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STATE TRADING AND REGIONAL ECONOMIC
INTEGRATION : THE EAST AFRICAN
EXPERIENCE

by

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Abstract

The paper examines the impact of state trading on the operation of the East African Common Market. The first part of the paper develops a general framework for the analysis of this question. After setting out the alternative concepts of integration corresponding to the principles of integration in market economies and centrally planned economies and the role of state trading therein, the paper contrasts them with the situation in integration attempts among developing countries with different economic systems. This is followed by a discussion of the definition, functions, structure and operation of state trading enterprises. An attempt is then made to explore the impact of state trading systems on intra-regional trade in the light of various obstacles to the expansion of such trade.

The second part of the paper traces the evolution and structure of state trading enterprises in the East African countries. The characteristics of state trading enterprises are then related to their impact on the growth of East African trade in recent years. Consideration is also given to other developments such as the increasing foreign exchange difficulties being experienced by the Partner States, especially Uganda and Tanzania, and the growth of the system of foreign trade planning in Tanzania. The implications of these developments for the East African Common Market are spelled out. In conclusion, the paper considers various recommendations to overcome obstacles to trade expansion posed by state trading enterprises, increasing foreign exchange difficulties and foreign trade planning.

STATE TRADING AND REGIONAL ECONOMIC INTEGRATION :
THE EAST AFRICAN EXPERIENCE *

The purpose of this paper is to investigate the impact of the growth of state trading enterprises in the Partner States on the operation of the East African Common Market. By way of introduction, the first section analyses the relationship between state trading enterprises and alternative types of regional economic integration. The framework developed there is applied to the common market and state trading enterprises in East Africa. The paper concludes with some tentative suggestions designed to strengthen the Common Market and make state trading enterprises compatible with its effective operation.

ALTERNATIVE CONCEPTS OF ECONOMIC INTEGRATION

Regional integration can take diverse forms, involving varying degrees and patterns of social, political and economic co-operation.¹ For our purposes, it is useful to distinguish between two types of integration arrangements: the one involving integration among market economy countries and the other among centrally planned economies.²

Integration among market economies consists in the creation of a customs union i.e. the abolition of all trade barriers among member states

* In preparing this paper, I have had the benefit of discussions with a large number of academics of the universities in East Africa, officials of the Partner States and the East African Community, and of the state trading enterprises. I am deeply indebted to them for sharing their information and insights with me.

1. The term economic integration can mean different things in different contexts: it may denote varying degrees of economic co-operation in a number of areas such as trade, mobility of labour and capital, payments, fiscal and monetary policies, social welfare provisions, and co-ordination of investment plans. This paper is concerned with the trade and related aspects of economic integration.

2. These are variously referred to as "free enterprise", "private enterprise", "capitalistic", "competitive" economies, on the one hand, and "public enterprise", "collectivist", "socialist" economies, on the other. In order to avoid terminological confusion, the former type of economies will be referred to in this paper as "private enterprise" and "market economies" and the latter as "public enterprise" and "centrally planned", though it should be noted that a public enterprise economy can operate through reliance on "markets", while a private enterprise economy may incorporate "central planning" in varying degrees.

and the erection of a common external tariff wall. The trade barriers may consist of tariffs, quantitative restrictions, outright prohibition of imports, licences, foreign exchange allocation, multiple exchange rates, and other administrative and regulatory measures designed to curb imports. The effective abolition of all trade barriers results in the creation of a single market for goods in the entire region. The resulting pattern of trade flows reflects differences in comparative advantage among member states. Thus the basic issue that arises in integration attempts among market economies is the creation of identical competitive conditions for producers, consumers and traders in the member countries.

In the centrally planned economies, on the other hand, most of the enterprises are publicly-owned, and the economy is organised on the basis of comprehensive national development plans, which lay down detailed targets for production, consumption and investment. The amount and composition of trade is determined in large measure by the annual plan. The import and export plans may or may not be based on an assessment of comparative advantage. In a situation like this where the quantity and composition of imports is determined in physical terms by the plan, the commercial barriers of the type mentioned above are irrelevant.

In keeping with the principles of their economies, most centrally planned economies conduct foreign trade through state export and import monopolies. Foreign trade is not regulated by the instruments found in market economies such as tariffs, exchange rate changes, licences etc. but by quantitative methods in accordance with the provisions of the annual plan.

Integration in the context of centrally planned economies thus means the creation of trade through the co-ordination of plans. At one extreme this could consist of a single plan for the whole region drawn up by a supranational authority or by national planning agencies working together. The regional plan will allocate specific production goals to different member states, and trade among them will reflect the specialisation of production implicit in the plan. The ideal of a single regional plan covering all the countries of the integration scheme may, however, be difficult to attain in the absence of some sort of federal government. The more usual pattern of integration among centrally planned countries is limited co-ordination of plans through agreements of inter-country specialisation in a limited range of products. Intra-regional trade will then reflect specialisation in these products.

The actual process of integration among market economies and among centrally planned economies may differ in significant respects from the theoretical ideal. In the market economies, the process of integration may not always involve the creation of competitive conditions within the region in all sectors. In the case of the European Economic Community, which typifies integration among market economies, there have been departures from the competitive solution in the case of agriculture, coal and steel, and energy. In all these cases, the EEC has adopted what may be called "marketing planning" solutions.³

Likewise, in the case of centrally planned economies, the process of integration may move nearer the model of market economies, if there were decentralisation of decision-making and greater reliance on the price mechanism. The recent reforms in Eastern Europe in the direction of decentralisation of planning and decision making in favour of individual enterprises could provide the basis for a different mode of integration. The leading example of economic integration among centrally planned economies is the Council for Mutual Economic Assistance (CMEA). Over the past decade and a half, economic integration among the member countries has been steadily strengthened, moving from ad hoc agreements on production and trade in a limited number of products to planned industrialisation and trade based on co-ordination of national development plans.⁴

3. For a discussion of the EEC, see D.L. McLachlan and D. Swan, Competitive Policy in the European Community (London, Oxford University Press, 1967); A.E. Walsh and John Paxton, The Structure and Development of the Common Market (London, Hutchinson, 1968); Dennis Swann, The Economics of the Common Market (Harmondsworth, Penguin Books, 1972).

4. United Nations, Economic Integration And Industrial Specialisation Among the Member Countries of the Council for Mutual Economic Assistance. (New York, 1966); CMEA Secretariat, Comprehensive Programme for the Further Extension and Improvement of Co-operation and the Development of Socialist Economic Integration by the CMEA Member Countries. (New York, 1971, United Nations). For recent reforms in Eastern Europe and their impact on economic integration, see S. Ausch, International Division of Labour and the Present Forms of Economic Mechanism in the CMEA countries, in I. Friss (editor), Reform of the Economic Mechanism in Hungary, (Budapest, 1969, Akademiai Kiado).

Neither of the two classical modes of integration are applicable in their entirety to economic integration among developing countries. In the first place, most of the integration arrangements among developing countries, unlike the EEC and CMEA, involve countries with significantly different economic systems. In the case of the East African Community, Tanzania has been moving progressively in the direction of a centrally planned economy, while Kenya and Uganda share in large measure the characteristics of a market economy. Similarly, in the Arab Common Market, the United Arab Republic, Syria and Iraq incorporate in varying degrees the characteristics associated with centrally planned economies, while Jordan continues to be largely a private sector economy. The situation in the Andean Group is fluid but Chile is committed to moving in the direction of a centrally planned economy, while Colombia and Ecuador remain private sector economies.

Secondly, there are very few developing countries which possess all the attributes either of market or of centrally planned economies. For example, developing countries which organise their economies on the model of centrally planned economies typically rely more on price mechanism for resource allocation than would be the case with most of the industrially advanced centrally planned economies. Similarly, the former have more private enterprise component in their economies than the latter. The developing market economies also differ from their developed counterparts in several respects. Firstly, the former are likely to be characterised more by monopolistic and oligopolistic structures in the modern sectors of their economies than the latter. Secondly, the public sector component of their economies tends to be more extensive than in the industrialised countries. Lastly, developing countries are more likely to have their economies regulated by non-price measures of one sort or another than the developed ones. The result of all these differences is that even though various developing countries may be described as market or centrally planned economies, their behaviour is likely to differ in significant respects from their developed counterparts.

The upshot of the preceding argument is that integration arrangements among developing countries cannot be simple carbon copies of those prevailing among developed countries, whether market or centrally planned. Attempts to force them along the lines of one model or the other are bound to create difficulties and tensions and prove incompatible with the interest of one

member state or the other. There is, therefore, a need for devising new structures and processes of integration which will fully reflect the diversity and characteristics of the economies of developing countries participating in an integration arrangement.

DEFINITION AND FUNCTIONS OF STATE TRADING ENTERPRISES

At the outset it is important to define what is meant by a state trading enterprise. In the past a number of attempts have been made to define state trading enterprises in terms of participation, or effective control by state authorities; others have emphasised the monopoly element as the defining characteristic of state trading enterprises.⁵ In so doing, they have prejudged the issues in question. It is clear that different definitions may be appropriate in different contexts. For purposes of this paper, a state trading enterprise is defined simply as one which is either wholly or in significant proportion owned by the state. In this definition, there is no presumption about the policies and behaviour of state trading enterprises, nor about the control exercised by state authorities in the determination of its purchase and sales policies.

This paper is concerned only with state trading enterprises engaged in the import business. It is useful to distinguish three categories of state participation in import business:

- 1) A state agency may be created to import all or part of the requirements for the central and local organs of government;
- 2) Public industrial, agricultural and mining enterprises may likewise import directly all or part of their own requirements;
- 3) State trading enterprises may import for subsequent distribution to other enterprises and organisations either for their own use or for further sale to individuals and enterprises.

Although all the three forms of state participation in import business may raise issues relevant for regional trade arrangements, this paper is concerned primarily with issues raised by category (3), i.e. where enterprises import not for their own needs but for general distribution in the country.

5. For a discussion of this question, see G.P. Verbit, Trade Agreements For Developing Countries, Chapter VI. (New York, Columbia University Press, 1969).

There are many reasons which have led countries to adopt partial or complete state trading in external commerce. Without being exhaustive, these may be summarised as follows:-

- i) In socialist countries, complete state control of foreign trade through state enterprises is an essential attribute of a centrally planned economy. The creation of state trading enterprises is merely the extension of the policy of public ownership in the field of foreign trade;
- ii) Countries may resort to state trading as an instrument of planning in the field of foreign trade. Governments, whether of centrally planned or market economies, may feel that they can more effectively control the volume, composition and prices of imports through state trading enterprises than through reliance on a system of private trading;
- iii) State trading enterprises may be created to bring about diversification of external commercial links. They are (an) especially instrument for promotion of trade with centrally planned economies;
- iv) State trading enterprises may be created to promote price reduction through breaking up private monopolies and through bulk purchase, or to secure greater price stability through subsidies or long term purchase agreements;
- v) State trading enterprises may also be used to provide covert or overt protection to domestic industry against imports. The advantage of providing protection through state trading enterprises, over other conventional measures, is that apart from its greater effectiveness, it is very difficult to establish the fact that domestic products are in fact being protected;
- vi) Some countries have established state trading enterprises to grant special privileges to certain groups of persons, either by restricting the distribution of imported products to such persons or by supplying goods to them at favourable prices to enable them to compete with other traders;
- vii) One of the oldest functions of state trading enterprises is to serve as a source of revenue. This is especially the case with such commodities as tobacco and alcohol;
- viii) A country may substitute state for private trading in order to close a loophole in the system of foreign exchange controls. In countries with exchange controls, over-invoicing of imports and underinvoicing of exports is a common technique for transferring capital abroad. The elimination of this practice may be one of the objectives of establishing state trading enterprises;
- ix) Finally, state trading in certain products such as narcotics, alcohol, pharmaceutical goods, arms and ammunition etc. may be justified on grounds of health, national security etc.

STRUCTURE AND OPERATION OF STATE TRADING ENTERPRISES

Before exploring the impact of state trading enterprises on regional trading blocs, it may be useful to say a few words about some of their relevant characteristics. Three aspects of their structure and operation are especially relevant to regional trade arrangements: extent of state trading, structure and decision-making, and linkages with wholesale trade and domestic productive enterprises.

There may be a great deal of variation in the extent of state participation in the import business. In general, the range of products handled by state trading enterprises will depend on the purposes for which they were created in the first instance. In centrally planned economies, all or a substantial part of imports may be handled directly by state trading enterprises. In other cases, a narrower range of products, justified on grounds of protection, revenue, balance of payments, health and security, or of promotion of indigenous traders, may be confined to state trading enterprises. In some countries, fairly clear cut criteria may be used in allocating importing rights between private and public trading enterprises. More often, the distribution of importing rights will have evolved over time in response to specific pressures and needs and may not reflect any overriding criterion.

As far as the structure and decision-making of state trading enterprises are concerned, there are at least four aspects of this question. Firstly, it is useful to know whether the state trading system consists of one mammoth corporation with divisions specialising in the importation of various goods and services, or of a number of enterprises co-ordinate with and more or less independent of each other. In the former case, it would be useful to have information about the exact relationship between the parent company and the specialised divisions in terms of management, finances and decision-making. Likewise, in the latter case, it would be useful to know the mechanism for co-ordinating the policies of different state trading enterprises.

The second structural aspect relates to whether the state trading enterprises have resulted in monopoly, competition, or something in between. The third aspect relates to their links with the organs of government such as the ministries of finance, planning, economy, commerce and industry, and central banks. At one extreme, the state trading enterprises may be integrated tightly into the governmental machinery and subordinated to one ministry or the other, with the consequence that all major decisions bearing on the

policies of the enterprises are taken within the Government. The other extreme is where state trading enterprises function largely independently of the Government; state control may amount to no more than the issuance of very general directives at the time of their establishment and the examination of their annual reports. In between these two extremes, there are numerous structural arrangements allowing for varying degrees of governmental control and influence on the operation of state trading enterprises.

The fourth and closely related question is the decision-making process in the state trading enterprises. The degree of autonomy enjoyed by the state trading enterprises in decision-making at various levels vis-à-vis the relevant ministries, as well as the process of decision-making within the enterprises themselves, are of relevance when evaluating the impact of state enterprises on regional trade blocs.

The links between the state importing enterprises and the internal distribution system have a close bearing on the working of regional integration schemes. There is considerable diversity in the patterns of internal distribution of imported goods. One possibility is that state trading enterprises may also be entrusted with the function of wholesale distribution of imported goods and in some cases, though this is rare in developing countries, of retail distribution as well. Even if the state trading enterprises do not engage in wholesale distribution, this function may be assigned to another enterprise(s) specialising in wholesale distribution. There is also, of course, the possibility that the wholesale and retail distribution of imported goods may be left entirely or in part to private traders. Yet another possibility is for the importing and distributing functions for particular products to be assigned to the domestic productive enterprises engaged in the production of that product.

A related issue is the system of distribution for domestically produced goods competing with imports. Once again there are a number of possibilities. In the first place, the productive enterprise may itself arrange the wholesale distribution of its output. Secondly, the state trading enterprise assigned rights of importation may be required to undertake the wholesale distribution of similar domestic goods. Thirdly, in countries with specialised state-owned wholesale distributors, these may be given the responsibility for distributing both the imported and domestic products. Finally, while the wholesale distribution of imported goods may be in the hands of state trading enterprises,

the distribution of domestically produced goods may be left largely in the hands of private traders.

IMPACT OF STATE TRADING ENTERPRISES ON REGIONAL INTEGRATION SCHEMES

The role of state trading enterprises in regional economic integration will depend on the nature of integration. In regional trade arrangements among centrally planned economies, the state trading enterprises play an important role in fulfilling the export-import commitments entered into as a result of the agreement. The existence of such enterprises facilitates the fulfilment of such commitments, as their purchasing policies can be more easily controlled by the Government.

On the other hand, in regional integration schemes among market economies, state trading enterprises are often looked upon as distorting fair competition, and often elaborate rules are devised to govern the behaviour of such enterprises to ensure equality of treatment between domestic products and the competing imports from the member states.⁶ This is done either by eliminating public trading monopolies or by ensuring, through a variety of means, adequate and fair access for products from the member states.

When we consider regional trade agreements among countries with different economic systems, as is typically the case with such agreements among developing countries, the existence of state trading enterprises creates both opportunities for expanded trade as well as additional difficulties in the way of its expansion, depending upon the prior constraints to expanded trade and the mode of integration. State trading enterprises would appear to be a particularly suitable means of trade expansion under at least three circumstances. In the first place, as is well known, trade among developing countries is hampered not only by the high cost and low quality of many of the products manufactured but also by the failure to develop adequate commercial and financial links, by lack of information about product availability, and prejudices of importers and

6. For a full discussion of these problems in the context of multilateral and regional trade treaties, see K.W. Dam, The GATT-Law and International Economic Organisation (Chicago, University of Chicago Press, 1970), Ch. 18; McLachland and Swan, op. cit., pp 59-60; and EFTA Bulletin, Vol. VIII No. 2, March - April 1967: Public Undertakings.

distributors in favour of the well-known brands originating in developed countries. State trading enterprises are well suited to counter some of these obstacles to trade expansion among member countries by forging new commercial and financial links, by introduction of new products and brands, and generally by improving knowledge about product availability and marketing possibilities in the member countries.

Secondly, in situations where trade is hampered by lack of foreign exchange which is reflected in numerous quantitative and other restrictions, or by detailed regulation of trade through direct controls in countries practising some form of central planning, state enterprises can play a positive role in trade creation through agreements to expand trade annually among member countries by specified amounts or proportions. State trading enterprises may be better able to fulfil trade commitments embodied in such bilateral or multilateral agreements than the private traders.

Similarly, where the emphasis in a particular integration scheme is on trade expansion through the co-ordinated development of new industries on a region wide basis, the state trading enterprises may be better suited than private traders to fulfil commitments with respect to exchanges of particular products. This is so because it is easier for the Government to control the policies and plans of state enterprises to ensure compliance with such undertakings, even when some of the transactions may not be fully justified by commercial considerations. This point is particularly relevant in situations where the existence of an integration scheme may be threatened by large imbalances in the trade among member countries. Correction of such imbalances may require purchases from the deficit countries even when these may not be justified on purely commercial grounds. Private traders interested primarily in profit maximisation cannot be expected to take such considerations into account when making purchasing decisions. While thus under such circumstances, state trading enterprises can play an important role in trade expansion, there are situations when their operations hinder the intra-regional trade. If the emphasis in a regional trade arrangement is placed on trade liberalisation through abolition of trade barriers, and reliance on market forces, state trading enterprises may hinder this objective in the following ways:-

i) They may follow a discriminatory purchasing policy which has the effect of providing protection to domestic production against imports from the member countries in contravention of the agreement on economic integration. There are many ways of varying degrees of subtlety through which a discriminatory purchasing policy may be practised. Either acting under instructions or on its own initiative, a state trading enterprise with monopoly in importation may decide not to import a product from the member states even though on grounds of price, quality or terms of payment and delivery, the imported product may be considered superior to the local product. A slightly more subtle way of pursuing a discriminatory policy may be by adding high mark-ups to imports, or of charging high commission to importers, so that the imports were put at a price disadvantage in the domestic market. The possibilities of discriminating against imports by this means obviously increase with the number of state-controlled stages of distribution of imports e.g. if not only the importation but also the wholesale and retail distribution were in the hands of state enterprises. Likewise, the administrative procedures for obtaining imports whether by the state trading enterprises or by agents appointed by them could be so burdensome and lengthy as to constitute a serious barrier to trade. The above techniques may also be used of course to favour imports from one partner state as against others.

ii) A state trading enterprise may also discriminate against imports from member countries in favour of imports from the third countries. This may happen for instance if the country has trade, aid or payments agreement with another country outside the trading bloc, under which it enters into a commitment to purchase specified quantities or values of certain products from it. Even in the absence of such an agreement, the state trading enterprises may either under instructions or acting on their own initiative pursue a policy of buying in the cheapest source in disregard of the tariff schedule in existence. If their decisions are based on c.i.f. values of imports, then the discrimination in favour of suppliers in the regional bloc which is the basis of the integration scheme is eliminated, and member countries are treated on par with suppliers from the third countries. While such a policy is rational from the point of view of the country, it is incompatible with the provisions of most integration schemes.

The operation of state trading enterprises could thus constitute an impediment to the objectives of integration; but whether it does so or not, will depend on the purchasing policies pursued by the enterprise. These in turn are largely a function of the structure and organisation of state enterprises, and in particular of their autonomy from the governmental machinery and the degree of competition among the enterprises themselves.

THE EVOLUTION OF THE EAST AFRICAN COMMON MARKET

The general framework of analysis developed above can now be applied to the East African situation. We shall describe briefly the evolution of the Common Market since the signature of the Treaty, before moving to a discussion of the growth of state trading enterprises and their impact on East African trade. As is well known, the Treaty for East African Co-operation created a modified customs union in the region.⁷ The main exceptions to the free movement of goods among Partner States are certain agricultural goods - mostly staple foods or major export crops, subject to special marketing arrangements, on which the Partner States are entitled to levy quantitative restrictions, and the right to levy transfer taxes by deficit countries on imports of manufactured goods from the surplus Partner States. The duration of these taxes, their magnitude and the products on which they may be levied are laid down in the Treaty.

Since the establishment of the East African Community, a number of developments have taken place in the Partner States which have affected the working of the Common Market. Of these, the three most important ones are the growth of state trading enterprises; the gradual extension of central planning; and the balance of payments difficulties experienced by the Partner States. Since state trading enterprises are discussed in the next section, the discussion here will focus on the other two points.

The Treaty was based on the assumption of the existence of largely private enterprise, market economies in the Partner States. But even before the Treaty became operational, this assumption had been rendered invalid by the extensive nationalisation of large enterprises in agriculture, manufacturing,, commerce and construction in Tanzania, following the Arusha Declaration of 1967. Since then, nationalisation has been extended to wholesale trade, urban properties and other economic activities. In 1970, Uganda also launched a large scale nationalisation move, which was partially reversed after the

7. Treaty for East African Co-operation (Nairobi, Government Printer, 1967).

military coup of the following year. Although no comparable large scale nationalisation has taken place in Kenya, the Government has moved to acquire majority or significant participation in a number of key sectors of the economy.

These developments have been accompanied by changes in the organisation of foreign trade. The creation of state trading enterprises in the Partner States is one manifestation of it; another is the gradual extension of planning to imports and exports in Tanzania. The increasing difficulties in foreign exchange experienced by the Partner States over the past two years have been another contributory factor to the modification of their commercial policies. Since these have affected substantially the working of the Common Market, it is necessary to give a brief account of them.

Since the sharp fall in foreign exchange reserves in 1971, the Uganda Government has taken a number of measures designed to curb imports. As from the 1st December, 1971, all imports have to be registered with the Bank of Uganda. Importers are required to make import deposits with the Bank of Uganda before they can be granted foreign exchange.⁸ Spare parts and raw materials are exempted from this requirement, but other essential imports need a deposit equal to 10 per cent of the c.i.f. value of imports; the proportion of deposits increases to 50 and 100 per cent depending upon the nature of imports, the highest rate being levied on luxury imports. These deposits have to be maintained for a period of six months for imports from outside East Africa and for three months for imports for the Partner States. In addition to this requirement, some administrative discretion is used in allocating foreign exchange for imports, licences being withheld for products which are available locally. In addition, there is a monthly ceiling of £5 m. on the level of imports. Thus it is possible for importers to get foreign exchange allocation but importation of the products may be delayed. Apart from this, there does not appear to be any elaborate planning of imports permitted into the country.

In Tanzania, attempts have been made in recent months to evolve some sort of foreign exchange plan. As far as imports are concerned, notional ceilings are laid down for different categories of imports reflecting development priorities and availability of local goods. The import plan

8. This requirement was abolished in June, 1972.

is implemented by the Bank of Tanzania. The Import Controller is advised by an inter-ministerial Advisory Committee on Imports, based in the Bank of Tanzania. Imports are regulated by a system of licences. The bulk of imports are confined to parastatals, and only a small proportion come under the Open General Licence (OGL). However, some of the goods listed under the OGL are also confined to parastatals. Licences must be obtained for the importation of all goods. The necessary foreign exchange is released only after the licence has been obtained. Imports from the Partner States, whether they are confined to parastatal bodies or not, require import licences.

In Kenya, imports are divided into two categories: those under General Open Licences (GOP), which do not require an import licence; and those under Specific Import Licences (SIL), which are further subdivided into three schedules A, B and C. Importation of goods under schedule B is prohibited altogether while those under C are restricted. After the additional restrictions introduced in December, 1971, several goods previously imported under GOP were transferred to Schedules D and E. Foreign exchange will not be made available for goods classified under Schedule E, while goods under Schedule D will require foreign exchange allocation licence. Furthermore, quotas were established for goods grouped under Schedule C. As far as imports from the Partner States are concerned, they are not subject to licence or foreign exchange allocation requirements except those which are confined to National Trading Corporation. Apart from these regulations, Kenya does not have a system of detailed foreign trade planning, with ceilings for different categories of imports in accordance with the annual development plan.

It will, therefore, be clear from the above account that there has been a considerable modification of the principle of a common market, as stipulated under the Treaty for East African Co-operation, due mainly to the increasing foreign exchange difficulties being experienced by the Partner States but also in some measure due to the extension of planning to the field of foreign trade. The net result of all this has been a steady erosion of free movement of goods and services within East Africa. The subsequent discussion of the role of state trading enterprises in the East African trade must be viewed in the light of these developments; for often the barriers to intra-regional trade ascribed to state trading enterprises have deeper roots in the changing economic systems and foreign exchange difficulties. The state trading enterprises are often no more than immediate agents of the execution of import policies.

EVOLUTION AND STRUCTURE OF STATE TRADING ENTERPRISES IN EAST AFRICA

State trading enterprises were established in the sixties in the East African countries. Although they all participate in the import business, there are considerable differences in the functions they perform, the scope of their activities, and their structure and organisation. It will, therefore, be appropriate to start with a brief description of their features prior to a discussion of their impact on regional trade.

In keeping with the economic ideology of Tanzania, the main function of the State Trading Corporation (STC) is the socialisation of trade.⁹ Consequently, over the past few years, the scope of the products handled by the STC has been steadily increased. The STC imports directly a large variety of imports. In 1970, about 32% of the total imports were confined to STC; of this, it physically handled about 75%. The remainder of the imports were distributed as follows: Government Ministries - 25%; National Development Corporation - 30% and Private Importers - 5%. NDC and its subsidiaries are responsible for importing their own requirements, and in some cases, the products manufactured by them. The STC was originally supposed to act as both an importing and wholesaling organisation. But it performed the wholesaling function in four districts only. For the rest of the country, it continued to utilise the services of the private established wholesalers for distribution of imported goods.

It was intended that the STC will also handle the wholesale distribution of locally manufactured goods, but this has not happened. The local manufacturers are free to distribute their goods through STC, private wholesalers, or through their own distribution system. In fact, many of the larger enterprises continue to distribute their goods directly; others make use of private

9. The functions, structure and scope of the STC are currently under review by the Tanzanian Government. A Parliamentary Select Committee appointed to look into some aspects of trade has recently published a report. An inter-ministerial committee appointed by the Government has also been studying the question of external and internal trade. It is likely that as a result of these inquiries, there may be major changes in the working of the STC. The account given here relates to the situation as it existed at the beginning of 1972.

wholesalers; relatively few appear to utilise the STC facilities.

The policy-making body in the STC is the Board of Directors, which consists of Principal Secretaries from a number of economic ministries, the Chairman of the Board being the Principal Secretary in the Office of the President. The Board is responsible for laying down the main policy and meets periodically to review the working of the STC.¹⁰ The Minister of Commerce and Industry, under whose Ministry the Corporation falls, has powers to issue directives to the STC.

The chief executive of the Corporation is the Managing Director. The Corporation is divided into four divisions - General Merchandise, Agricultural Machinery and Technical Equipment, Export and Shipping. Each of the divisions is further subdivided into product divisions, each headed by a product manager. The line of responsibility runs from product manager to division head to the Managing Director.

The Kenya National Trading Corporation (K.N.T.C.) was established with the main purpose of promoting Africanisation of commerce. A total of 49 products in the field of provisions, textiles, and hardwares, have been confined to KNTC. Of these products, some are specified and can only be handled by other citizen traders. The KNTC is also, of course, free to handle items not legally confined to it, just like any other trader. The Corporation buys certain items on its own account such as sugar, salt, cement and bicycles. These are then sold to wholesalers who are appointed distributors for KNTC products. About 60% of the KNTC turnover is in these products. For the rest of the products, the KNTC appoints agents who are responsible for the importation and sale of these goods. KNTC gets a commission on these products.

10. After the decision to socialise the wholesale trade, a Committee of Implementation was set up, consisting of several Principal Secretaries and other leading officials. There is some overlapping membership between the Committee and the Board; while the former is concerned with matters internal to the STC, the latter has a wider mandate covering the whole question of socialisation of trade.

In principle, the confinement of products to KNTC applies both to imported and locally produced goods. In practice, it has proved extremely difficult to enforce this with respect to locally produced goods. Thus while KNTC handles imported products confined to it, not all of the similar locally produced goods pass through its hands. The wholesale distribution of its products is given to African traders, in keeping with its policy of promoting African share in commerce.

KNTC is a subsidiary of the Industrial and Commercial Development Corporation. The final policy-making body is the Board of Directors, with its Chairman and Vice-Chairman. The latter is also the Permanent Secretary, Ministry of Commerce and Industry. The Board functions independently subject to broad policy directives from the Minister of Commerce and Industry. It meets once every month or every second month. The chief executive of the Corporation is the General Manager.

The Corporation is divided into three departments - Commercial, Accounts, and Personnel. The Commercial Department is further sub-divided into sections dealing with textiles, hardware, produce, investment and market research. The other departments are also sub-divided into sections. Each of the sections is headed by an Assistant Manager. Thus the chain of responsibility runs from the Assistant Managers to the Division Managers to the Managing Director.

The original purpose behind the establishment of the state trading enterprise in Uganda was to extend both state and African participation in trade. There have been a number of important changes in Uganda in the last two years with respect to state trading enterprises. The current position is that, in contrast to Kenya and Tanzania, there are two parastatal bodies dealing with trade. The Uganda National Trading Corporation (NTC) was created to deal in certain specified goods, both imported and locally produced, and to distribute them to African traders. In May 1970, however, a new body called Export and Import Corporation (EIC) was established to deal with all external trade. After the change of regime in Uganda, the EIC was turned basically into a licensing body for imports.¹¹

11. In the Third Five Year Development Plan for Uganda, it is stated: "Government has recently reviewed the operations of the NTC and the Export and Import Corporation. Consequent upon this review, it has been decided to set up early in the Plan period, a new corporation, to be known as the State Trading Corporation (STC). The staff and facilities of the two existing corporations will form the core of the STC". p. 247. At the time of writing, this fusion had not taken place.

The current position, therefore, is that all non-government imports must be licensed by the EIC. Although soon after its establishment a number of imports were confined to the Corporation in which it was to have monopoly, subsequently it was decided that it will not handle imports on its own account. All importers must first obtain an import licence from the Corporation for which it charges a commission of 1% of the c.i.f. value of imports. This commission is waived for imports by some parastatals, and also in respect of raw materials, spare parts, machinery and equipment. In its licensing decision, the Corporation is guided by the foreign exchange position, the nature of the product to be imported, and the availability of local products.

The Corporation is governed by a Board of Directors who are appointed by the Minister of Commerce and Industry. The Chairman of the Board is also the Managing Director of the Corporation. Other members of the Board are independent persons with business experience. The Board makes the final policy decisions subject to directives from the Government. It meets once or twice a month. The Corporation is divided into six divisions, which are headed by Managers. These divisions are textiles, motor vehicles, food products, tyres, wines and spirits, and the Co-ordinating Department.

NTC has a monopoly in the importation of certain essential products such as salt, rice, sugar, hollow-ware, oils, fishnets, etc. Although it enjoys a legal monopoly in the importation of these products, these continue to be imported by other traders as well. It is estimated that NTC imports account for a mere 3% of total imports coming into the country. The Corporation has appointed sub-distributors who perform the wholesaling function. Local manufacturers of these products may either use the NTC facilities, or distribute them directly. Like other importers, NTC is also required to obtain an import licence from the EIC.

The final policy decisions are taken by the Board of Directors, whose Chairman is the Managing Director of NTC, and which meets once a month. Other members, who may or may not be Government officials, are appointed by the Minister for Commerce and Industry. The Permanent Secretary in the Ministry is one of the members of the Board. The Board is subject to policy directives from the Government. The Corporation is divided into four departments: Administration, Operation, Cash and Personnel.

IMPACT OF STATE TRADING ENTERPRISES ON THE COMMON MARKET AND TRADE IN EAST AFRICA

It is not possible to measure quantitatively the impact of state trading enterprises on the working of the common market and the growth of East African trade. It has already been mentioned that the state trading enterprises have been only one among a number of factors which have eroded the functioning of free trade among the Partner States. Before examining the possible impact of state trading enterprises, it is necessary to see how the other factors - foreign exchange difficulties and planning of foreign trade - have affected the East African trade.

The move towards planning of foreign trade in Tanzania in fact implies that the volume and composition of imports coming into the country will increasingly be related to requirements arising out of the annual plan. If this principle is extended to imports from the Partner States, as appears to be the case, the whole basis of a common market, as embodied in the Treaty, is undermined; for the principle of a common market implies that imports from the member states must be permitted without any barriers and treated in all respects on par with domestic products. Clearly then, the kind of foreign trade planning envisaged in Tanzania is incompatible with the conventional common market. It is not possible to say to what extent the imports from the Partner States have been hindered by the move towards foreign trade planning and the accompanying system of licences and priorities for imports; but that it has had a negative effect on the growth of East African trade is beyond doubt.

Similarly, the system of import licensing in Uganda, with priority given to essential products, and those not available locally, combined with the import deposit requirements, is an infringement of the principle of common market in that it introduces administrative barriers to imports from the Partner States and results in favourable treatment of domestic products over imports from the Partner States.

The policies pursued by the state trading enterprises are often a mere reflection of these wider national commercial policies. But in addition to these factors, do the state trading enterprises constitute additional, autonomous obstacles? There are at least three ways in which this may happen, and these are borne out by the experience in East Africa.

In the first place, the state trading corporations may be under instructions to give preference to domestic suppliers over suppliers in the Partner States in their purchasing decisions. It is, for example, alleged that the STC is required to give a preferential margin of 20 - 25% to domestic suppliers in its purchasing decisions. Likewise, the Export and Import Corporation is alleged to satisfy itself that a particular product is not available locally before approving a particular import licence. Allegations have also been made that with the confinement of batteries and tyres to KNTC, the latter has tended to favour Kenyan made products over the competing products from the Partner States. Examples of alleged discriminatory practices of this sort could be multiplied from all the three countries.

Secondly, the operation of state trading enterprises may in effect result in discrimination against imports from the Partner States, even though this may not have been the intention. This can happen for a number of reasons such as the charging of high margins on imported goods, confinement of imports and wholesale distribution of imported products while the locally manufactured products have no restrictions on their distribution, the administrative delays experienced by importers compared with the distribution of local products, the inefficiency of state trading enterprises, and so on. There is no evidence that differential profit margins have been used by any state trading corporation in East Africa to discourage imports. On the other hand, it has already been shown that in all the three countries, while confinement to state trading enterprises of certain imported products is widespread, this regulation is seldom, if ever, enforced on local competing products. This may confer important advantages to local products vis-a-vis imports from the Partner States. Furthermore, administrative delays involved in obtaining import licences and the inefficient operation of state trading enterprises may also have hindered the growth of imports in Uganda and Tanzania from the Partner States.

Thirdly, imports from the Partner States may be discriminated against vis-a-vis imports from the third countries, because the latter are cheaper on c.i.f. basis. In all three countries, imports by the state trading corporations are subject to import duties. Nor have the enterprises been directed to purchase on the basis of the c.i.f. value alone. Therefore, this sort of discrimination against imports from the Partner States does not

appear to have been practised on any significant scale. However, trade agreements by individual countries with third parties may have the same effect, even though this was not intended. For example, under the agreement for the financing of the Tanzam Railway, the local costs incurred in Tanzania are financed by the importation and sale of Chinese goods. This in effect means that Tanzania is committed to buying goods worth a certain amount every year from China. Such purchases must inevitably have an effect of diverting trade away from the Partner States, unless the goods specified were those not produced in East Africa. This has not been the case with purchases from China which have included a large variety of consumer goods.

There is no simple way of calculating the trade reducing effect of the factors mentioned above, but there can be little doubt of the fact that trade among East African countries would have expanded at a higher rate over the past three years in the absence of the obstacles mentioned above.

SOME TENTATIVE RECOMMENDATIONS ON THE COMMON MARKET AND STATE TRADING ENTERPRISES IN EAST AFRICA

The earlier discussion has brought out the serious erosion of the common market in East Africa which has taken place over the past two to three years. It seems clear that unless a deliberate effort is made to reverse these trends, the drift towards disintegration of the common market will continue, throttling East African trade and jeopardising other areas of co-operative activity. At the same time it is clear that the solution to the problems of the East African Common Market and trade cannot lie in a restoration of the economic structures and policies which prevailed a few years ago. A durable and realistic solution to these problems must take into account not only the existing diversity in economic organisation and ideology among the Partner States, including the diverse role of state trading enterprises, but also the recent changes in economic conditions such as foreign exchange difficulties, which are likely to continue for the foreseeable future. What is needed is a series of concerted measures designed to strengthen the common market and to lay the basis for a new dynamism to the East African trade.

In the first place, the Common Market must be made a reality. This has implications for the operation of state trading enterprises and for measures taken to safeguard balance of payments. As far as state trading enterprises are concerned, it is important to ensure that they

follow non-discriminatory policies with respect to imports from the Partner States. One way of doing this would be through restructuring of state trading enterprises to allow for internal competition. If state trading enterprises are allowed autonomy in their operations and are required within a country to compete with each other in their purchases and sales, their behaviour may approximate that of private traders. Adoption of this system is perfectly compatible with public ownership of means of production and exchange within the economy, as is shown by the experience of a number of socialist countries in Eastern Europe. Although this solution would solve most of the problems connected with the operation of state trading enterprises, it does not appear feasible in the East African circumstances. The scarcity of managerial and executive personnel, the organisational problems, and the possible foregoing of benefits of economies of scale and specialisation, would preclude the adoption of this system at this juncture in East Africa.

The alternative would be to move towards an approximation of this system by devising a set of rules for the operation of state trading monopolies. The purpose of these rules would be to ensure that imports originating from the Partner States are treated identically in all respects to the domestic products. The East African countries have already agreed in principle to the kind of rules that would be necessary. These rules state:-¹²

1. Where the State Trading Corporation, or any authorised distributor or dealer, acts as principal, it/he must undertake to purchase promptly and, where commercially appropriate, to stock goods produced in other Partner States.

2. Where the State Trading Corporation, or any authorised distributor or dealer, acts as agent, it/he must accept and place promptly any order from dealers for goods produced in other Partner States.

3. Where the State Trading Corporation, or any authorised distributor or dealer, acts as principal, its/his profit margin and other charges on any commodity must be the same for goods produced locally as for goods produced in other Partner States, other things being equal, and must in no circumstances exceed its/his profit margin and other charges on the same commodity imported from foreign countries.

4. Where the State Trading Corporation, or any authorised distributor or dealer, acts as agent, its/his commission on any commodity must be the same for goods produced locally, other things being equal, and must in no circumstances exceed its/his, commission on the same commodity imported from foreign countries.

12. Supplied by the Common Market Secretariat of the East African Community.

5. The Commission and/or profit margin applied by the State Trading Corporation to distributors and/or sub-distributors of any commodity must be the same for goods produced locally as for goods produced in other Partner States, other things being equal.

6. Profit margins taken by the State Trading Corporation, or any authorised distributor or dealer, on goods from other Partner States and of which there is no domestic production must not be excessively high in relation to the services rendered.

7. Confinements which are applicable to goods produced in other Partner States must equally be applied to foreign imports and domestic production of the same commodities.

8. Distributive outlets for goods imported from other Partner States must not be so reduced by the State Trading Corporation or any authorised distributor or dealer, as to restrict sales and service facilities to the detriment of trade.

While it is possible in theory to agree on a set of rules applicable to state trading confinements, in actual practice it may prove extremely difficult to implement them. The East African countries have already agreed upon the implementation procedures for these rules. But in the end the only guarantee of compliance with these rules must be the good faith of the Governments concerned. Nevertheless, if the rules are to prove workable, there must be provision at some level for adjudication on disputes arising over their implementation.

An alternative way of ensuring fair competition for products from the member countries is to allow manufacturers and traders in one country to set up importing and distribution facilities in the other countries. This assumes that apart from state trading, there are no foreign exchange or other barriers to importation from the member countries, and thus the existence of competitive importing and distribution facilities will ensure that state trading enterprises will not be able to provide covert protection to domestic manufacturers. This proposal amounts to a virtual abandonment of monopoly for state trading enterprises in individual products or for all imports.

The acceptance of any of the above solutions would go a long way in removing the difficulties which have arisen in the Common Market over the operation of state trading enterprises. But the difficulties caused by scarcity of foreign exchange will still persist. It is, therefore, important to devise arrangements which will cushion East African trade against restrictions applied on balance of payments grounds. The Treaty for East African Co-operation does not contain any provisions on this. What is needed is a set of rules which

would state clearly the circumstances under which restrictive measures might be applied to imports from the Partner States. The rules should also define the duration of these measures and the kind of restrictions that would be permitted. At the least, the restrictions on imports from the Partner States should be less onerous than on external imports.

However, unless more positive steps are taken, the restrictions placed on balance of payments grounds can all too easily turn into permanent obstacles to East African trade. If the payments difficulties persist for a long time, consideration should be given to devaluation by the state experiencing trade deficits.¹³ If the payments difficulties are of a short run nature, the East African trade may be cushioned against them by the creation of some sort of payments arrangements among the Partner States. The purpose of such an arrangement would be to provide short to medium term credit to the countries experiencing payments difficulties for purchases from the Partner States. The bulk of the finance for the scheme would have to be provided through external assistance. The scheme could either be operated by the three Central Banks or by the East African Development Bank.¹⁴

In addition to these steps to strengthen the Common Market, it is necessary to provide a new basis for a dynamic expansion of East African trade through a co-ordinated development of new industries. Past experience in East Africa has indicated the great difficulty in achieving agreement on a comprehensive programme for joint industrialisation. For the immediate future, the target should be a more limited one; ad hoc agreements on production, location, and marketing of specified industries of a regional nature. This approach to the problem has been successfully adopted in the Andean Group in Latin America.

13. The case for devaluation by a Partner State in persistent payments difficulties has been argued cogently by Marshall Hall and Dhiru Tanna, Comments on Exchange Rate Unification, paper presented to the 1971 Universities Social Science Council Conference, Makerere, December, 1971.

14. I have argued the case for a payments union of this sort in D.P. Ghai, The East African Community: The Way Ahead, in African Development, April, 1972.

In the East African context, it would be an attractive idea to provide in addition for the joint ownership of integration industries. By this means the concept of joint ownership already embodied in the railways, airways, harbours, shipping, and research institutes could be further extended to directly productive enterprises. The device of joint ownership will further ensure that all Partner States benefit from all integration industries and will thus have a stake in their viability and efficient operation.

The major part of financing of these ventures could be undertaken by the East African Development Bank. However, in order for it to be able to do this, it will be necessary to plan for a considerable increase in its capital. Once again agreement will be much easier to reach if a major part of the additional finance could be provided by aid agencies - international, bilateral and regional such as the African Development Bank. A project of this kind designed to cement and consolidate the economic integration in the East African region should have a special appeal for external donors.