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SELECTED THEORETICAL ASPECTS OF THE INTERNATIONAL INTEGRATION OF UNDERDEVELOPED COUNTRIES²

Abstract

The key theoretical problem related to integration of less developed countries is the possibility of legitimate application of the existing theoretical framework of international economic integration to developed as well as developing countries (the question of its universality).

The article aims at presenting selected theoretical approaches to the economic integration of less developed countries in the context of the general theory of international integration. With the use of an historical approach to the descriptive analytical method, the relevant international and Polish literature on the topic spanning from the middle of the past century until the beginning of the 21st century were thoroughly analysed.

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Introduction

Questions surrounding the international economic integration of underdeveloped countries have long been the subject of scholarly debate. Since the second half of the twentieth century there has been a basic academic consensus (Balassa, 1973, p. 5-6; Robson, 1987, p. 3; El-Agraa 1989, p. 11; Miklaszewski 1999, p. 14;

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Makać 2001, p. 30), that the main objective of international economic integration is to exert a positive impact on the economic growth and development of countries involved in the process³. The theory of economic integration formulated by B. Balassa (the conditional convergence hypothesis) has now entered the canon of development theory (Bartkowiak, 2013, p. 159-162) and it is difficult to argue with Balassa's view on the economic issues that face underdeveloped countries, which holds that "in underdeveloped countries, considerations of economic development are of basic importance ..." (Balassa, 1973, p. 6).

On the level of theory, however, a number of differences can be observed among scholars, especially in their approach to the possibility of using current theories of regional integration (their universality) to analyse both highly developed and underdeveloped countries.

The purpose of this article is to present selected theoretical aspects of the international economic integration of underdeveloped countries in the context of the general theory of international integration. The analysis is based on an analytical-descriptive method used in a historical perspective, and relies on important Polish and international literature on the subject published between the middle of the 20th and the start of the 21st century. Due to formal constraints, the article only focuses on the main themes of the debate.

The integration of underdeveloped countries in light of the traditional theory of international economic integration

The first part of this discussion aims to determine whether it is appropriate to analyse underdeveloped countries in a traditional framework, based on the standard theory of customs union proposed in the middle of the 20th century by Viner (1950), whose ideas were further elaborated by Meade (1956) and Lipsey (1960), as well as by scholars such as Johnson (1962), Makower and Morton (1953). Their research was static and limited to analysing the direct effects of customs unions based on the price mechanism; the reason was that dynamic (indirect) effects were believed to be linked to the establishment of a single market, i.e. a more profound form of economic integration (Czepurko, 1972, p. 93-121).

J. Viner supplemented the theory of the customs union, and hence the theory of integration, with the basic concepts of *trade creation and trade diversion*. Trade creation is understood as the emergence of new trade flows between member

³The first attempts at linking the theory of economic integration with the theory of economic development were undertaken at the beginning of the 1960s., (Czepurko, 1972, p. 94). The relationship between international economic integration and economic growth and development have since become the subject of numerous empirical studies, including: Rivera-Batiz & Romer, (1996); Vamvakidis, (1998); ion (2004).

states as a consequence of introducing free trade within the union. Trade diversion, on the other hand, involves replacing cheaper imports from non-member states with local products or products from the territory of the union, whose prices have become competitive thanks to the liberalisation of internal trade and the simultaneous imposition of uniform external customs duties⁴.

Subsequent research (Meade, Lipsey) allowed one to distinguish two additional effects (sub-effects): production effects, whereby higher-cost local products are replaced by cheaper imports from a partner country, and consumption effects, whereby the consumer potential of a given society grows as local prices go down to the price level of the customs union. The growth of consumer demand and the attendant rise in imports are currently bracketed under the concept of trade creation. As remarked by Bijak-Kaszuba (2003, p. 79), "it is assumed to have a production aspect (replacing local production with imports) and a consumption aspect (relying on imports to satisfy increased consumer demand)". As a consequence of trade creation in this sense, trade volumes grow and welfare increases, which has led many to interpret trade creation as a clearly positive effect of the customs union, both from the perspective of individual member states and the entire world economy. In trade diversion, on the other hand, the direction of supply is shifted from more to less efficient producers; accordingly, the use of production factors decreases in efficiency, and the process can be analysed as a negative effect of the customs union (Siwiński, 1976, p. 36). In traditional theory, whether a given customs union creates or diverts trade (i.e. whether trade expands or shrinks on a global scale) is an important determinant in allowing an estimation of its benefits.

It should be noted, however, that under certain circumstances, and especially from the perspective of individual member states, trade diversion can also generate important positive results. Zielińska-Głębocka (1997, p. 218) refers to a situation "when higher-cost imports from third parties or less efficient member states are replaced with lower-cost supplies from a new country that joins the union. Once the structure of trade changes, prices in the customs union go down, and production and consumption effects of trade set in. Losses in the export share of higher-cost countries promote an increase in allocation efficiency and foster the growth of welfare in individual member states"⁵.

Some scholars claim that the general theory of economic integration can also be fully applied to underdeveloped countries. These include A. M. El-Agraa

⁴The traditional theory of a customs union is widely discussed in relevant literature, including: El-Agraa (1983); Chacholiades (1978); Robson (1987); Bożyk & Misala (2003); Misala (2001); Zielińska-Głębocka (1997).

⁵The interpretation of trade creation and diversion effects was discussed by, among others: Kowalczyk (1999); Schiff & Winters (2003).

(1989, p. 98-99), whose theory, based on the verification of Brown's model (Brown, 1961), places particular emphasis on the static benefits that accompany resource reallocation. On the level of theory, he claims, there are no differences between customs unions established by developed and developing countries.

Scholars who take issue with this claim, to mention but a few, include Allen and Meier; both reject the applicability of the standard customs union theory to developing countries (Andic, Andic, & Dosser, 1971, p. 15). Balassa (1968, p. 90) believes that "the traditional theory of a customs union has limited applicability to the integration of developing economies", and calls for a new theory to address the issue. Linder (1968, p. 91), in turn, maintains that the traditional view cannot be unreservedly applied to trade between underdeveloped countries, but at the same time dismisses the possibility of creating a theory of customs unions and economic development that would have a universal application. Thus, he belongs to a group of scholars who do not reject the theory of the customs union as altogether inapplicable to developing countries, but who dismiss a particular version of it that only deals with developed economies. This approach drives home the fact that there can be "variants" of the customs union and that their success criteria may be different than conventionally assumed. It can also be valuable for the analysis and politics of underdeveloped countries. Scholars in this group focus on the issues of industrialisation, the protection of international trade resources, and the interpretation of the static effects of the customs union.

Kitamura (1968, p. 56) emphasises that trade diversion is an essential component of integration policy and discrimination can be seen as an inherent feature of such agreements. Hence, he views trade diversion as "rather positive than negative", adding that "especially in underdeveloped regions, the margin of preference must be extensive enough to promote economic growth through creating a broadened regional market".

This is supported by the Polish economist, Dobosiewicz (1976, p. 226), who maintains that for developing countries trade diversion is not only beneficial but even necessary. It decreases their dependence on a narrow group of suppliers, and above all, creates better conditions for long-term development. This allows them to move away from one-sided specialisation and achieve independence from developed countries.

In contrast to the traditional theory of customs union, in which trade creation is seen as positive and trade diversion as negative, Andic, Andic, and Dosser (1971, p. 25-26) conclude that in reality both can have positive and negative implications for the welfare of the union. Therefore, both effects should be divided into individual components and not taken as a whole to improve or decrease the welfare of the group.

Linder (1968, p. 105) suggests something else entirely; in his view, when studying expected integration benefits and putting them to the best use, trade creation

and diversion should be treated as a single concept, labeled as a “beneficial change in trade direction”. Following Linder, Sakamoto claims that when trade diversion occurs from a developed country to a relatively more efficient developing country, the group’s overall welfare need not decrease. He also uses the term of *efficient trade diversion* to signal that resources generated in this way could not be acquired by the given region or country without integration (Hosny, 2013, p. 142).

Literature does not ultimately settle the question of how the static effects of the union are affected by economic competitiveness and the complementarity of individual member states (Wysokińska, 1995, p. 871). There is a general agreement that actual or potential complementarity in the economic structures of partner countries promotes integration (Bożyk & Misala, 2003, p. 28-29). This corresponds with the view of many contemporary researchers studying the economic integration of underdeveloped countries (Langhammer & Hiemenz 1990, p. 68; Inotai 1991 p. 5-6; Shams 2003 p. 2), who claim that differences in the ownership of production factors and complementary economic structures are generally conducive to the process.

The integration of underdeveloped countries and a new theory of international economic integration

Attempts at dynamising the theory of the customs union were first undertaken at the beginning of the 1960s by Balassa, who introduced the income mechanism into his analyses of the customs union’s impact on international trade. This meant undertaking research on the influence of the customs union on the growth rate of national income in particular member states and its feedback influence on their trade (Czepurko, 1972, p. 121).

Principal dynamic effects include: strengthening competition within the integrated area, understood especially as new opportunities for producers to enter hitherto inaccessible markets; accelerating technological progress and innovation; (company-internal and company-external) scale benefits linked to the growth of market size, and investment effects (Chacholiades, 1978, p. 558-559)⁶.

When a union is formed, new opportunities are created for “internal” and “external” investors, which, in the long run, may lead to investment creation and diversion (Machlup, 1986, p. 163). Investment creation is understood as a rise in total investment throughout the global economy, while investment diversion involves moving investment from third parties to member states (Misala, 2001,

⁶An extended discussion of the dynamic effects of integration can be found, for instance, in: El-Agraa (1983); Balassa (1973); Robson (1987); Bożyk & Misala (2003); Misala (2001); Zielińska-Głębocka (1997).

p. 359). The economic interpretation of investment effects differs from the interpretation of short-term trade effects. Investment diversion can be a positive event, signaling a more efficient use of capital in places where its marginal efficiency is higher, which leads to a growth in the total income of member states (which does not preclude that losses may be sustained by the owners of production factors in third party countries, from which capital is diverted). Investment creation causes a surge in GDP, on the condition that potential savings are greater than the opportunities for investment or when it is possible to stimulate a greater trend to save and thus maintain their high level. Otherwise, investment creation can generate losses by contributing to recession (Machlup, 1986, p. 164-165). Despite these risks, stimulating investment effects (and attracting investments that do not incur a debt relationship – FDI) is now considered one of the main economic goals of member states in a union (Zorska, 2007, p. 38) and has particular importance for underdeveloped countries.

Dynamic effects are much more difficult to analyse than static effects (Chaholiades, 1978, p. 558) nevertheless, many scholars suggest it is the dynamic, and not the static approach that is better suited to analysing the integration of developing countries. Kitamura (1968, p. 38) writes: "...for developing countries, it is not the change in foreign trade revenues as such, but the need to speed up economic development that provides the essential impetus and yardstick for regional economic integration. Since the economic growth of countries in these regions requires fast and far-reaching transformations in the structure of production and trade, an analysis of welfare growth that follows certain changes to existing structure and trade can be less important than an analysis of their impact on investment and technological progress".

In his book on economic integration in Africa (*Economic Integration in Africa*), Robson (1968, p. 56-58) delivers a trenchant critique of the traditional theory of the customs union, which he considers to have very limited applicability to the integration of developing countries. He maintains, however, that just because traditional theory largely focuses on the analysis of integration problems within a static framework does not mean that it has no relevance for less developed countries, where the focus is on economic growth and development.

In this context, as Jaber (1971, p. 256) recapitulates, most authors agree that the traditional theory of integration has limited (if any) applicability to the integration of underdeveloped countries. In their view, it should be approached as an issue of economic development rather than a tariff problem; in order to assess the expediency of economic integration among the least developed countries, emphasis should be put on dynamic effects above all.

Rueda-Junquera (2006, p. 4) concurs, adding that the basic justification for the integration of underdeveloped countries is provided by the dynamic approach. He sees the provisions made as part of integration agreements as a means of

accelerating the growth rate of members states and promoting their long-term development. He also believes that integration programs can contribute to creating auspicious economic conditions for overcoming the structural problems of underdeveloped countries.

Conclusions

The analysis warrants the conclusion that the bulk of the debate about the applicability of the theoretical framework of international economic integration to underdeveloped countries focuses on the static aspect of the process. Opinions are divided over its usefulness in this context; most scholars approach it with many reservations. There is a much broader consensus with regard to the dynamic approach. Scholars agree that the latter can be expected to lead to the long-term growth and development of partner countries and should thus be the primary justification for the economic integration of underdeveloped countries..

It should be noted that the theoretical framework elaborated for developed countries specifically highlights the positive effects of integration. Experience dictates, however, that its costs are very high and net profits extremely difficult to achieve under the specific conditions of underdeveloped countries. In the latter, integration additionally requires that comprehensive, country-specific subsidiary measures be taken; in the context of the institutional inefficiency of many underdeveloped countries, such (usually spontaneous) initiatives are often doomed to failure. The numerous unions created by African countries are a good case in point. In existence since the 1960s, they have only brought very modest short- and long-term effects. Because the exports portfolio of individual countries is very limited, (for the bulk of African states, a single product accounts for more than half of all exports), partners' demands often cannot be met within the region, which means that union-external exports continue to predominate. In terms of long-term effects, investment effects are now the most noticeable. These, however, can hardly be attributed to the actions of the groups; to a much greater extent, they stem from the "new investment philosophy", implemented mainly by the Chinese.

At the same time, it seems that the theoretical framework created to analyse international economic integration in the previous century, which continues to furnish the foundation for the economic cost-and-benefit analyses of economic integration, also requires a certain adjustment to the conditions of the present-day world economy. In particular, it should focus on stimulating positive feedback between regionalisation and globalisation and harnessing both for the improvement of the economic situation of underdeveloped countries.

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