency of local operations or by unwarranted monopoly profits is difficult to say. If industries are in fact inefficient, perhaps their efficiency can be expected to increase over time. If the high local prices are explained by monopoly profits, there is some scope for the governments to tax away a greater share of these profits. These are exceedingly complex issues and clearly beyond the scope of the present inquiry.

The biggest question mark is the external economies factor. One of the principal reasons for an underdeveloped country to favor industrialization, even when this is seemingly uneconomic, relates to the externalities this industry may generate. Quite apart from the "infant industry" argument, there is an "infant economy" argument which presents a persuasive case for industrialization. Until economists know a great deal more about these phenomena, the gains from externalities cannot be quantified.

The above discussion suggests a loss from economic integration to both Uganda and Tanganyika relative to Kenya, but this may be offset by the gain to East Africa as a whole. In this case, Uganda

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1 If "inefficiency" relates to the absence of external economies, then the performance of these industries is indeed likely to improve over time.
and Tanganyika would gain in absolute terms from participation in the common market. Although this is possible, it seems more likely that the gains to these two countries would be only marginal. The evidence suggests that the gains accrue mainly to Kenya. The benefits that go to Uganda and Tanganyika are at least partly offset by the higher prices these countries must pay for commodities produced in Kenya and by the loss in employment resulting from the preference of investors for establishing their plants in Kenya.

No account has been taken here of the possibilities for compensation. The analysis should not in any way be construed as arguing that Uganda or Tanganyika should opt out of the common market. This analysis does argue, however, that Uganda and Tanganyika have a basis for requesting continued, and possibly expanded, compensation from Kenya.¹

¹Only the common market has been considered. Uganda and Tanganyika undoubtedly derive substantial benefits from the Common Services Organization, perhaps relatively greater benefits than Kenya.
IV. COORDINATING ECONOMIC POLICIES

The analysis thus far has been in terms of the effect of a common market on the structure of incentives affecting investment decisions, and the resulting impact on the East African economy. However, since the discussion has been linked to factors affected by economic union per se, there has been no consideration of an important class of forces that impinge on economic decisions, and that are related to the common market issue.

A common market does not operate in a vacuum. The institutional factors that comprise the economic and political environment in which the common market operates significantly affect the impact of the common market on the economic growth of the area. Economic union can be viewed as a purely permissive structure; by relaxing certain barriers to trade, it permits a more rational use of resources. It does not, however, guarantee this rationalization. Whether resources are in fact utilized more efficiently, so that the potential gains from economic integration are realized, will depend on whether relaxing these barriers is effectively translated into decisionmaking. If the common market results simply in the elimination of constraints that were ineffective to begin with (because of some other constraints that were effective), then clearly it will have no impact.

This section will consider an important element that enters into investment decisionmaking in addition to market forces -- government economic policy. More specifically, we shall consider how the formulation of policy at a national level can affect the contribution of economic integration to the East African economy.

One important way in which East Africa can be distinguished from, say, Western Europe is by the greater role of the government in economic activity. In East Africa, economic development is a vitally important objective of government policy, and much government activity is directed to the attainment of this goal. As impersonal market forces have not brought about an economic result acceptable to the
East African governments, there is appreciable concern with supplementing the operation of these forces with deliberate policy measures aimed at stepping up the rate of economic growth.

There are significant implications for the workings of the common market. If the East African governments, working either jointly or separately, adopt policies intended to exert a vital influence on the allocation of resources, then it is important to consider to what extent these decisions serve either to reinforce or to conflict with the forces generated by the establishment of the common market. If, for example, the common market tended to push industry from Uganda to Kenya but if, at the same time, it were a deliberate policy objective of the East African governments, working together, to force all of the area's industry into Uganda, then clearly the gains from economic integration would be greatly reduced. It would also be true that, by adopting policy measures in conflict with the pattern of incentives generated by market forces, the governments would limit their own effectiveness. Hence it is important to consider to what extent government policy in East Africa is compatible with the smooth functioning of an economic union. It is particularly important to resolve intercountry conflicts of interest in the context of the gains or losses to East Africa as a whole.

THE COMMON MARKET THUS FAR

The East African common market has existed since 1922; consequently the disadvantages of autarky have been avoided -- at least in part -- throughout this period. As noted in Section II, there has undoubtedly been some trade creation, and some gains from economies of scale, externalities, and factor mobility as well. In some cases, industries have been able to gear production to the whole East African market (transport costs permitting) rather than to the market of a single country alone. Although trade diversion and monopoly pricing may have offset part of the gain, it seems highly likely that economic union has resulted in a net benefit to East Africa.
But one can argue that the common market to date has provided considerably less benefit than its potential would allow. In large measure this is because officials in the three participating states have failed to develop what has been termed "an East African point of view." The tendency to regard issues from a purely national point of view was manifest long before the first of the East African states gained its independence. It was reflected in the debates among colonial officials concerning the possible formation of an East African federation and concerning the fixing of external tariffs. Even today the opposition expressed in Uganda and Tanganyika to continuing the common market seems to arise more from expatriate civil servants than from African policy makers. In large part, this may reflect the fact that the policy makers are prepared to make some concessions to a measure that is ideologically acceptable to them, even if it has high economic costs. If this is the case, it augurs well for economic cooperation in the future.

Still, even among policy makers, there is some skepticism, especially in Tanganyika, regarding continued participation in the common market. Uganda, perhaps, has no reasonable alternative to continued participation; Tanganyika, however, being on the coast, is more favorably situated for the development of trade with the rest of the world. Tanganyika is also able to import raw materials for local industry more economically than can Uganda. Whereas Uganda's opportunities are limited for developing extensive trade ties with the countries to the west -- Congo, Rwanda, Burundi -- and possibly Sudan to the north, Tanganyika's possibilities for trade expansion are probably better. This is reflected in the attitude of some Tanganyika officials towards the common market issue.

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1See the Raisman Report, op. cit.
2Although the recently expressed reluctance on the part of Uganda towards political federation is noteworthy.
3Conceivably, Kenya and Tanganyika together could exert economic pressure on Uganda by virtue of their control over Uganda's rail outlets to the sea.
There are some policy makers who are on record as favoring continued economic union, but whose actions are seemingly inconsistent with regional cooperation. Thus, the question of whether or not to encourage the establishment of a particular industry in East Africa is often considered in terms of its contribution to a particular economy rather than its contribution to the area as a whole. In this regard, there is some active competition among the three countries for prospective new industries and considerable pressure on existing industry to set up parallel plants in all three states. This point of view is illustrated by the mutual inconsistencies in the economic outlooks of the three states. For example, recent discussions by the author with government officials in each of the three East African countries suggested that these officials tend to view the common market as an institution enabling that country to expand its interterritorial exports. Much less thought is given to the other side of the coin: that each country must also expand interterritorial imports. In fact, in many cases, concern was voiced over the dependence of one East African country on imports from the others, and some interest was expressed in reducing this dependence by adopting policies aimed at achieving greater self-sufficiency; such policies are, of course, inimical to trade creation and to economies of scale.

In many instances, industries have tended to develop along parallel lines in two or more countries, even when this appears to be uneconomic. Parallel development does serve to reduce the inequities in economic advantage that have arisen in East Africa since World War II. The question is whether there is not a preferable way of redistributing the gains. Tanganyika's gains from economic union depend not only on its fractional share of the East African pie; but on the over-all size of the pie.

**Compensation**

In principle, if an economic union provides a net gain to the group as a whole, it is possible for each country to derive a gain as well. In the absence of intervention, a country that is made worse
off as a result of participating can be compensated by others so as to leave all participants a net gain. The only situation in which this might be impossible is one in which the redistribution of income resulting from the economic union is itself the source of gain. If an East African common market results in some redistribution of resources from Tanganyika to Kenya; if these resources make a greater marginal contribution to output in Kenya because of differences in the economic potential of the two countries; and if this factor accounts for the net gain from the formation of an economic union, then any attempt to compensate Tanganyika at the expense of Kenya will make not only Kenya but the group as a whole worse off. In such a case, the gains from economic union are intimately related to the distribution of resources among participants.

Apart from this case, in principle the device of compensation can be used to enable each and every country to share in the gains from formation of an economic grouping. But compensation may be a great deal harder to effect in practice than in theory, and knowledge that compensation is theoretically possible is little consolation to the losing party. One important question is whether compensation can be undertaken in such a manner as to leave each participating economy effectively better off as a result of its participation in the economic union.

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1. To some extent, the gains from the East African common market do result from a relative redistribution of economic activity -- hence income -- from Uganda and Tanganyika to Kenya. But this is not the only source of gain.

2. In principle, Tanganyika could be compensated by Kenya's sending consumption goods to Tanganyika. The problem referred to arises only if the redistributed income is invested in Tanganyika.

3. It is possible also that a redistribution of income from Tanganyika to Kenya will provide a net gain even if the marginal productivity of capital is lower in Kenya. This would occur if the marginal savings propensity is sufficiently higher in Kenya than in Tanganyika to more than offset the differences in the productivity of capital. In such a case, compensating Tanganyika would mean shifting capital resources to where their marginal productivity is higher, but the rate of growth of the area as a whole would nevertheless be reduced as a result.
There are several principles upon which compensation can be based. In this section, two will be briefly considered: (1) planned industrial location and (2) fiscal redistribution.

**Planned Industrial Location**

Assuming that economic union results in an increased industrialization of the area, it is possible to channel some of the new industry into, say, Uganda, according to Uganda's comparative industrial advantage. Although this policy might result in both Kenya's and Uganda's being at least as well off with the union as without it, such a policy will nevertheless also have a damaging effect on incentives with respect to the private sector. Whether industry is forced to establish at one place rather than another, perhaps through a policy of licensing, or whether incentives are created that tend to favor one point relative to another for certain types of industries, the net result is certain to be a reduction in the total flow of industry into the area.¹ Similarly, with respect to the public sector, channeling industry to an area where economic resources bring a lower return results in an inefficiency of resource use. Thus, as Hazlewood and Henderson have said,² subsidizing "lagging sectors" is a luxury underdeveloped areas cannot afford.³

**Fiscal Redistribution**

A better alternative is fiscal redistribution, with the more rapidly growing area (presumed to be the area deriving the greatest

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¹A reduction, that is, compared with the formation of a common market without such constraints, but not necessarily a reduction compared with a policy of economic separation.


³But it may nevertheless be necessary for political reasons. So long as national governments retain a sufficient degree of autonomy, and so long as industrialization is viewed as having high political value, it will be difficult to prevent each country from having at least a minimal share of the area's industry.
gain from economic union) subsidizing the others. But where the
existing East African revenue pool compensates Uganda and Tanganyika
only for the loss in customs revenue resulting from trade diversion,
and from the trade diverting aspects of the industrial expansion and
new industry types of economies of scale, it may be necessary for
redistribution to go further and compensate also for the increased
proportion of new industry the common market shifts towards Kenya.
Whether or not this is the case depends on the attitudes and bargain-
ing strategies of the three countries.

Fiscal redistribution also lowers the growth rate. By shifting
governmental capital resources to an area where investment opportuni-
ties are less profitable, the region as a whole suffers. This is
especially important in East Africa because of the large role played
by the governments in the economy. However, it makes sense to (1)
permit foreign capital to go where it pleases, and (2) reallocate
governmental resources to compensate for the resulting uneven pattern
of development. This will result in a greater over-all availability
of capital in the area and a more efficient use of capital in the
private sector. The relatively inefficient allocation of resources
in the public sector can be viewed as the necessary price for retain-
ing the common market. This solution may be the best obtainable, in
view of the political constraints imposed.

Fiscal compensation has been proven workable in East Africa,
although Kenya would certainly strongly resist any attempt to broaden
the concept; for example, to go so far as to provide all participants
in the economic union with equal rates of growth.\footnote{On this point, see K. G. V. Krishna, "Some Economic Aspects of
an East African Federation," \textit{op. cit.}, p. 101.} It is probably
feasible to offer sufficient compensation to both Uganda and Tan-
ganyika to hold the common market together. With increased regional
coordination, the prospects are good for the fairly rapid development
of an East African manufacturing sector -- certainly more rapid than
under a policy of economic separatism.
Some concessions will undoubtedly have to be made to political factors. But East Africa as a whole will have a more rapid rate of growth if industry is permitted to develop largely along economic lines. The reason is that any interference with the natural tendency of new industry in an underdeveloped country to cluster is likely also to remove some of the advantages of economic union. In the case of East Africa, this means that the over-all rate of industrialization will be greater if Nairobi is permitted to continue to develop as the leading industrial center.

Although fiscal compensation is preferable to interference with industrial siting, the noneconomic aspects of the desire for industrialization cannot be ignored; thus political realities will doubtless dictate some compromise between economic and political criteria, with the obvious result that not all decisions will reflect the best economic judgment.¹ This will further serve to reduce the rate of economic growth below what would otherwise be attainable.

**OPPORTUNITIES FOR REGIONAL COOPERATION**

The issues discussed above present both a threat and an opportunity to East Africa: a threat because, if ignored, they present a constant source of friction among the three East African states; an opportunity because, if accepted, they provide a source of further gain. The absence of harmony among the three states is simple enough to explain. There are many policies that are in the interests of one state at the expense of the others. In the absence of some framework for coordination among the three countries, it is quite natural for each country to act in its own interests. The solution to the problem is to provide the needed framework.

If major decisions are based on national interests rather than on an over-all East African interest, the pace of industrial development in East Africa will be a good deal slower than the area's potential would allow. It is important to take into account the unevenness

¹We are not suggesting that decisions should ignore noneconomic considerations, but only that there is a cost in their doing so.
of the benefits participating states receive from economic integration, and to compensate the countries that receive less than their share of the gains, however measured. But compensation should be based on the unevenness of gains from the program as a whole, and not on each individual project. If a project-by-project approach is taken, the rate of industrialization — and of economic development generally — will be retarded by a pattern of resource utilization that is uneconomic from a regional point of view. It will be retarded also by the continual need to bargain and compromise individually on any issue that generates a conflict of interests among participants — and most issues of importance probably fall into this category.

Industrialization in East Africa is certain to use large amounts of those resources in shortest supply: capital, managerial abilities, and highly specialized technical skills and knowledge. For this reason, large economies can be realized through eliminating the costly duplication of industrial facilities in different countries, and this can best be accomplished by coordinating national development plans or, better still, by formulating an East African plan.

Economic coordination in planning the development of the industrial sector provides an excellent opportunity to achieve a relatively efficient utilization of resources in a sector that is literally in its infancy — provided policies that satisfy basic economic criteria are formulated. Because the industrial sector is so underdeveloped at present, it can be shaped along economic lines right from the beginning. In this respect, economic integration may present fewer problems in East Africa than in Western Europe, where the industrial sector is better established, and any attempt to shift resources from one field to another is likely to injure someone's interests and consequently to meet with stiff opposition. But a commitment to effective economic union in East Africa must mean development of a regional
(as opposed to a national) point of view, together with a regional approach to economic planning.\textsuperscript{1}

\textsuperscript{1}This is perhaps one of the strongest arguments for an East African federation. In the absence of political federation, it is difficult to see how three independent states can maintain effective common market arrangements. Events of the past few months suggest that, without political federation, the future of the common market and the common services will be threatened.
V. A GREATER EAST AFRICAN COMMON MARKET

In Section I there was a brief reference to recent discussions concerning the possible enlargement of the East African common market. Countries that have been mentioned at one time or another during the past two years as possible participants in a larger East African economic union include the islands of Zanzibar and Mauritius to the east; Ethiopia, Somalia, and Sudan to the north; Congo (Leopoldville), Rwanda, and Burundi to the west; and Northern Rhodesia, Southern Rhodesia, and Nyasaland to the south -- in all, quite an impressive list. In this section, the merits of including these additional countries in the East African common market will be considered.

SIZE OF THE MARKET

Table 8 compares population and income in East Africa with these same variables in the neighboring countries cited above. Ethiopia, Congo, and Sudan are relatively large countries, in terms of both population and income. Southern Rhodesia, although small in population, has an income more than half that of East Africa. A "Greater East African" common market (see map, p. x) -- that included all of the neighboring countries listed in Table 8 in addition to East Africa -- would have a total population of 81 million, more than five times that of East Africa. And the income of this larger grouping would be $5.7 billion, or more than four times the income of East Africa. In this respect, including these countries would represent a considerable increase in aggregate purchasing power.

As the last column of Table 8 suggests, the case for an expanded union appears less bright when purchasing power density is considered. With the exception of Mauritius and Zanzibar, both densely populated islands, the countries surrounding East Africa all have a relatively low PPD. The group as a whole has a PPD of only 1.8, less even than that of East Africa.

The transport system connecting population clusters in East Africa with those in the neighboring countries is far inferior to the
<table>
<thead>
<tr>
<th>Country</th>
<th>Population (thousands)</th>
<th>Income ($ millions)</th>
<th>Purchasing power density (4,000 per square mile)</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Africa</td>
<td>25,252</td>
<td>1,589(^a)</td>
<td>2.3</td>
</tr>
<tr>
<td>Somalia</td>
<td>2,030</td>
<td>56(^b)</td>
<td>0.2</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>12,400</td>
<td>902(^b)</td>
<td>0.6</td>
</tr>
<tr>
<td>Sudan</td>
<td>12,400</td>
<td>1,265(^b)</td>
<td>1.5</td>
</tr>
<tr>
<td>Northern Rhodesia</td>
<td>2,450</td>
<td>577(^c)</td>
<td>0.3</td>
</tr>
<tr>
<td>Southern Rhodesia</td>
<td>3,140</td>
<td>825(^a)</td>
<td>0.5</td>
</tr>
<tr>
<td>Nyasaland</td>
<td>2,890</td>
<td>165(^c)</td>
<td>1.3</td>
</tr>
<tr>
<td>Mauritius</td>
<td>501</td>
<td>167(^b)</td>
<td>17.0</td>
</tr>
<tr>
<td>Zanzibar</td>
<td>293</td>
<td>31(^a)</td>
<td>45.0</td>
</tr>
<tr>
<td>Congo (Leopoldville)</td>
<td>12,753</td>
<td>1,201(^b)</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>81,151</strong></td>
<td><strong>6,753</strong></td>
<td><strong>1.8</strong></td>
</tr>
</tbody>
</table>

**Notes:**
\(^a\) Gross domestic product.
\(^b\) Gross national product.

**Sources:**

East Africa: See Tables 1 and 3.

Other Countries:


system within East Africa itself. It may well be cheaper to ship
goods to Mogadishu from London than from Nairobi or Kampala, because
of the differential cost of ocean and road freight charges. Or, to
take another example, although Sudan is considerably closer geographi-
cally to Kenya than to the countries of Western Europe, the cost of
shipping many types of goods from Kenya may be considerably greater.
There is no rail link between Kenya and Sudan, and the roads are
relatively poor. The problem is further complicated because the part
of Sudan closest to East Africa is the least economically developed
and hence has the lowest purchasing power (and purchasing power
density).

Of course, the transport system need not be regarded as a datum.
Transport in Africa was built for the needs of a colonial pattern of
trade, with rail and road serving to connect inland areas with the
sea. Today, Africa is still heavily dependent on trade with Europe:
the export of tropical agricultural goods (or minerals) and the import
of manufactures. But the pattern of trade is changing.

Although it may appear uneconomic today to build rail links or
all-weather roads between East Africa and many of the neighboring
countries, the situation may change dramatically in the next few
decades. ¹ One would expect the process of economic integration itself
to strengthen the argument for a greatly augmented transport system,
one designed for the needs of intra-African trade. Transport forms
one of the fields in which coordinated economic planning among coun-
tries has the most to offer.²

THE PATTERN OF TRADE

The pattern of trade that has emerged during the past decade
between East Africa and the contiguous states is shown in Table 9

¹ A rail link between Kenya and Northern Rhodesia was considered
a decade ago. See Sir Alexander Gibb, Consultant's Report on the
Railway Link from Northern Rhodesia to Kenya, Lusaka, 1954.

² As noted in Section II, roads are probably more economic than
rail for the development of intra-African trade; and, of course, a
road system would be much cheaper to construct.
### Table 9

**EAST AFRICAN EXTERNAL TRADE (EXURPS PLUS IMPORTS) WITH NEIGHBORING COUNTRIES. 1950-1961**  
(thousands of dollars)

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sudan</td>
<td>1,658</td>
<td>2,346</td>
<td>3,940</td>
<td>2,814</td>
<td>3,492</td>
<td>3,472</td>
<td>4,046</td>
<td>4,057</td>
<td>1,411</td>
<td>2,128</td>
<td>3,623</td>
<td>3,744</td>
</tr>
<tr>
<td>Congo and Ruanda-Urundi</td>
<td>2,419</td>
<td>2,943</td>
<td>4,253</td>
<td>4,388</td>
<td>4,836</td>
<td>4,494</td>
<td>5,429</td>
<td>7,675</td>
<td>9,601</td>
<td>8,655</td>
<td>8,826</td>
<td>11,157</td>
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<tr>
<td>Zanzibar</td>
<td>3,760</td>
<td>5,393</td>
<td>3,903</td>
<td>5,174</td>
<td>4,194</td>
<td>4,242</td>
<td>4,553</td>
<td>5,506</td>
<td>4,214</td>
<td>4,586</td>
<td>4,718</td>
<td>3,945</td>
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<td>Rhodesia and Nyasaland</td>
<td>1,414</td>
<td>1,892</td>
<td>1,792</td>
<td>2,226</td>
<td>3,506</td>
<td>3,721</td>
<td>3,346</td>
<td>2,596</td>
<td>3,973</td>
<td>3,626</td>
<td>3,351</td>
<td>8,644</td>
</tr>
<tr>
<td>Mauritius</td>
<td>476</td>
<td>n.a.</td>
<td>3,999</td>
<td>1,994</td>
<td>935</td>
<td>361</td>
<td>1,042</td>
<td>846</td>
<td>823</td>
<td>1,333</td>
<td>1,526</td>
<td>1,512</td>
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<td>Somalia</td>
<td>1,400</td>
<td>1,698</td>
<td>2,030</td>
<td>1,630</td>
<td>1,333</td>
<td>1,490</td>
<td>1,361</td>
<td>1,156</td>
<td>1,201</td>
<td>1,078</td>
<td>1,492</td>
<td>2,083</td>
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<tr>
<td>Ethiopia</td>
<td>213</td>
<td>193</td>
<td>151</td>
<td>207</td>
<td>249</td>
<td>160</td>
<td>129</td>
<td>137</td>
<td>297</td>
<td>311</td>
<td>605</td>
<td>644</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>11,340</td>
<td>14,053</td>
<td>20,067</td>
<td>18,433</td>
<td>18,545</td>
<td>17,920</td>
<td>19,906</td>
<td>22,277</td>
<td>21,520</td>
<td>21,717</td>
<td>25,141</td>
<td>34,729</td>
</tr>
<tr>
<td>Other external trade</td>
<td>401,747</td>
<td>599,926</td>
<td>668,487</td>
<td>536,020</td>
<td>594,826</td>
<td>701,019</td>
<td>690,586</td>
<td>701,529</td>
<td>661,887</td>
<td>675,881</td>
<td>737,190</td>
<td>713,893</td>
</tr>
<tr>
<td>Inter-territorial trade</td>
<td>24,508</td>
<td>25,729</td>
<td>30,957</td>
<td>37,744</td>
<td>70,320</td>
<td>43,725</td>
<td>43,456</td>
<td>52,602</td>
<td>50,856</td>
<td>56,274</td>
<td>63,809</td>
<td>70,101</td>
</tr>
</tbody>
</table>

**Source:**

which indicates East African external trade (exports plus imports) with each of eight nearby countries or country-groups for the years 1950-1961. For comparison, the table also shows, for the same period, East African external trade with the rest of the world, as well as interterritorial trade. The summary figures, expressed in index numbers (with 1950 set equal to 100) are also shown in Table 10 and are plotted in Fig. 2.

Consider trade with the eight countries taken together, and compare this with other external trade and with interterritorial trade. Figure 2 is useful in illustrating the relative rates of growth during the period of the three sets of trade figures. An inspection of the data reveals that trade with the eight has grown faster over the 12-year period than other external or interterritorial trade. But this growth consisted of a very rapid rise between 1950 and 1952, a relatively small increase from 1952 to 1960, and a sudden spurt during the last year of the period.

The time path of interterritorial trade has been much more regular. In percentage terms interterritorial trade rose by less than trade with the eight, but this seems to have resulted only from the very rapid increase in the latter between 1950 and 1951 (to be discussed below). Other external trade increased more slowly than either of the other two variables, and was virtually constant from 1955 to 1961.

Table 11 shows domestic exports (exports net of re-exports), re-exports, and net imports (imports less goods transferred interterritorially) to the eight neighboring countries, during the period 1950-1961. This is also plotted in Fig. 3. Domestic exports exceeded both net imports and re-exports during all of the period except for the last year. In 1961, while domestic exports declined slightly,

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1The figures for Northern Rhodesia, Southern Rhodesia, and Nyasaland, and for Rwanda and Burundi, are aggregated in all the tables presented here. In some tables, moreover, Rwanda and Burundi (referred to by their former name, "Ruanda-Urundi") are grouped together with Congo.
Table 10

INDEXES OF EAST AFRICAN EXTERNAL TRADE, 1950-1961
(1950 = 100)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade with neighboring</td>
<td>100</td>
<td>124</td>
<td>177</td>
<td>163</td>
<td>164</td>
<td>158</td>
<td>176</td>
<td>196</td>
<td>190</td>
<td>192</td>
<td>222</td>
<td>306</td>
</tr>
<tr>
<td>countries</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other external trade</td>
<td>100</td>
<td>149</td>
<td>166</td>
<td>133</td>
<td>148</td>
<td>174</td>
<td>172</td>
<td>175</td>
<td>165</td>
<td>168</td>
<td>183</td>
<td>178</td>
</tr>
<tr>
<td>Inter-territorial trade</td>
<td>100</td>
<td>105</td>
<td>126</td>
<td>154</td>
<td>165</td>
<td>178</td>
<td>177</td>
<td>215</td>
<td>208</td>
<td>230</td>
<td>260</td>
<td>286</td>
</tr>
</tbody>
</table>

Source:

Constructed from data presented in Table 9.
Fig. 2—Value indices of East African trade
Table 11
EAST AFRICAN EXPORTS, RE-EXPORTS, AND IMPORTS FROM NEIGHBORING COUNTRIES, 1961
(Thousands of dollars)

<table>
<thead>
<tr>
<th>Country</th>
<th>Domestic exports</th>
<th>Re-exports</th>
<th>Net imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sudan</td>
<td>2,915</td>
<td>815</td>
<td>14</td>
</tr>
<tr>
<td>Congo and Ruanda-Urundi</td>
<td>2,862</td>
<td>9,531</td>
<td>1,764</td>
</tr>
<tr>
<td>Zanzibar</td>
<td>2,033</td>
<td>1,232</td>
<td>680</td>
</tr>
<tr>
<td>Rhodesia and Nyasaland</td>
<td>1,638</td>
<td>784</td>
<td>6,222</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1,322</td>
<td>168</td>
<td>22</td>
</tr>
<tr>
<td>Somalia</td>
<td>837</td>
<td>1,187</td>
<td>59</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>305</td>
<td>101</td>
<td>238</td>
</tr>
<tr>
<td>TOTAL</td>
<td>11,912</td>
<td>13,818</td>
<td>8,999</td>
</tr>
</tbody>
</table>

Source:
Fig. 3 — East African trade with neighboring countries
both net imports and re-exports increased sharply, thereby accounting for the sharp rise in total trade with the eight countries during that year.

The relatively rapid rise in trade with the neighboring countries during the period as a whole resulted in large measure from the rise in net imports and re-exports. Net imports rose more than five-fold between 1950 and 1951, largely because, in 1950, the port of Mombasa had been unable to handle all of the goods that would normally have been landed there, forcing many ships to unload at Zanzibar instead. Some of these goods were transhipped to East Africa in 1951, when congestion at Mombasa had subsided somewhat. The high level of net imports in 1952 can be explained largely in terms of an abnormally large shipment of sugar from Mauritius to East Africa (continued, though at a reduced level, in the following year). Finally, the doubling of net imports during the last year of the period can be explained in terms of large government purchases of maize from Southern Rhodesia in response to the severe shortages experienced in East Africa at that time.

Re-exports increased more than four-fold during the period; but a substantial part of this increase occurred during the final year, because re-exports to the Congo and Ruanda-Urundi doubled as the result of a breakdown in the normal methods of distribution in the wake of the Congo emergency. It therefore became more expedient to ship goods to the eastern parts of the Congo and to Ruanda-Urundi through East Africa.

East African domestic exports to the neighboring countries increased by only 65 per cent during the period 1950 to 1951, as contrasted with a 76 per cent increase in total domestic exports during the same period. Thus, the share of East African domestic exports going to these countries declined during the 12-year period. During the same period, moreover, interterritorial trade nearly tripled in value (and exhibited a steadier rate of growth at that). It is perhaps
significant that manufactured goods played a much larger relative role
in interterritorial trade than in trade with the neighboring countries.

**The Gains from a Greater East African Common Market**

East African trade with the neighboring countries accounts for
only 4 per cent of total external trade, and is only half as great
as interterritorial trade. This seems to suggest little advantage in
integrating the neighboring countries into the East African economy. But,
whether or not a Greater East African market is at all meaningful
depends less on the magnitude of trade at present than on the prospects
for achieving a significant expansion in trade, and on the gains that
would result.

Whether or not inclusion of the neighboring countries in the
East African common market would serve to expand trade between East
Africa and these countries depends to a large extent on the factors
responsible for the small volume of trade at present. It is indeed
possible that trade would be somewhat greater in the absence of tariffs
and other artificial restrictions on the flow of goods; but it seems
unlikely that formation of a common market would in itself result
in a dramatic increase in regional specialization and, as a conse-
quence, in an expanded flow of trade among the countries of Greater
East Africa. It seems likely that the relative insignificance of
trade is due also to: (1) the similarity of economic structures of
the countries in Greater East Africa; (2) high transport costs; and
(3) absence of institutions to promote trade, as have existed, for
example, within East Africa.

**Similarity of Economic Structure**

With regard to the first point, there is little scope for trade
with the neighboring countries so long as these countries produce
essentially the same products as East Africa. For example, high on

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1It may also suggest little disadvantage; but the effort and
administrative costs involved in enlarging the common market, and the
risks involved, should be offset by a fairly high expected gain.
the list of imports for each country in the region are manufactured goods, and there is little prospect that Greater East Africa will become substantially more self-sufficient in the production of these goods in the near future. Or, looking at the other side of the coin, each country in Greater East Africa depends importantly on foreign exchange earned from the sale of exports, and these exports consist largely of agricultural goods and minerals. It seems unlikely that markets for these products can be found within the region, at least in the foreseeable future.

However, the process of economic development is intended to change the structure of the Greater East African economies. Although few manufactured goods are currently produced in this region, the production of manufactures is certain to increase sharply over the next few decades. In the absence of any attempt to develop the Greater East African countries along complementary lines, industrialization is certain to take the form of parallel development -- that is, duplication of many industries in a number of countries -- with a consequent absence of a basis for specialization and trade. But it might be possible to achieve a substantially greater degree of economic interaction and interdependence. In this respect, perhaps it is encouraging that trade in manufactured goods -- including processed foods, beverages, and tobacco -- which constitutes a large and growing percentage of interterritorial trade, is as yet not well developed between East Africa and the neighboring countries. For it is precisely this trade that could be expected to benefit most from an enlargement of the East African common market, and from other measures aimed at economic cooperation among the countries of Greater East Africa.

Transport

It might be difficult to develop the region on the basis of an emerging pattern of complementarity. Inadequate transport is one reason why such development may prove difficult and costly. As noted above, the transport system connecting East Africa with the neighboring areas is very imperfectly developed, making it expensive to ship
goods from producer to consumer within this larger area. Although the growth of trade between Kenya and Uganda has been fostered by the railway line connecting the two countries, no comparable system links East Africa with Sudan, Ethiopia, or the Rhodesias. It may be economic to introduce some small improvements in the existing transport system, but it is likely to be many years before it pays, for example, to build a rail link between Northern Rhodesia and Tanganyika, as has been recently suggested. Such a railway may be built for political reasons, but it appears difficult to justify such a move on economic grounds, at least for the time being.

For the type of trade now existing (and likely to develop) between the East African countries and the contiguous states, a railway may be unnecessary; an improved road system may be quite satisfactory. The Greater East African countries will continue to depend on markets in Europe for the bulk of their exports -- agricultural and mineral products. But the trade likely to develop among African countries will tend to consist of light manufactures -- processed foods, textiles, footwear, and so on -- products with a relatively low weight-to-value ratio, which can be shipped economically by road. Of course, even the road system connecting East Africa with the surrounding states needs a great deal of improvement to enable the transport of goods to be put on a low cost, dependable basis. But it should be far cheaper to improve already existing roads than to attempt to build a rail system.

One should not be too optimistic concerning the prospects for improved transport facilities, and for the impact of such improvements on trade with the neighboring countries. The distances between population centers are great; FPD in Greater East Africa is exceedingly low. Between East Africa and the countries to the north is a relatively poor and undeveloped area -- Kenya's northern province, southern Ethiopia, and the southern part of Sudan. To the south, it is a considerable distance from the larger centers of East Africa to the richer parts of Northern and Southern Rhodesia. Although it is doubtless true, as a general proposition, that improvements in transport will help "open the area" economically, so will alternative uses of the
resources; and the alternative uses may, incidentally, provide a much greater direct economic benefit. However, it is fair to say that some improvements in transport are likely to prove economic in time.

**Institutional Factors**

Institutional factors help explain the relatively more rapid growth of trade within East Africa than between East Africa and her neighbors. Whereas it was government policy in former British East Africa for several decades to encourage the growth of trade within the region, no such policy existed with respect to the other countries in the area. In fact, trade has been impeded by such policies as exchange control -- for example, exchange control by Sudan in 1950 and 1959 resulted in a dramatic decline (in percentage terms) of Sudanese imports from East Africa.

The formation of a Greater East African common market would in itself tend to promote some increase in trade within the area. Improvements in the road system would provide further gains. But there is little reason to expect the increase in trade to be appreciable unless positive steps are taken by the governments concerned to promote increased trade based on a realistic view of regional resource specialization. A much greater degree of economic cooperation is required than has existed to date, resulting in the kind of planned industrialization that allocates to each country the industries for which that country has a comparative advantage, in a Greater East African context.

This kind of coordination has not yet developed even among Kenya, Uganda, and Tanganyika. It seems less likely that such extensive coordination would be attainable by a still larger, less homogeneous group. Within East Africa, the prospects for economic cooperation are much greater. The East African countries have similar cultures, a common language, a common background of British administration, and similar governmental institutions. Much more important, the existence of the East African Common Services Organization serves as an important unifying link, a foundation upon which a regional planning authority
can be built. And the prospects for bringing the three East African states together into a political federation are much greater than that of forming a larger Greater East African federation.

The difficulty of achieving economic coordination in a Greater East African setting forces one to be pessimistic concerning the prospective gains from enlarging the East African common market. In addition, it appears likely that any expansion in the common market would be brought about at the cost of regional coordination and unity in the smaller East African grouping as well. If this is the case, then the larger grouping might not only promise a small gain but might threaten an actual loss. If the choice is between a larger common market on the one hand, and a smaller but tighter group, the latter is probably preferable, for the reasons cited in Section IV. This is particularly true in view of the obstacles raised by the transport system. Because of high transport costs -- and a high cost of improving the transport network -- the gains from an expanded common market would be limited in any event. But because of the difficulty of achieving economic coordination in the larger group, it makes more sense to proceed slowly, first strengthening the existing common market, and then adding new countries only at a later date.

**DISTRIBUTION OF THE GAINS**

It is of some interest to consider the differential effect that expanding the East African common market would have on the three East African states. One would expect that an effectively enlarged economic union would shift the center of gravity of the East African market for manufactures and in this way possibly affect the distribution of the gains. The extent to which this would happen would depend, of course, on what improvements in the transport system were introduced. But, with even modest improvements in transport, such areas as western Uganda and southern Tanganyika, now on the fringes of the East African market, would doubtless benefit from the expanded market; in other words, the fringe of the market would be shifted out.¹

¹This would also raise a new set of problems concerning compensation.
Table 12 shows the total external trade between Kenya, Uganda, and Tanganyika, respectively, and the neighboring countries, in 1961. Most of Tanganyika’s trade was with the Rhodesian Federation, Ruanda-Urundi, and Zanzibar, as one might expect on the basis of location. Also to be expected, Uganda’s trade was largely with Congo, Sudan, and Ruanda-Urundi. Kenya’s trade was more evenly spread among the eight countries, possibly reflecting the greater diversity of Kenya’s economy. Kenya accounted for 44.9 per cent of East African trade with the eight countries, and better than half of the trade with Mauritius (93.9 per cent), Somali (81.5 per cent), Ethiopia (77.8 per cent), and the Rhodesian Federation (50.8 per cent).

Table 13 contains figures on domestic exports from Kenya, Uganda, and Tanganyika, respectively, to the same eight countries. Domestic exports are of particular interest because they indicate the extent to which the neighboring countries serve to expand the market for East African products. From the table, the role of transportation is again unmistakably large. Uganda’s domestic exports are concentrated in Sudan and Congo, whereas Tanganyika’s domestic exports are shipped mainly to Zanzibar, Ruanda-Urundi, and the Rhodesian Federation. Kenya’s domestic exports are much less concentrated geographically than those of the other two East African states. Moreover, Kenya accounts for the major part of total East African domestic exports to the group as a whole, and to Ethiopia, Ruanda-Urundi, Sudan, and Mauritius individually.

If East African exports to the contiguous countries expand relative to interterritorial trade, then Uganda and Tanganyika stand to gain relative to Kenya. The figures suggest that either Uganda or Tanganyika has a relative advantage in shipping goods to four of the eight countries, and these four account for the major part of East African exports to the eight countries as a whole. In aggregate terms, we see that Kenya accounts for just over 40 per cent of East African domestic exports to the eight countries, as compared with 65 per cent of intra-East Africa exports. This suggests that Kenya might play a somewhat less important role in a Greater East African common market.
Table 12

EAST AFRICAN TRADE WITH NEIGHBORING COUNTRIES, 1961
(thousands of dollars)

<table>
<thead>
<tr>
<th>Country</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Tanganyika</th>
<th>East Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sudan</td>
<td>1,235</td>
<td>2,458</td>
<td>53</td>
<td>3,746</td>
</tr>
<tr>
<td>Zanzibar</td>
<td>1,803</td>
<td>507</td>
<td>1,635</td>
<td>3,945</td>
</tr>
<tr>
<td>Rhodesia and</td>
<td>43,904</td>
<td>428</td>
<td>3,822</td>
<td>48,154</td>
</tr>
<tr>
<td>Nyasaland</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Congo</td>
<td>3,366</td>
<td>4,264</td>
<td>851</td>
<td>8,483</td>
</tr>
<tr>
<td>Ruanda-Urundi</td>
<td>1,184</td>
<td>2,097</td>
<td>2,397</td>
<td>5,678</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1,420</td>
<td>6</td>
<td>87</td>
<td>1,513</td>
</tr>
<tr>
<td>Somalia</td>
<td>1,697</td>
<td>207</td>
<td>179</td>
<td>2,083</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>501</td>
<td>112</td>
<td>25</td>
<td>638</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>55,112</td>
<td>10,079</td>
<td>9,049</td>
<td>74,240</td>
</tr>
</tbody>
</table>

**Source:**

Table 13
DOMESTIC EXPORTS FROM KENYA, UGANDA, AND TANGANYIKA
TO NEIGHBORING COUNTRIES, 1961
(thousands of dollars)

<table>
<thead>
<tr>
<th>Country of Destination</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Tanganyika</th>
<th>East Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sudan</td>
<td>543</td>
<td>2,335</td>
<td>39</td>
<td>2,917</td>
</tr>
<tr>
<td>Zanzibar</td>
<td>795</td>
<td>162</td>
<td>1,075</td>
<td>2,032</td>
</tr>
<tr>
<td>Rhodesia and Nyasaland</td>
<td>462</td>
<td>67</td>
<td>1,086</td>
<td>1,635</td>
</tr>
<tr>
<td>Congo</td>
<td>426</td>
<td>918</td>
<td>106</td>
<td>1,452</td>
</tr>
<tr>
<td>Ruanda-Urundi</td>
<td>745</td>
<td>154</td>
<td>512</td>
<td>1,411</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1,243</td>
<td>6</td>
<td>73</td>
<td>1,322</td>
</tr>
<tr>
<td>Somalia</td>
<td>518</td>
<td>207</td>
<td>112</td>
<td>837</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>288</td>
<td>-</td>
<td>14</td>
<td>302</td>
</tr>
<tr>
<td>TOTAL</td>
<td>5,042</td>
<td>3,849</td>
<td>3,017</td>
<td>11,908</td>
</tr>
</tbody>
</table>

Note:
- None.

Source:
than in the present East African common market; but this follows only from a highly aggregated view of the pattern of trade.

At a more disaggregated level, Table 14 presents figures on domestic exports of manufactured goods (SITC groups 5, 7, and 8) to the same group of countries. Of manufactures exported to the group, 62.7 per cent originate in Kenya. With respect to individual countries, Kenya accounts for the lion's share of East African manufactured exports to each country except Rhodesia and Nyasaland. It appears that the central role played by Kenya in providing manufactured goods to Uganda and Tanganyika has resulted also in Kenya's being the leading exporter of these goods to neighboring countries.

This might lead one to think that measures to promote an expansion of trade between East Africa and the nearby economies would merely result in a scalar expansion of the present interterritorial trade pattern, with industry continuing to locate primarily in Kenya. This result follows from the fact that the type of trade most likely to be significantly affected by an expanded common market is trade in manufacturing. Initially, at least, if the surrounding countries were to increase their imports of East African products, Kenya's industrial sector would receive a boost by virtue of its being more firmly established. The tendency would be for Kenya's manufactures to replace those of some country outside of Africa (trade diversion) or to substitute for industry now established in the country in question (trade creation).

Over a longer period of time, however, forces might be set in motion tending to draw a larger share of new industry into other countries. Western Uganda, which is now on the fringe (geographically) of the East African common market, would have a strategically more desirable position, for example, if the Congo were drawn into the group. This possible shift in the center of gravity of the group would be of great significance as regards the distribution of gains. But this effect is highly speculative, and would at any rate occur only after some time.
Table 14

EAST AFRICAN DOMESTIC EXPORTS OF MANUFACTURES
TO NEIGHBORING COUNTRIES, 1961
(U.S. dollars)

<table>
<thead>
<tr>
<th>Country</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Tanganyika</th>
<th>East Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Somalia</td>
<td>140,674</td>
<td>-</td>
<td>38,175</td>
<td>188,849</td>
</tr>
<tr>
<td>Sudan</td>
<td>41,272</td>
<td>1,585</td>
<td>-</td>
<td>42,857</td>
</tr>
<tr>
<td>Mauritius</td>
<td>713,468</td>
<td>3,966</td>
<td>12,555</td>
<td>729,981</td>
</tr>
<tr>
<td>Rhodesia and Nyasaland</td>
<td>130,298</td>
<td>-</td>
<td>581,109</td>
<td>711,407</td>
</tr>
<tr>
<td>Zanzibar</td>
<td>130,522</td>
<td>5,597</td>
<td>43,529</td>
<td>179,648</td>
</tr>
<tr>
<td>Congo</td>
<td>95,312</td>
<td>122,665</td>
<td>7,076</td>
<td>225,053</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>141,137</td>
<td>-</td>
<td>14,358</td>
<td>155,495</td>
</tr>
<tr>
<td>Ruanda-Urundi</td>
<td>216,600</td>
<td>68,776</td>
<td>64,439</td>
<td>349,815</td>
</tr>
<tr>
<td>TOTAL:</td>
<td>1,619,283</td>
<td>202,591</td>
<td>761,241</td>
<td>2,583,115</td>
</tr>
</tbody>
</table>

Note:
- None.

Source:
One interesting possibility is that the area would eventually develop several highly interdependent centers, each concentrating on certain industries, as well as serving its respective local market. For the time being this seems little more than fanciful, given the small economic size of the market, but it is worth bearing in mind as a long-range possibility.

Another point of interest concerns what effect possible improvements in the transportation system would have on the agglomerative tendency. Balassa has pointed out that improvements in transportation tend to make the market larger but, at the same time, also tend to reduce the advantages offered by proximity to a larger center. Thus, although it will be cheaper for an industry in Nairobi to supply remote markets, it may also be easier for an industry to set up farther from Nairobi because of the improved access to the facilities of that city, even from a distance. One would think that the results of improved transportation would be an increased profitability of industries that are economic only at a fairly large scale, for the market effectively served by an industry will be greater. At the same time there may be a gradual decentralization -- together with an improvement of efficiency -- of industries serving local markets.

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2 Which effect predominates depends on the importance of transport costs in the industry concerned.
VI. SOME POLICY SUGGESTIONS

The preceding sections have considered the contribution that economic integration makes to economic development in East Africa. This section will pull together the conclusions that emerge from the earlier discussion and suggest some policy measures to improve the performance of the East African common market.

There is a strong case for continuing the present East African common market. Largely because of economies of scale and, possibly, external economies, an industrialization program has a greater likelihood of success if industrial output is produced for an integrated market. Although the effective expansion of the East African market is overstated by a simple addition of the three country markets, the expansion is certainly sufficient to have a significant effect on the profitability of a number of industries. Moreover, although the transport system within East Africa is certainly not highly developed by western standards, it is sufficiently developed to provide for the shipment of goods among the major population centers of the area at a relatively low cost; and the demand for industrial goods is heavily concentrated in these centers.

The East African market has probably resulted in some trade diversion to high cost producers, and consequently in an inefficient resource use. But there is reason to believe that this effect has been offset by trade creation. It is true that, in a newly developing area, where labor has a low opportunity cost, the gains from trade creation are likely to be low; but there are greater prospects for substantial gains from trade based on specialization in the coming decades. A growth in the interdependence of the East African economies can well lead to a rise in the relative importance of interterritorial trade and an increase in the benefits derived from this trade.

It can be argued that at a very early stage of economic development the chief contribution of a common market is its effect on the inflow of new capital. In later years, when the opportunity cost of labor is higher, the gains from utilizing resources more efficiently
may match, and eventually surpass, those from new foreign investment. In this scheme of development, East Africa is still at the first stage. At this stage, the common market probably makes a relatively small contribution to over-all East African income -- small, for example, compared with measures to increase the productivity of the agricultural sector. One might hazard the guess that if the common market broke up, in the short run the result would be only a one or two per cent decline in the area's income.

The real importance of the common market relates to its role in the subsequent stage of East African development, when labor becomes a scarce resource, and when the labor force becomes relatively highly skilled and functionally specialized. At that time, the opportunities for interterritorial specialization and trade will be greater. Coupled with opportunities for economies of scale, this might mean that the common market will then contribute a higher percentage to a higher East African income.

Capital mobility can play an important role in the East African common market by channeling private investment resources to the area with the greatest investment opportunities. Even more important, foreign private capital is drawn into the common market because of the additional industries made profitable as a result of external economies and economies of scale. In East Africa, foreign capital generates new income by creating employment for labor whose opportunity cost may not be much above zero. Of course, even after the opportunity cost of labor will have risen appreciably, foreign investment will continue to play an important role.

But whether East Africa derives the bulk of the gains from economies of scale, and from the new investment resulting from the appearance of economies of scale, depends on pricing policy in the industries affected. As these industries are likely to be subject to monopoly control, and as a profit-maximizing monopolist will not automatically pass on the gains from economies of scale to the economy, it is necessary for the East African governments to devise appropriate
policies to ensure that the industries are forced to share the gains with the economy. This is particularly true with respect to foreign monopolists, for in this case the monopoly profits do not enter into East African income. However, the danger remains that a highly restrictive policy will create more harm than good by reducing incentives for businessmen to invest in East Africa.

It seems likely that, although the common market creates an over-all rise in East African income, most, if not all, of this gain accrues to Kenya. It is not possible to determine whether Uganda and Tanganyika are made better or worse off as a result of economic integration with Kenya.¹ In time, both Uganda and Tanganyika are certain to derive a larger share of the gain as industry becomes less centralized; but in the next decade or so, neither Uganda nor Tanganyika will gain more than marginally from the common market, and either or both country may lose. This suggests the need, in the short run at least, for Kenya to provide compensation to both countries.

Redistributing the gains will not per se strengthen the common market economically. Indeed, redistribution may weaken the common market by shifting resources to areas where these resources make a lower marginal contribution to raising output. But compensation may be necessary on political grounds, especially as a short run measure. Kenya should view compensation as a necessary price to ensure the continuation of the common market and to ensure also the cooperation of its two common market partners. Viewed from an East African point of view, compensation represents a necessary compromise between maximizing over-all East African income and satisfying the demands of the individual participants.

¹One important aspect of East African economic integration that is not discussed here is the role of the East African Common Services Organization (EACSO). EACSO has, by administering a number of services -- for example, postal service, railways, harbors, collection of customs revenues -- created very large benefits for the three East African countries, because EACSO has permitted these countries to economize on a very scarce resource: top-level managerial skill. It may well be that, with regard to the common services, Uganda and Tanganyika have received greater gains than Kenya.
Given the necessity of compensation, fiscal redistribution is preferable to industrial redistribution. Some industry will flow to Uganda and Tanganyika in response to the operation of economic forces. Beyond this, there may be a need to site additional industry in these countries for political reasons. But East African development will suffer if private industry is narrowly confined with respect to choice of location.

In order to realize the full potential of an East African economic union, it is important that active and deliberate measures be taken to promote increased trade based on regional resource specialization. This is almost certain to mean, in a newly developing area like East Africa, much more coordination of economic policies than has existed to date. It would be especially desirable for the East African countries to establish a regional planning authority, perhaps building on the structure already provided by the Common Services Organization. A regional organization charged with responsibility for planning development on an East African basis could have a tremendous impact on economic development, and on industrial development in particular. Such an organization could take stock of the area's needs and of its resource availabilities, and could plan the character and pace of development over the coming years. It would clearly be a step forward for East Africa to face its economic problems in this manner.

It would be advantageous also for compensation to be handled as an integral part of the regional development plan. Compensation is going to result in a tendency for governmental resources to flow out of Kenya, as an offset to the inflow of private industrial capital. Assuming a part of the public funds are used to build industry, this implies a relatively more important role of the government in the industrial sectors of Uganda and Tanganyika than in Kenya. This need not be disadvantageous, but it is important that the government not become involved in competing with private capital. It is therefore well to think through the industrial development of the region -- the government's role as well as that of private enterprise.
It may well be that political federation has a vitally important economic function in East Africa. For one thing, as we have noted, several stresses and strains have appeared in the operation of the common market, even before Tanganyika's independence in 1961. With all three independent by the end of 1963, intercountry conflict of interests will be potentially greater. One country may choose to allocate its resources in a way that is regarded as necessary by that country for political reasons not optimal for the region as a whole. The government of Tanganyika, for example, may find it difficult to explain to its electorate why most industry goes to Kenya. One solution would be for Tanganyika to insist on its "fair share" of the region's new industry; but this, as we have seen, defeats the purpose of economic integration. A better alternative would be to form a federation, trying to convert national points of view to an East African point of view. If this can be done, the prospects of retaining the common market would be greatly strengthened.

With regard to enlarging the economic union beyond East African borders, it was noted that a Greater East African market would be four times as large as the East African market alone, although the limitations put on intercountry trade by the inadequate transport facilities mean that the gains would be limited. A substantial expansion in trade, and hence a greater degree of regional specialization, on a Greater East African basis is unlikely to come about in the immediate future, but would doubtless be forthcoming in time, especially if the transport system were improved.

The objection to enlarging the common market at the present time is that this might dilute the smaller group. In other words, the gains from expansion would quite likely be more than offset by the resulting weakening of East African ties. It is, of course, possible that the East African common market could be strengthened and, at the same time, other countries added on to form a looser framework, superimposed on the other. It seems unlikely that such an arrangement would work. For one thing, the gains from an enlarged common market are likely to be of little consequence without some economic
coordination, and it seems doubtful that the larger grouping could provide the degree of coordination that one might expect of East Africa.

Federation is of such overriding importance to East Africa that it should not be sacrificed for a more vaguely perceived gain from an expanded common market -- at least, not yet. Economic ties among Kenya, Uganda, and Tanganyika can be strengthened, possibly through the formation of a political federation, together with the establishment of a central economic authority with some planning responsibility. When this has been accomplished, it may appear advantageous to enter into looser economic relations with the surrounding countries, with the objective of integrating these economies more fully with East Africa at a still later date. It might be possible to enter into specific kinds of joint ventures with some of the neighboring countries -- for example, improvement of the transport system. But formation of a common market, if it is to be effective, would involve a more complex administrative machinery than currently exists to coordinate economic affairs in the participating countries. Although this might be desirable in time, it would best be put off until Kenya, Uganda, and Tanganyika are able to strengthen their economic ties.
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