

**REGIONAL INTEGRATION AND BANKING INDUSTRY IN EAST AFRICA
COMMUNITY**

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DECLARATION

This dissertation is my original work and has not been submitted for award of a degree to any other University.

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DEDICATION

This research paper is lovingly dedicated to my parents who have been my constant source of inspiration. They have given me the drive and discipline to tackle any task with enthusiasm and determination. Without their love and support this project would not have been made possible.

ABSTRACT

The main objective of this study was to investigate the concept of Regional Integration and Banking Industry in East Africa Community. Banks in Nairobi County that are found in East Africa Community are in a good position to give the information required for our study. The study relied on primary data which was collected using open and close questionnaires developed in line with the objectives of the study and analyzed to draw the conclusion of the study finding both quantitative and qualitative techniques were applied in data analysis. Sample was selected using a systematic random sampling. According to Mugenda and Mugenda (2003) a sample of 30% and above is considered representative for a population less than 500. Data was collected from 15 banks and the results were presented in tables, figures and content delivery to highlight the major findings. They were also presented sequentially according to the research questions of the study. Mean scores and standard deviations analyses were used to analyse the data collected. The raw data was coded, evaluated and tabulated to depict clearly the factors affecting banking industry in regional integration. The findings indicate that the rapid growth of population, requirement of banking services and economic markets increasing foreign investors have brought the banking industry in regional integration to the situation of a large industry having a significant place in regional development. The research recommended that Regional integration the banking sector is extremely important given the pivotal role that banks play in the provision of credit, the transmission of monetary policy and the maintenance of systemic stability. Nonetheless, research on banking sector competitiveness includes very few countries and only Kenya from the EAC sub-region

TABLE OF CONTENTS

DECLARATION	ii
ACKNOWLEDGEMENT.....	iii
DEDICATION	iv
ABSTRACT.....	v

CHAPTER ONE

REGIONAL INTEGRATION

1.1 Introduction	1
1.2 Statement of the Problem	2
1.3 Objectives of the Study	4
1.4 Literature Review regional integration	4
1.4.1 The evolution of customs union theory	4
1.4.1 Economic integration around the world	8
1.4.2 East African integration.....	9
1.4.3 Economic cooperation in the financial sector.....	10
1.4.4 Financial Benefits of Regional Integration.....	12
1.4.5 Challenges on East Africa regional integration.....	15
1.5 Theoretical Framework on regional integration.....	16
1.6 Justification of the Study.....	18
1.7 Hypothesis.....	20
1.8 Research Methodology.....	20
1.8.1 Research Design	20

1.8.2 Population.....	21
1.8.3 Sampling Design.....	21
1.8.4 Data Collection Methods.....	22
1.8.5 Data analysis.....	22
1.9 Chapters summary.....	23

CHAPTER TWO

THEORETICAL UNDERPINNING OF REGIONAL INTEGRATION

2.1. Introduction.....	24
2.2 Background Of The Regional Integration Concept.....	25
2.3 Customs Union Theory.....	28
2.4 Institutionalism.....	30
2.5 Intergovernmentalism.....	32
2.6 Functionalism.....	33
2.7 Neo-Functionalism.....	36
2.8 Conclusion.....	37

CHAPTER THREE

REGIONAL INTEGRATION EXPERIENCES

3.1 Introduction.....	39
3.2 Integration In East Africa Community.....	39
3.2 European Union Integration.....	40
3.3 Latin America Integration.....	44
3.4 Integration in Asia.....	49
3.5 Africa’s Integration.....	54

3.5.1 Eastern and Southern Africa regions	57
3.5.2 Regional economic integration in West Africa	57
3.5.3 Regional economic integration in Central Africa.....	59
3.5.4 Regional Economic Integration in North Africa	60
3.6 Conclusion.....	61

CHAPTER FOUR

DATA ANALYSIS

4.1 Introduction	64
4.2 Demographic factor.....	64
4.2.2 Distribution of Age Group.....	65
4.2.3 Academic background	65
4.2.4 Length of service	66
4.2.5 Management skills	67
4.3 Impact of Regional Integration on Banking Industry.....	68
4.3. 1 Political Influence on Policy Making	68
4.3.2 Attribute to growth and smooth running banking industry in the region	69
4.3.3 Economic Integration and the Current Developments in East Africa Community	70
4.3.4 Attractive Features in EAC Regional Integration.....	70
4.3.5 Importance Prior Research in Banking.....	71
4.3.6 Effects of Regional Integration to Financial Institution	72
4.3.7 Challenges Encountered in Banking Industry in the Region.....	73
4.3.8 The effect of non-financial pressure groups on monetary policy	74
4.3.9 Regional Integration Benefits to the Banking Industry	74

4.3.10 Regional Integration Impact on Bank Development and Growth	76
4.3.11 Improving Regional Policy.....	76

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 Introduction	80
5.2 Summary	80
5.3 Conclusion.....	81
5.4 Recommendation.....	83
REFERENCES	86

QUESTIONNAIRE

CHAPTER ONE

REGIONAL INTEGRATION

1.1 Introduction

Regional integration is a process in which states enter into a regional agreement in order to enhance regional cooperation through regional institutions and rules. Its objectives could range from economic to political although it has become a political economy initiative where commercial purposes are the means to achieve broader socio-political and security objectives. Regional integration can be defined along three dimensions: Geographic scope illustrating the number of countries involved in an arrangement variable geometry, the substantive coverage or width that is the sector or activity coverage trade, labor mobility, macro-policies, sector policies, etc., and the depth of integration to measure the degree of sovereignty a country is ready to surrender, that is from simple coordination or cooperation to deep integration¹. Past efforts at regional integration have often focused on removing barriers to free trade in the region, increasing the free movement of people, labor, goods, and capital across national borders, reducing the possibility of regional armed conflict, and adopting cohesive regional stances on policy issues, such as the environment, climate change and migration. Such an organization can be organized either on supranational or intergovernmental decision-making institutional order, or a combination of both.²

Regional integration as a concept and process developed in the 1950s following the creation of the European Economic Communities³. As a process, regional integration refers to a voluntary collective action among states within a geographical proximity to economically and

¹ John H. Jackson. (1989). *The World Trading System*. Cambridge. MIT Press.

² Harrison B & Rosamond, Ben *Theories of European Integration*. Houndmills: Palgrave, (2000), p. 12.

³ Coulibaly, S., Roberts, A., Foster, V. and Deichmann, U. (2010). *Africa's Infrastructure: A Time for Transformation*, A report submitted to Infrastructure Consortium of Africa on Deepening Regional Integration.

politically harmonise policies, production, and trade issues with a view of optimising efforts in addressing national and regional challenges, the end result being an economic and political community.⁴ Whereas William Wallace adopted a more generalised definition as the creation and maintenance of intense and diversified patterns of interaction among previously autonomous units⁵ There has been great progress in integrating the EAC capital markets and the most apparent manifestation of this is the cross listing on the DSE, USE and Rwanda OTC of three Kenyan listed companies, five Kenyan listed companies and one Kenyan listed company respectively: East African Breweries Limited, Kenya Airways Limited, Kenya Commercial Bank, Equity Bank and Jubilee Holdings Limited.⁶

The East African Community is the regional intergovernmental organization of the Republics of Burundi, Kenya, Rwanda, Uganda and the United Republic of Tanzania with its Headquarters in Arusha, Tanzania. The Treaty for Establishment of the East African Community was signed on 30th November 1999 and entered into force on 7th July 2000 following its ratification by the Original 3 Partner States – Kenya, Uganda and Tanzania. The Republic of Rwanda and the Republic of Burundi acceded to the EAC Treaty on 18th June 2007 and became full Members of the Community with effect from 1st July 2007⁷.

1.2 Statement of the Problem

Clearly, the success conditions for regional integration are many, varied and difficult to achieve. This difficulty has continued to constrain African efforts from the beginning of the

⁴ Venables, A.. The economic integration of oligopolistic markets. *European Economic Review*, (1990) Vol. 34: 753-73.

⁵ Frieden, Jeffrey A. & Lake, David A. *International Political Economy: Perspectives on Global Wealth and Power*. New York: Bedford and St. Martin's, (2000), p. 4.

⁶ Cadogan Financial (2008). *East African Community (EAC) Regionalization: Models and Findings Report*. The Private Enterprise Partnership for Africa Efficient Markets Institutional Development Initiative (ESMID), March 2008.

⁷ EAC (2007) Secretariat, Protocol on the Establishment of the EAC Custom Union, Arusha, EAC secretariat.

region's romance with regional integration. African countries lack the income levels and the structural complementarities that could be relied upon to generate appreciable gains from specialization based on regional integration, both within and across industries. These regional markets, even when fully liberalized and integrated, are typically not large enough to serve as a viable basis for achieving high levels of industrial growth and efficiency. In reality, most African regional integration schemes have not achieved full integration; and the domestic policy in individual member countries have also been generally at variance with the ideals of harmonized and coordinated pursuit of regional objectives.

More generally, a recent survey of African regional integration schemes suggests that the design and implementation of many of the arrangements in effect actually constrain rather than promote intra-regional affairs⁸ This counter-intuitive result seems to emanate from such prominent features as consensual decision-making arrangements, over-lapping and sometimes conflicting memberships, lack of regional level monitoring of the implementation of decisions, apparent unwillingness of governments of member countries to cede authority to the regional bodies, and the consequent lack of resources and power by the regional secretariats to take initiative and promote regional perspectives. In addition, non-compliance with and delayed implementation of agreed trade liberalization schedules have not enhanced intra-regional trade expansions; while in many cases, the chosen instruments of integration are virtually guaranteed to discourage rather than promote intra-regional trade. Finally, the absence of effective compensation mechanisms has further hindered the implementation of certain trade liberalization measures in particular regional integration schemes. Taken together, these problems show that East Africa's regional integration schemes have generally not been fully implemented as

⁸ Winter L.A. and P.M. Martins. 2004. When comparative advantage is not enough: Business costs in small remote economies. *World Trade Review*, 3(3): 347-383.

designed. This is clearly demonstrated by the observations that, in many of them, internal trade barriers, poor infrastructure and high cost intra-regional transactions. Initial conditions and structural features of some of the regional integration schemes were more conducive to higher intra-regional trade flows than in others.

1.3 Objectives of the Study

- i. To investigate on the concept of economic integration and the current developments in East Africa Community
- ii. To determine the effect of regional integration on financial institution in east Africa
- iii. To examine challenges encountered in regional integration in the East African Community

1.4 Literature Review regional integration

In this section literature review on the impact of regional integration and banking industry in east Africa community in promoting regional development have been reviewed. The literature review has majored on the evolution of customs union theory, Economic integration around the world, East African integration, Economic cooperation in the financial sector, Economic cooperation in the financial sector, Financial Benefits of Regional Integration and Challenges on regional integration comprehend its literature.

1.4.1 The evolution of customs union theory

The best known customs unions have included the Zollverein between Germanic states in the nineteenth century, the Cobden Treaty between France and the United Kingdom, and the EEC, now known as the EU. Belgium, the Netherlands and Luxembourg established Benelux in the 1940s, while Belgium, France, Italy, Luxembourg, the Netherlands and West Germany set up the EU. Customs union theory builds on relatively strict assumptions such as perfect competition in

commodity and factor markets. It has both positive and negative welfare effects, as compared to a situation in which every member state practices protectionism

According to Viner the establishment of a custom union could have ambiguous welfare effects⁹. It is all depended on the issue of trade creation versus trade diversion. Trade creation would be new trade created by the supply of goods from a lower cost source than before. A member country would now import from the other member countries (within the union) goods that it formerly did not import at all because the price of the protected domestic product was lower than the price of the import from any foreign source plus the duty. Therefore, there would be a gain in welfare for that country. Trade diversion would be a situation in which a member country would buy from a more expensive partner instead of buying from a country with low production costs outside the customs union. In this case, there would be a loss of welfare for that country. It would not only increase its cost but also lose the tariff it would charge the third country outside the custom union.

Viner thus stressed the discriminatory aspects of regional trade liberalisation¹⁰. The essence of what Viner said is that the welfare costs derived from trade diversion are borne by the consumers of the member countries, not by the exporters of third countries. Viner's customs union theory depended on the assumption that the production costs of future partner countries were supposed to be constant, whatever the amount produced. Viner's analysis focused on resource allocation changes and on production efficiency when a customs union is formed. Viner's analysis did not cover the reaction of consumer demand within a union when the prices of traded goods decreases/increases. Economic theory tells us that any price reduction will have a

⁹ Viner, J. "The Customs Union Issues", New York: Carnegie Endowment for International Peace 1950. pp. 314 –315.

¹⁰ Viner, J. "The Customs Union Issues", New York: Carnegie Endowment for International Peace 1950. pp. 314 –315.

positive impact on welfare, known as the consumer's surplus whilst an increase in price will reduce the consumer surplus.

Linberg focused on this secondary positive effect and affirmed that a trade-diverting customs union would be beneficial for its members¹¹. This statement openly contradicts the conclusions of Viner (1950). It is obvious that the consumer surplus effect may compensate for the negative trade diversion effect on the production side, provided the decrease in local prices is sufficiently large.

Meade¹² and Lipsey eliminated the hypothesis of consumption in fixed proportions by discussing the effects of the establishment of a customs union on the change in terms of trade between the economies involved. They stressed that if a change in the flows of trade is due to the “substitution” of goods, then a substitution effect in the consumption of goods would tend to increase the volume of imports from the partner country and decrease the imports from the rest of the world; and would make consumers replace the consumption of goods produced in the local market by goods imported from the partner country, if the establishment of a customs union changed relative prices of the goods in favour of the partner country.

According to Bhagwati argue that when countries within the customs union end up buying from higher cost producers within the union over the least-cost producers outside the agreement, consumers still benefit¹³. Despite the advantage of reduced tariffs which translate into lower prices of traded goods the national treasury of the customs union members suffers because it will have lost the tariffs that would have been charged. The above argument is especially true for countries whose trade share to Gross Domestic Product is higher and the customs revenue

¹¹ Linberg, L. N. [1963]. “The Political Dynamics of European Economic Integration”, Stanford, Calif: Stanford University Press, p.10.

¹² Meade, J.E. 1955. *The theory of customs unions*. Amsterdam: North Holland.

¹³ Bhagwati, J. 1990. Multilateralism at risk: The GATT is dead, long live the GATT. *World Economy*, 13: 149-69.

share of the national budget is larger. If gains to consumers outweigh the added amount paid to the producers in the high cost partner country, the result can be a net welfare gain for the country, that is, depending on which is higher¹⁴. But this is only true if we assume that output of any industry in a particular country increases over the long-run relative to the national economy as a whole, its costs of production per unit also rises. But there are industries where you could get economies of scale returns. But anyway, free traders would argue that there would only be a benefit if this lower cost were even lower than the cost in the international market (before duties).

The theory of regional economic integration has passed through two different periods in history¹⁵. The first period put emphasis on the impact of customs union formation on production, consumption and trade flows. In the period, from 1960 onwards, economists began to question what the real objectives were of those entering integration schemes. Some time earlier, with the development of the second best theory, economists had reached the conclusion that regional economic integration would not lead to maximum welfare gains in comparison to the global integration which would result from multilateral tariffs reduction. There was consensus among the theoreticians in the 1970s and 1980s that discriminatory trading arrangements, such as customs unions, tend to be welfare-enhancing for their members provided these trading arrangements are regionally-based and fairly open to new membership and, also on condition that the members acting together are able to influence the terms of trade with the rest of the world. Supply-side improvements within the integrating area benefit the non-member consumers (whether final or intermediary) as well as the exporters since fixed costs to penetrate the unified market tend to decrease.

¹⁴ Meade, J.E. 1955. *The theory of customs unions*. Amsterdam: North Holland.

¹⁵ Krauss, M. 1972. Recent developments in customs union theory: An interpretive survey. *Journal of Economic Literature*, 10: 413-79

1.4.1 Economic integration around the world

Over the past decade major changes in the world have taken place, which has turned the economies of the world into regional blocks, namely, East Asia, South Asia, Sub-Saharan Africa, Latin America, Caribbean and OECD, among others. The focus is on the southern African block based on the emergence of the European Monetary Union in 2000, which bears testimony to the success of economic integration to date. Other important trade block formations that are quite powerful today are the Free Trade Area in North America and the establishment of Mercosur, both which fulfill the optimum currency area criteria.

On the whole Latin America and Mercosur have shown some progress towards fully-fledged economic integration arrangements. In eastern and southern Asia, major transformations have already come to the fore and more is on the horizon. An attempt to intensify economic integration in some sense has primarily manifested itself within the context of the Association of Southeast Asian Nations (ASEAN). Also, the collapse of the Soviet Union has created much more potential to various political and economic integration initiatives in the east of Eurasia. At the same time, Africa has to adapt to the dynamic political and economic changes in order to cope with the pressures to promote economic development and economic growth. Throughout Africa vigorous efforts are being made to promote adjustment, development and economic regional integration.

Studies have been conducted by various institutional structures such as the International Monetary Fund (IMF), the Southern African Development Community (SADC), the United Nations Conference on Trade and Development (UNCTAD) and other institutional structures in Africa. No in-depth research has been done of regional financial integration in southern Africa,

especially on all issues pertaining to the integration of exchange rate systems, capital and money markets, banking regulatory frameworks, and fiscal and monetary issues.

1.4.2 East African integration

Economic integration in the east of Africa dates back as early as 1917 with the establishment of the East African Common Market (EACM), which is made up of Kenya, Tanganyika (now part of Tanzania) and Uganda. This was followed by the signing of a treaty of East African cooperation in Kampala, Uganda on 06 June 1967, which led to the establishment of the East African Community (EAC), which collapsed in 1977¹⁶

The East African Currency Board comprised of Kenya, Uganda, Tanganyika and Zanzibar was formed in 1919. The other important institution for economic integration was the East African Development Bank, which was established in 1967¹⁷. The third organisation was founded by Uganda, Kenya and Tanzania in 1967 with the sole purpose of establishing an entity that would provide financial assistance to national projects and implement the efforts of national development finance institutions.

Eastern Africa is a region with the largest number of RECs and intergovernmental regional bodies in Africa. Nearly all of the 12 countries in the region are members of four of the eight RECs⁵ recognized by the African Union. Each of the countries belongs to at least two RECs while some belong to up to four RECs/regional intergovernmental organizations (IGOs). This multiple membership feature) is counter-productive and often results in duplication of resources and conflicting goals and policies. In addition, East African countries are also

¹⁶ The intermediate steps are creation of a Free Trade Area (FTA), Customs Union, Common Market and Monetary Union (and ultimately a single currency) 2007 p 45-56.

¹⁷ Coulibaly, S., Roberts, A., Foster, V. and Deichmann, U. (2010). Africa's Infrastructure: A Time for Transformation, A report submitted to Infrastructure Consortium of Africa on Deepening Regional Integration.

members of development finance institutions that span across different regional groupings¹⁸. These include the PTA Bank, the East African Development Bank (EADB), the Agency for Trade insurance, and other financial institutions with broader regional scope and membership. In this context, trends such as that of the Tripartite Arrangement are encouraging¹⁹.

1.4.3 Economic cooperation in the financial sector

Financial sector cooperation is championed by the three multilateral groupings in the southern African region. These regional issues in finance are addressed by EAC through its two main structures namely the directorate of Trade, Industry and Finance and Investment and the Committee of Central Bank Governors in EAC. The other multilateral grouping in the finance sector is ESAF, which also enhances financial sector cooperation. The Multilateral Monetary Area (MMA) is another important financial cooperation agent in the southern region of Africa, notwithstanding the importance of ECOWAS, which is comprised mainly by countries in the eastern and southern part of Africa.

Regional cooperation in finance is eminent, taking into consideration the complex nature of the financial systems of countries in the region. Throughout the region almost all countries are confronted by similar financial and monetary problems, which prohibit economic growth and development in the region. Some of the basic common problems are fiscal laxity, bad monetary discipline, lack of institutional capacity, undeveloped financial markets and a shortage of investment and foreign reserves. Regional financial cooperation would over time resolve these obstacles and enhance greater financial sector integration with greater economic benefits by achieving convergence in the region.

¹⁸ Monetary Affairs Committee (MAC) – Committee of EAC Central Bank Governors - Communique of the 13th MAC Meeting held in Arusha, Tanzania, May 10, 2010. P 67.

¹⁹ Monetary Affairs Committee (MAC) – Committee of EAC Central Bank Governors - Communique of the 13th MAC Meeting held in Arusha, Tanzania, May 10, 2010 p 34

Regional cooperation in the financial sector must be done with the objective of promoting sustainable economic development and growth. Financial sector cooperation can be achieved through sound measures, which aim at macro-economic stability, financial system strengthening, mobilising and using external and domestic savings more efficiently, and by encouraging expansion and diversification of international and intra-regional investment.²⁰ Regional financial sector cooperation was thus far based on the following platforms: banking sector cooperation, cooperation in the insurance industry, money and capital markets cooperation, intra-regional currency convertibility, external debt management cooperation, cooperation in attracting project and trade finance and clearing and settlement cooperation.

Banking sector cooperation should address the challenges facing the regional banking sector. Banking sector reform should ensure good banking practices that would attract foreign banks to the market and allow the development of domestic and regional banks. Banking cooperation focuses on the following areas: banking supervision, credit specifications, licensing and regulation, capital adequacy, deposit insurance, the interbank deposit market, collateral, liquidity ratios and reserve requirements.²¹ Numerous projects of cooperation have been undertaken on the above-mentioned issues. The EAC Banking Association was established to uniform norms and standards for the banking practices in the region. Banking cooperation will enhance the attainment of the right mix between national institutions' regional and global banks and that could benefit the region as a whole.

²⁰ Opolot & Luvanda. Macroeconomic Convergence in the East African Community: Progress and Implications for the Proposed Union, Bank of Uganda Staff papers, (2009). 1(3),53-

²¹ Cook and Sachs *The transaction costs for creating institutions to manage regional public goods can be prohibitively high* (Boulder, CO: Lynne Rienner Publishers, 2002), 141

1.4.4 Financial Benefits of Regional Integration

Regional integration is seen as a rational response to the difficulties faced by a continent with many small national markets and landlocked countries. As a result, African governments have concluded a very large number of regional integration arrangements, several of which have significant membership overlap. While characterized by ambitious targets, they have a dismally poor implementation record. Part of the problem may lie in the paradigm of linear market integration, marked by stepwise integration of goods, labor and capital markets, and eventually monetary and fiscal integration. This tends to focus on border measures such as the import tariff. However, supply-side constraints may be more important²². A deeper integration agenda that includes services, investment, competition policy and other behind-the-border issues can address the national-level supply-side constraints far more effectively than an agenda which focuses almost exclusively on border measures.

There are a number of financial gains arising from regional integration. Regional integration had led to reduction in the cost of Information communication technology (ICT) in Africa. The most immediate direct benefits of enhanced connectivity in African countries are reduced prices and better service for international voice and Internet connectivity. Prices for most services in countries with underwater cable access are half those in countries without access.²³ Such large price reductions could boost demand for these services and, ultimately, economic productivity.

²² EAC (2007) Secretariat, Protocol on the Establishment of the EAC Custom Union, Arusha, EAC secretariat.

²³ Leamer, E. E., and Storper, M. (2001). The Economic Geography of the Internet Age. *Journal of International Business Studies* 32 (4): 641–65.

Regional integration has been proposed in the literature as a solution to stock market development in smaller emerging countries.^{24,25} Proponents of this approach have argued that regional integration can bring greater efficiency, synergies, and economies of scale; attract the foreign flow of funds; foster risk sharing and portfolio diversification; act as an impetus to financial sector reforms, thereby broadening the competitiveness of regional financial systems and minimizing the risks of financial instability; facilitate capital market development; and lead to economic growth.²⁶

The African continent's economic geography makes transport connections with the world something of a public good. Major corridors to the sea connect the continent's landlocked countries to the major seaports, through a combination of road and rail infrastructure. The main ports include Douala (Cameroon) for central Africa; Durban (South Africa) and Maputo (Mozambique), for southern Africa; Dar es Salaam (Tanzania) and Mombasa (Kenya) for eastern Africa; and Abidjan (Côte d'Ivoire), Cotonou (Benin), and Dakar (Senegal) for western Africa. About \$200 billion a year in imports and exports moves along these corridors, barely 10,000 kilometers long. About 70 percent is in good or fair condition, with donors channeling more resources to improve infrastructure along the routes.²⁷ However, regulatory and administrative hurdles continue to inflate costs and prolong delays for freight movements along these strategic arteries. Tariffs for road freight are several times higher than in other parts of the developing

²⁴ Demirguc-Kunt, A., T. Beck, and P. Honohan, (2008). *Finance for All? Policies and Pitfalls in Expanding Access*, A World Bank Policy Research Report, (Washington: The World Bank).

²⁵ Tahari, A., P. Brenner, E.D Vrijer, M. Moretti, A.S. Senhadji, G. Sensenbrenner, and J. Sole, (2007). *Financial Sector Reforms, Prospects for Financial Integration in Maghreb Countries*, IMF Working Paper 07/125 (Washington: International Monetary Fund).

²⁶ Coulibaly, S., Roberts, A., Foster, V. and Deichmann, U. (2010). *Africa's Infrastructure: A Time for Transformation*, A report submitted to Infrastructure Consortium of Africa on Deepening Regional Integration.

²⁷ Teravaninthorn, S. and Raballand, G. (2008). *Transport Prices and Costs in Africa: A Review of the Main International Corridors*. Directions in Development Series. Washington, DC: World Bank.

world, which is attributed not to higher road transport costs in Africa, but to exceptionally high profit margins in the trucking industry.²⁸ These margins in turn reflect cartelization and restrictive regulatory frameworks, such as market entry barriers; technical regulations; and the tour de role system that allocates freight business based on queuing, particularly in central and western Africa. This system favors large fleets with mostly older trucks in poor condition.

The community stands to gain from different avenues which include: Increased Investment, both domestic and foreign, because of its position as a competitive and attractive market area with vast investment opportunities in the, agro-processing, mining, tourism and fishing industries, manufacturing and services as well as investments in regional infrastructure, including roads, railways, telecommunications, energy and the Lake Victoria Development Programme.”²⁹

Improved standards of living resulting from; lower product and service prices, increased competition between firms and the employment of economies of scale which means increased productivity levels and elimination of internal inefficiencies from the firms in the market.³⁰ Employment opportunities resulting from increased production leading to reduced levels of unemployment and reduced brain drain.³¹ Institutions such as Kenya Commercial Bank have been employing more in the last decade due to having access to the other partner states in the community. These employment opportunities have been of benefit to the nationals of the countries the bank has entered into.

²⁸ Ibid (2008).

²⁹ Coulibaly, S., Roberts, A., Foster, V. and Deichmann, U. (2010). Africa’s Infrastructure: A Time for Transformation, A report submitted to Infrastructure Consortium of Africa on Deepening Regional Integration.

³⁰ World Bank Report, 1999, pg 1

³¹ East African Community Secretariat, East African Customs Union: Information and Implications, 2001, pg 5

Global Trade: A commitment was made by the EAC Partner States in 2002 to act collectively in global trade issues in articulating their interests and when negotiating. This is because the Partner States share common interests. An example would be in the tourism and wildlife sector with the launch of joint marketing of East Africa as a single tourist destination. The partner States hold joint promotion under one common exhibition area in different markets around the world such as the World Travel Market (WTM) in London.³²

Consumers will benefit from higher food security in the region.³³ This is because of free movement of agricultural produce from areas of plenty to areas with shortages. Several times like in Kenya there has been a shortage of maize which has resulted in the government importing maize from South Africa. The East African Community will help to stop such occurrences giving local governments and businesses the option to purchase products from other partner states and thus save on import duty.

Benefits of the EAC to ordinary citizens will include optimal utilization of the existing training and education facilities resulting in reduced costs of human resource development for citizens, greater mobility and enjoyment of accruing benefits, improved health facilities and availability of drugs, improved power supply through the establishment of a common grid, and enhanced quality management through establishment of common standards.³⁴

1.4.5 Challenges on East Africa regional integration

The EAC faces a variety of challenges which can be classified into tariff barriers and non-tariff barriers. Examples of non-tariff barriers include deficient road infrastructure and telecommunications networks that lead to high transport and communication costs, lack of

³² East Africa Handbook, pg 9

³³ East African Community Secretariat, East African Customs Union: Information and Implications, 2001, pg 4

³⁴ EAC Strategy Workshop, Nairobi, 2000

information on trade opportunities.³⁵ The road network has led to the high cost of transport making it difficult to encourage trade in the region. This is coupled with regular down-time of vehicles used to transport products due to the bad infrastructure. Information on trade opportunities would encourage the business sector to be more pro-active thus leading to the achievement of the East African goals way sooner.

Other barriers to trade in the region include duty and tax administration problems, corruption, customs procedures, licensing procedures, police checks and roadblocks, immigration procedures and transit difficulties.³⁶

Membership to different regional blocs: This imposes undue administrative and financial cost on Partner States.³⁷ Kenya for example is a member of COMESA (Common Markets for East and South Africa), IGAD (Inter-Governmental Authority on Development) and the East African Community. It has different obligations in these different organizations which reduce its level of commitment to the EAC making the achievement of its goals in the EAC to be achieved more slowly than would be anticipated.

1.5 Theoretical Framework on regional integration

The theory of focus so as to appreciate regional integration as an important strategy especially in banking industry is Regionalism. The integration process can be compared along different dimensions, the scope which includes a range of issues, the depth which is the extent of policy harmonization, institutionalization; the extent of formal institutional building and

³⁵ Heinz-Michael Stahl, East African Community Customs Union Tariff Liberalisation Impacts in Perspective, East African Community, 2005, pg 49

³⁶ Heinz-Michael Stahl, East African Community Customs Union Tariff Liberalisation Impacts in Perspective, East African Community, 2005, pg 51

³⁷ M.A. Consulting Group, Study on the Establishment of an East African Community Common Market: Final Report, August 2007, pg 17& 18

centralization; the degree to which effective authority is centralized.³⁸The early stages here agenda expands to cover non-tariff barriers, market regulation, and the development of common policies at the micro and macro levels. Regionalism is a theoretical concept used to analyse an international system. It can also be regarded as an aim, goals and driving force that underline conscious efforts by the members of a region to increase or control various forms of interaction and cooperation hence a complex of attitudes, loyalties and ideas which concentrate the mind of the people upon what they perceive to be their region. An important indicator to regionalism is the extent to which in Africa union, regional development and regional politics come to shape and define the domestic landscape. Regionalism Theory and conflict resolution in East Africa acknowledges that it is no longer fashionable to regard regional countries as being primarily institutions for economic development, geared towards the creation of a single market.

Regionalism theory focuses on the role of shared domestic attributes or characteristics by having the responsibilities of regional cooperation and integration that is likely to depend heavily on the coherence and viability of the states and state structure in a given region³⁹. The absence of viable states makes difficult the process of region building, as warlords are bound to move in if the state collapses, such a problem is part of the major obstacles towards effective regionalism in parts of Africa including EAC⁴⁰.

Neo-Functionalist theory is a theory of regional integration that places major emphasis on the role of non-state actors – especially, the “secretariat” of the regional organization involved and those interest associations and social movements that form at the level of the region – in providing the dynamics for further integration. Member states remain important actors in the

³⁸ Fawcett L. and Hurrell A, (eds.) (1995), *Regionalism in World Politics*, Oxford, Oxford University Press.

³⁹ Boyd, G, (1984). *Regionalism and Global Security* Lexington: Lexington

⁴⁰ Bhagwati, J. (1993). “Regionalism and multilateralism: an overview”. In J. de Melo and A. Panagariya (1993) (eds). *New dimensions in regional integration*. Cambridge University Press for CEPR.

process. They set the terms of the initial agreement, but they do not exclusively determine the direction and extent of subsequent change. Rather, regional bureaucrats in league with a shifting set of self-organized interests and passions seek to exploit the inevitable “spill-overs” and “unintended consequences” that occur when states agree to assign some degree of supra-national responsibility for accomplishing a limited task and then discover that satisfying that function has external effects upon other of their interdependent activities.⁴¹ According to this theory, regional integration is an intrinsically sporadic and conflictual process, but one in which, under conditions of democracy and pluralistic representation, national governments will find themselves increasingly entangled in regional pressures and end up resolving their conflicts by conceding a wider scope and devolving more authority to the regional organizations they have created⁴². It is important to conclude that the state strength and regionalism do not stand in opposition but that states remain the essential building blocks with which regionalist arrangements are built.

1.6 Justification of the Study

Over the past decade major changes in the world have taken place, which has turned the economies of the world into regional blocks, namely, East Asia, South Asia, Sub-Saharan Africa, Latin America, Caribbean and OECD, among others. The focus is on the southern African block based on the emergence of the European Monetary Union in 2000, which bears testimony to the success of economic integration to date.

The EAC faces a variety of challenges which can be classified into tariff barriers and non-tariff barriers. Examples of non-tariff barriers include deficient road infrastructure and telecommunications networks that lead to high transport and communication costs, lack of

⁴¹ Arthur L. Stinchcombe, *Constructing Social Theories* (New York: Harcourt, Brace and World, 1968), pp. 32.

⁴² Heinz-Michael Stahl, *East African Community Customs Union Tariff Liberalisation Impacts in Perspective*, East African Community, 2005, pg 49

information on trade opportunities. The road network has led to the high cost of transport making it difficult to encourage trade in the region. The links between national policies are of prime importance in relation to the world's financial and capital markets and this has made borders less significant, to the extent that global financial linkages and capital movement are a top priority of the macroeconomic policy analysis of every economy.

The need for regional financial integration is paramount, especially so that emerging countries could hedge against the risks in the global competitive financial arena. Financial integration would help emerging economies, including African economies, to gain access to resources and technology to expand and diversify their markets. Markets could be expanded through intraregional trade, which implies that member countries would benefit if the trade creation effects outweighed any trade diversion effects. This would allow the complementary production of goods and more potential for specialization among the regional members.

Regional integration is perceived as having the potential for growth-enhancing investment in both physical and human capital. The efficiency of regional integration would increase both local and foreign investment. This would induce more foreign direct investment (FDI) in the region which would bring some credibility to the regional financial system. Financial integration in the region would entail flexible policies, which includes investment, fiscal and monetary policy that would increase global integration, reduce the transaction costs and encourage more regional investment. These would afford the southern African region the opportunity to compete in the global financial markets because of a stable, reputable regional financial standing.

The success of regional financial integration could be evidenced by the EU and other East Asian and Pacific economies. These would be a step closer to the African Common Market or the African Monetary Union, because of the economic integration. The importance of this study

therefore lies in uncovering the problems that the EAC countries face in respect of monetary integration, what is required to resolve these issues, whether the macro economic framework for achieving convergence are plausible, and how achieving the macro economic targets for convergence would impact on EAC when measured against the convergence criteria of the EU.

1.7 Hypothesis

1. There is a significant impact of regional development on Regional integration and banking industry in East Africa community though challenges and opportunities revitalize and resuscitate regional banking
2. Good governance in East Africa financial and monetary integration leads to effective strategy implementation of Regional integration and banking industry in east Africa community

1.8 Research Methodology

This section will provide a discussion of the outline of the research methodology that will be used in this study. It focuses on the research design, population of study, data collection methods and makes conclusions based on the data analysis and data presentation methods that will be used in this study⁴³.

1.8.1 Research Design

The research study to be undertaken will examine the impact of regional integration on banking industry in the East Africa Community. The type of research design that will be used for this study will be the explanatory design. This will involve explanation of causes and effects of the independent and dependent variables associated with the problem. According to Denscombe,

⁴³ Mugenda, O.M and Mugenda A.G. (2003); Research Methods. *Act Press. Nairobi.*

explanatory research is used when asking research questions that deal with causal process⁴⁴. Statistical mean and standard deviation as well as percentages will be used to summarize the responses. In view of the fact that the study will mainly be exploratory in nature, the researcher will be of the opinion that it will be possible to draw conclusions without the use of very complicated qualitative statistical tools that might jeopardize a very clear presentation of the findings of the research.

1.8.2 Population

The targeted population for the study was 20 commercial banks in East Africa whereby three commercial banks in Kenya that are operating in East Africa Region are randomly selected as a sample. According to Cooper and Schindler, the sampled population is that part of the target population that is accessible and available for sampling⁴⁵. The study makes use of the random sampling method which is suitable in this context. According to Jankowicz, surveys are particularly useful when you want to contact relatively large numbers of people to obtain data on the same issue or issues, often by posing the same questions to all.⁴⁶

1.8.3 Sampling Design

The sampling design is a fundamental part of data collection for scientifically or socially based decision making. A well-developed sampling design plays a critical role in ensuring that data is sufficient to draw the right conclusions. A sound, socially or scientific based decision must be based on accurate information. The handling method and the representation of the data should correspond to the objective of the study. The sampling design will indicate the number of samples taken and will also identify the particular samples (for example, the ministries where

⁴⁴ Denscombe, M. (1998), *The Good Research Guide for Small Scale Social Research Projects*. New Delhi: Viva Books Private Limited.

⁴⁵ D. R. Cooper and P. S. Schindler, *Research Methods* (7th ed. New York: Irwin/McGraw-Hill, 2000) p 112

⁴⁶A. D. Jankowicz, *Research Projects* (6th ed. London: Thomson Learning, 2002) p 87

particular views of the samples were collected). Along with this information, the sampling design will also include an explanation and justification for the number and responses of the samples.

1.8.4 Data Collection Methods

The study will use both primary and secondary data was collected from key informants from the 20 banks which are operating in East Africa Community. To achieve this, an interview guide will be used to collect primary data. The interview will be conducted by the Researcher personally. The interview guide has unstructured questions which will be used so as to encourage the respondent to give an in-depth response without feeling held back in revealing of any information. With unstructured questions, a respondent's response may give an insight to his feelings, background, hidden motivation, interests and decisions and give as much information as possible without holding back.

Secondary data will be collected on attitudes and perception and the importance of the study and cannot be over-emphasized also be collected to augment the studies. The study will also rely on secondary data such as text books, journals, and academic papers that are to be found in the University of Nairobi and other libraries. This instrument of data collection enables the researcher to control the setting; it is flexible as one can probe and in the process get in-depth information⁴⁷. The study will also rely on secondary data such as text books, journals and academic papers that are in various libraries in Nairobi as well as government printers.

1.8.5 Data analysis

The data will be analyses in two fold⁴⁸, one general approach will be applying content analysis. Content analysis as a technique for making inferences by systematically and objectively

⁴⁷ Mugenda, O.M and Mugenda A.G. (2003); Research Methods. *Act Press. Nairobi.*

⁴⁸ Jankowicz A. D., *Research methods in social science* (6th ed. London: Thomson Learning, 2002) p 87

identifying specified characteristics of messages and using the same to relate trends. The data will be qualitative in nature, due to this fact, content analysis will be used to analyse the data.

1.9 Chapters summary

Chapter one outlines the introduction to regional integration and banking industry in east Africa community, it comprises the back ground of the study, statement of the problem and justification of the study. The hypothesis and objectives are clearly specified as well as the research methodology. Chapter two focuses on theoretical underpinning of regional integration. The chapter also examines the banking integration models around the world, more specifically that of the East Africa Community. Chapter Three explores different experience of regional Integration, Regional integration experiences globally and how the continent has gained financial benefits. The economic integration initiatives are analyzed as classified in the East Africa region and measurement of economic integration starting with the theoretical approaches of measurement followed by an evaluation of the performance of East Africa in the next chapter. The chapter includes a discussion of the Optimum Currency Area and African Integration Index Methods of measuring financial integration performance. Chapter Four presents A Critical analysis of Regional integration and its Impact on Banking Industry in East Africa, i.e. the barriers to financial integration, and it get into the costs and benefits of financial integration. Finally, a macroeconomic overview, regional financial integration in East Africa, capital flows in the region, structural changes in the international financial markets and regional developments in EAC financial markets, are investigated. Chapter 5 presents the research findings from the sample population and present analysis. It looked at whether this research approves or disapproves the hypothesis.

CHAPTER TWO

THEORETICAL UNDERPINNING OF REGIONAL INTEGRATION

2.1. Introduction

Regional integration as a process towards economic and political integration can best be understood by placing it in the right theoretical context. An understanding of the theories forming the thought process that eventually leads to the conception of a regional integration initiative leads to a better analysis of any matter in the integration framework adopted. The EAC is no exception. This study, by confining itself to the inter-linkage of both the political and economic aspects borrows heavily from dominant theories on regional integration from both disciplines. Functionalism and the custom union theories are the two main theoretical references used in this study. The functionalist approach to regional integration has great eminence in the context of the EAC which grapples with whether member states should cede their sovereignty to a supranational organization⁴⁹.

The challenge for East Africa's regional integration is the need to arrive at a common agreement on the best form the regional body should adopt to yield maximum benefit to member states. Much needs to be harmonized in the area of policy if rapid results are to be realized. In a region that is still economically underdeveloped by global standards, much effort is needed to identify the most ideal principles and theories to guide the region's growth and development. In addition to this, these principles must be moulded into a form that provides for their practical application in the real economic experience of the five member states.

⁴⁹ Cadogan Financial (2008). East African Community (EAC) Regionalization: Models and Findings Report. The Private Enterprise Partnership for Africa Efficient Markets Institutional Development Initiative (ESMID), March 2008.

While forms of regional integration theory were already in existence⁵⁰, specific study of the phenomenon began with a focus on Europe in the early 1950s, shortly after the end of World War II. European integration began with only six states: Belgium, France, Germany, Italy, Luxemburg, and the Netherlands. Initial post-war discussions on European rebuilding included grandiose visions that called for a “United States of Europe ”. However, a more pragmatic and basic approach towards cooperation was adopted, starting with the creation of the European Coal and Steel Community (ECSC), established by the Treaty of Paris in 1952. The community was adopted by the six states primarily as an economic preventative measure against further war as integrated coal and steel production would make any military action significantly more costly and difficult. The ECSC led to the first European institutions including the High Authority, a predecessor to the current-day Commission, and the Common Assembly, which was the predecessor to the current-day Parliament (Europa 2010, Treaties and Law). Though the institutions had limited authority, they were an important first step toward regional integration as they constituted a decision-making body that extended beyond the nation- state.

2.2 Background Of The Regional Integration Concept

The theory and concept of integration has gone through tremendous development starting in earnest in the 20th Century. The focus at that time was Europe and much of the integration discourse centered on explaining European integration. The beginning of organized regional integration is traced back to 1952 with the formation of the European Coal and Steel

⁵⁰ Schoeman, N.J. (2002), EconomicGrowthandDevelopmentConstraintsinAfrica, Journal of Public Administration, Vol. 37, No. 3.1, November, 2002.

Community (ECSC). That was a reaction to the need to preserve the economies of Europe.⁵¹ This was a move that was seen as a force aimed at uniting Europe. It is this initial process that grew into the European Economic Community (EEC) which came into existence in 1958. European integration has the longest history and as such it demonstrates its advancement. From the EEC, it transformed itself into the European Community (EC) in 1992 and consequently into the European Union (EU) in 1997. Europe's greatest interests with regard to integration were security and economic advancement particularly after the economically devastating Second World War. The Preamble to the 1951 treaty establishing the European Coal and Steel Community stated its aim as: "to create, by a establishing an economic community, the basis for broader and deeper community among peoples long divided by bloody conflicts." ⁵² This captures the ultimate ideal of attaining economic development by realizing that the security and political infrastructure of the time was not conducive for economic growth.

After the war, most of the European economic structure had been premised on the provisions of the Bretton Woods Agreement of 1944 alongside the Marshal Plan which was an American aided program to help European states to reconstruct their economies destroyed by the war. Later programs for development were anchored on the OECD countries action plan and the Maastricht and Benelux Treaties. This was coming at a time when the region was still wary of deeper forms of integration bearing in mind that the disastrous political differences among European nations had not been done away with⁵³. There were still suspicions among the leaderships of the various nations. Through these treaties, Europe was reaffirming the great

⁵¹ Laursen, F. (2008), Theory and Practice of Regional Integration, Paper presented at the Miami-Florida European Union Centre, University of Miami, Florida on February 25, 2008.

⁵² Tsoukalis, L. (1993), The New European Economy: The Politics and Economics of European Integration, Oxford: Oxford University Press.

⁵³ Andrei, L.C. (2010), European Economics, Update. Another Ten Theses on the Economic Integration, Theoretical and Applied Economics Vol. XVII, No. 10 (551).

need to attain some form of political-economic view point that would provide for sound policy harmonization to get the benefits from a monetary induced form of cooperation.

In the formative years, the process of integration was seen as a political process and much of the economic aspects were at least relegated to the background. The beginning of the integration process came at a time when the world was still recovering from the economic depression of 1933 which shook all the major economies of the world. At this time and particularly in Britain, Keynesian type of economic remedies had been prescribed to recover from the depression. This particularly called for greater government involvement in the economy to regulate aspects that would induce aggregate demand and consumption. Secondly, the world had seen the devastating effects of warfare occasioned by the 1st and 2nd world wars. Coming from a period of political hostilities and economic hardships, it was unfathomable that the European nations would pursue a form of integration particularly one that would have them cede some elements of their sovereignty to a supranational entity. There still were tensions and suspicions between the states⁵⁴. They were however moving rapidly into a future that required the development of new policies on technology, the environment and monetary policies all of which were to be a departure from the past.⁵⁵

Another aspect that characterizes the European integration attempt is that Europe had successfully created nation states⁵⁶. European influence had by this time already been passed to other parts of the world through the process of colonization and the spheres of influence this created. The newly emerging independent states of Africa, Asia and Latin America

⁵⁴ Schoeman, N.J. (2002), EconomicGrowthandDevelopmentConstraintsinAfrica, Journal of Public Administration, Vol. 37, No. 3.1, November, 2002.

⁵⁵ Andrei, L.C. (2010), EuropeanEconomics,Update.AnotherTenThesesontheEconomicIntegration, Theoretical and Applied Economics Vol. XVII, No. 10 (551).

⁵⁶ Mistry, P.S. (1996), RegionalIntegrationArrangementsinEconomicDevelopment;PanaceeorPitfall? FONDAD, The Hague, Netherlands.

were adopting structures and policies that were heavily patterned on the ones from their affiliated European nations. In Africa for instance, calls for regional integration started coming in the early 1960s as many nations gained their independence. This came at a time when national leaders were engaged in frantic attempts to better their nations. Many nationalist leaders spearheading the national struggles for independence had assumed that merely sending the colonialists away would solve all the problems of their citizens. Needless to say, the first attempt at regional integration came with the goal of attaining African Unity through the formation of the Organization of African Unity (OAU)⁵⁷.

2.3 Customs Union Theory

The customs union theory in addressing the welfare dimension of regional integration is closely similar to functionalism. Advanced by Jacob Viner, the theory postulates that a customs union can result in either trade creation or trade diversion. Viner defines a custom union as the process of “elimination of intra-trade barriers and the equalization of tariffs on imports from non-member countries.”⁵⁸ In ideal economic integration, a customs union is the third stage of integration after a preferential trade area and a free trade area.⁵⁹ The EAC integration process however deviates from this structure in that the customs union is the first stage in the economic integration process.⁶⁰ A custom union aims at the formation of a single customs territory. With regard to the economic activity of integration partners, trade becomes a fundamental focus with the main aim being the realization of economies of scale in a bid to realize economic development. The EAC bloc for instance is able to eliminate diseconomies of

⁵⁷ Schmitter, P.C. (1970), A Revised Theory of Regional Integration, International Organization, Vol. 24, No. 4.

⁵⁸ Viner, J. (1950), The Customs Union Issue, New York: Carnegie Endowment for International Peace.

⁵⁹ Viner, J. (1950), The Customs Union Issue, New York: Carnegie Endowment for International Peace.

⁶⁰ Mushega, N.A; Secretary General, EAC, in the foreword to the Treaty for the establishment of the EAC, Publication of the EAC Secretariat, Arusha 2002, pp. v.

scale occasioned by the fragmented nature of their markets and economies while operating in separation. The customs union came into effect on 1st January 2005 after ratification of the Customs Union Protocol.⁶¹ This marked a crucial turning point for the EAC integration process. It clearly signaled that at last, the dream of integration was becoming a reality.

The customs union seeks to attain harmony between the five member states through the realization of a common external tariff to be applied in trade dealings among all the member states with non-member states, elimination of internal tariffs, common rules of origin for application by all states, common standards for all products produced and imported, harmonized trade policies and a common export promotion mechanism. Customs Unions become effective when the output of inefficient producers are replaced after the elimination of tariffs in the region with cheaper imports of more efficient producers within the region to the benefit of both producers and consumers. Trade diversion effects on the other hand occur when imposition of a CET puts suppliers from countries outside the integrating area in a competitive disadvantage by encouraging imports from less efficient producers within the integrating area.⁶² The good of this for the EAC is that imports that have traditionally been obtained from countries outside the EAC can now be replaced with intra-EAC imports. The customs union is the regional tool to boost the visibility of the region in its dealings with other regions. There are quite a number of challenges that have to be overcome before tangible results are realized. The customs union faced and still faces today challenges touching on national sovereignty, non-tariff barriers to trade, language barriers, inaccurate trade data due to unrecorded cross-border trade, a weak dispute settlement mechanism and the overlapping

⁶¹ Bagamuhunda, K. (2005), The EAC Customs Union, Presentation by the EAC Director of Customs at a Sensitization Workshop on the EAC at the Grand Regency Hotel, Nairobi, June 29, 2005.

⁶² Delegation in Tanzania, EAC, Arusha on 30th October, 2009.

membership of the EAC members to other regional bodies

In comparison to the European Union (EU) customs union, there are many lessons that the EAC can learn from the former. It is vital to point out that the EAC envisages its integration to move through five stages; Preferential Trade Area/Free Trade Area (2000), Customs Union (2005), Common Market (2010), Single Currency (2012) and finally a Political Federation (2013).⁶³ The progress made in this regard will depend to a large extent on the responsiveness of decision makers to address any problems that arise over the course of the integration process to ensure that the right management framework is in place for sufficient policy and operational changes to facilitate a smooth flow of the process.

2.4 Institutionalism

Institutionalism as a theoretical framework for explaining regional integration stems from the contributions of March and Olsen who argued that institutions are important because of the impact they yield on political outcomes. Institutions intervene between the preferences of actors and the policy outcomes that are desired. Institutions do not therefore carry political actors along a defined path nor do they follow their preferences, they are able to channel the access of the actors to attain the resultant changes which are the intents that the institution seeks to follow⁶⁴. Institutionalism has had variants in the form of historical institutionalism and rational choice institutionalism. The former regards the period of an institution's origins as crucial to understanding later developments. For instance, to comprehend and project on the future of the EAC, one needs to place its origin and the beginning of East African cooperation to

⁶³ Clarke, T. (2009), Customs Union and Economic Integration: The European Experience, Presentation by the EC

⁶⁴ Iona, A. (2010), Historical Institutionalism as a Regional Integration Theory: An Outline of Theory and Methodology, Paper Prepared for the Fifth Pan-European Conference on EU Politics, Porto, Portugal, 23rd -26th June, 2010.

that time in history. Understanding the context in time when this was conceived aids in a proper contextualization of its aims and objectives. Historical institutionalism must develop a means of analyzing phases of institutional development beyond the path and time of an institution's formation.⁶⁵

Rational choice institutionalism on the other hand assumes that actors will only engage in rational pursuits of their self-interest. Institutions therefore act as a moderating force with regard to the strategies that political actors adopt in the pursuit of these self-interests.⁶⁶ Rational institutionalism therefore is premised on a set of detailed formal rules and regulations. This may however be compromised in cases where these rules are misinterpreted or where actors recourse to informal rules. These defeat the rational approach. It is assumed that any decision options have to be subjected to an elaborate process of identifying the costs and benefits of each option and then based on a ranking, all options subjected to a detailed scrutiny prior to the most optimal option being selected. This however may not find practical application in many issues that normally arise in an integration area⁶⁷. For instance, security imperatives in one country in the integration area that affect to a large extent the trade aspects of another member may be compromised since security decisions though calculated are often spontaneous reactions. For instance some demonstrations in Nairobi, Kenya may affect passage of goods to land locked Rwanda, Uganda and Burundi. Security agents in Kenya would therefore take the most appropriate measures at the time and these would not be rationally deliberated.

⁶⁵ Anadi, S.K.M. (2005), *Regional Integration in Africa: The Case of ECOWAS*, Unpublished PhD Thesis Presented to the University of Zurich.

⁶⁶ Ibid

⁶⁷ Anadi, S.K.M. (2005), *Regional Integration in Africa: The Case of ECOWAS*, Unpublished PhD Thesis Presented to the University of Zurich.

2.5 Intergovernmentalism

Intergovernmentalism conceptualizes integration as a series of bargains between the heads of government of the leading states in a region. Its basic assumption is that integration takes place within domestic politics. Converging interests that form the basis for deliberations are based on the interests of large states where harmony is attained by big states buying off the smaller ones. The theory contends that despite this, the smaller states would still need an international organization to help them deal with complex issues that they are not equipped to handle on their own. Intergovernmentalism however places a lot of focus on heads of government as the vital forces behind integration schemes. This ignores the many other players that make integration in the first place possible like the civil society and the private sector. Application of this theory may be limited in the case of the EAC since all the integrating states are undergoing similar circumstances and consequently from a power perspective no single country can be said to wield the capacity to dominate the rest.

Successful application of this theory can best be applicable in a region without frequent changes of government and where the domestic political and policy environment remains unchanged for a relatively longer period of time. This cannot be said to be the existing environment for the EAC region. The political systems and cultures are prone to change with adoption of new political dispensations. The competitive nature of the economic production of the five states due to similar economic products and activities makes the reality of an intergovernmental approach to be limited in application. Similarly, application of this theory is dependent largely on the bargaining power of the head of the government of the individual state. This may not lead to the realization of equitable benefits for all the member states in

proportion to their population and economic size⁶⁸.

2.6 Functionalism

Regional integration efforts in Africa have faced the challenge of refusal by member states to always stand by their obligations as stipulated in the objectives and regulations governing regional arrangements. This is both politically and economically driven⁶⁹. The first aspect can only be addressed through a political process. Member states must realize the benefits accruing to their citizens from the process of regional integration. Upon weighing the welfare benefits to citizens vis-à-vis the costs of ceding some level of control to a regional body, a country is at a better position to determine whether they should pursue an integration process further. Muuka et al argue that sustained political and ideological will on the part of individual member governments is critical to the success of any regional economic grouping.⁷⁰

Functionalism as a theory was postulated for explaining or advocating the need for creation of regional organizations. This was advanced by Mitrany who argued that the link between authority and a definite territory can be broken. It seeks the attainment of a regional organization that would not be rooted on the territorial confines of the states forming it. In a world characterized by economic interdependence, functionalism assumes that social, technical and humanitarian problems can be prioritized and solved⁷¹. This is because in a world of economic interdependence common economic interests create the need for international

⁶⁸ Keohane, R.O. (1984), *After Hegemony: Cooperation and Discord in the World Political Economy*, Princeton: Princeton University Press.

⁶⁹ Muuka, G.N. et al (1998), *Impediments to Economic Integration in Africa: The Case of Comesa*, Journal of Business in Developing Nations, Volume 2, Article 3.

⁷⁰ Anadi, S.K.M. (2005), *Regional Integration in Africa: The Case of ECOWAS*, Unpublished PhD Thesis Presented to the University of Zurich.

⁷¹ Schmitter, P.C. (2007), *Theorizing Regional Integration and Inter-Regional Relations*, Paper presented at the ECPR Joint Workshops, Helsinki, May 7-12, 2007.

institutions and rules.⁷² Functionalism has been criticized for its assumption that states can be able to cooperate even in areas where their vital interests are at risk of being ceded to supranational organization. This would result in a state-like supranational organization that could easily be dominated by the powerful states in the regional arrangement.³⁰

Regional integration from a functionalist approach can best be seen from a weakening of the state apparatus through the transfer of loyalties to a supranational organization. This is hard to attain and can only be arrived at through realization of results from cooperation in one area. Once that is realized, the integrating units can then move onto a different aspect. This is to be repeated in all the elements of the integration up to a point where it is realized that these are best handled not by the state but by the supranational entity. This can be seen to commence from economic, then social and ultimately technical cooperation. This ultimately can lead to the attainment of political harmony leading to resolution of political conflicts and elimination of war. Cooperation among nations pursuing different political-economic structures and at different levels of economic development would seem unworkable in the current global political system.⁷³ The functioning of international institutions like the International Labour Organization (ILO), International Monetary Fund (IMF), World Bank and the UN agencies do not support the idea that functional cooperation can be realized separate from a political environment present in the member states.

The application of functionalism to the EAC recognizes that the regional integration takes place at an intersection of diverse interests of the multiple states which differ in political culture, ideology, economic, political and legal systems. These differences have to be

⁷² Anadi, S.K.M. (2005), *Regional Integration in Africa: The Case of ECOWAS*, Unpublished PhD Thesis Presented to the University of Zurich.

⁷³ Keohane, R.O. (1984), *After Hegemony: Cooperation and Discord in the World Political Economy*, Princeton: Princeton University Press.

managed in the right manner if any sustained relationship among the integrating states is to be realized. From a functionalist angle, it is not enough that the individual citizens of the countries have some welfare gains to be realized from the integration. There must be the will by the authorities at the leadership of these countries to work together towards a mutual good for all states. Should there be a feeling that one state or some states are deriving more benefit than the others, then the cooperation is in jeopardy.⁷⁴

This in the case of the EAC led to a move towards negotiation for harmonized policies towards a market driven integration initiative. There were however some concerns that at the time of undertaking the integration exercise, some members were at an advantaged position over others. A case in point was the case of taxation and in particular Value Added Tax (VAT) and excise duty. This was to lead to the arrival at a Common External Tariff (CET) for the region. With the general aim of attaining greater general welfare for the citizenry, functionalism tends to paint a picture of an EAC that will attain an equalization of social conditions that would result in economic development. Should this fail, then a conflict is to be expected. Individual citizens will evaluate the gains realized or lost during the integration vis-à-vis those prior to the integration process. It is vital to note that whereas the populace would anticipate rapid changes in their economic standing, results of tangible economic growth leading to economic development would most likely not be witnessed in the short run. This is the period in which enabling structures and mechanisms for meaningful integration are to be effected and policies found not to be working as initially conceptualized monitored and reviewed. The most immediate reaction would be a shift towards mistrust of the integration. If no tangible benefits are realized in the short run, citizens might pressure their governments to reconsider the relevance of the

⁷⁴ Oppong, R.F. (2007), *A Relational Theory of Economic Integration and its Implications for Africa's Economic Integration Initiatives*, Research Group, Lancaster University, Faculty of Arts and Social Sciences.

integration body or to demand a pull out altogether. It remains the functionalist assertion that the individual is free to enter into a variety of relationships.⁷⁵

Functionalism has been reviewed over time in explaining the role of supranational entities. For instance, it fails in analyzing the total environment within which functional arrangements would diminish the need for state- centered political structures. This is supported by the fact that up to date no supranational organization has come up in the ideal form. The UN is yet to attain such a status. Secondly, the issue of human welfare is an idealistic utilitarian social undertaking that pre-supposes that human conduct can be guided.

2.7 Neo-Functionalism

Neo-functionalism arose out of the need to come up with an explanation of regional integration in Europe. This theory argues on the importance of states as the primary actors in an integration process.⁷⁶ It is within a state that there are interest groups and political parties which all contribute to the process of decision making on how the conduct of the state is to be undertaken. Policy directions by the head of state or government are informed by these groups collectively and individually. Political parties normally have the most organized forums particularly the ones that are represented in the National Assemblies. States are the core units that participate in decisions to enter into regional integration arrangements and once treaties are signed, they spearhead the ratification process by their law making organs of government. This theory postulates that even before a regional integration arrangement is arrived at, the

⁷⁵ Schmitter, P.C. (2007), *Theorizing Regional Integration and Inter-Regional Relations*, Paper presented at the ECPR Joint Workshops, Helsinki, May 7-12, 2007.

⁷⁶ Anadi, S.K.M. (2005), *Regional Integration in Africa: The Case of ECOWAS*, Unpublished PhD Thesis Presented to the University of Zurich.

economies of member states are interdependent⁷⁷.

Progression of the integration leads to a shifting of loyalties from the state to the supranational organization. Integration under neo-functionalism is deemed to only occur where economic, social, technical and to a small extent political activities exist in common. These form the key aspects where cooperation can commence and one activity area leads to cooperation in another activity area. Aspects of goodwill, pursuit of common interests or the common good are assumed to lead to greater integration. Neo-functionalism came under great criticism when its predictions of a spillover effect did not materialize for European integration.

Neo-functionalist logic adopts an indirect penetration of the political by the way of the economic. This might be a difficult end to accomplish where there exist different levels of economic development among the integrating states. Since the fusion of the integration process is politically driven, a much longer time might be required before the economic aspect of the integration attains substantial growth to impact on the political aspect. For the EAC, the region faces this challenge as the general rise in the economic development of the region can only be deemed to be a long term measure as opposed to a short term one. This may pose a setback in an understanding of the EAC integration.

2.8 Conclusion

Regional integration is a complicated process whose understanding cannot be quickly derived from mere theoretical postulations. Arrival at the most appropriate theoretical approach to explain regional integration needs to take into consideration the unique patterns followed by the particular region under study. For the EAC, functionalism is best placed in that it does not only constrain itself to regional integration exclusively but rather to the broader

⁷⁷ Haas, E.B. (1958), *The Uniting of Europe: Political, Social and Economic Forces, 1950-1957*, Stanford: Stanford University Press.

concept of international cooperation. This is where it differs from neo-functionalism which addresses particularly regional integration. Institutionalism and Intergovernmentalism are greatly limited in leading to an understanding of the EAC integration due to the great emphasis they place on the institutional formation process and the main political actors respectively. The customs union theory on the other hand best captures the particular stage that the EAC is going through with the coming into effect of the customs union and the common market. This is because the trade dynamics under this theoretical approach best fits into the integration process. Neo-functionalism on the other hand does not provide for an analysis of forms of cooperation outside the regional integration. This is a limitation since relations of EAC member states with other countries outside the integration area are vital due to their membership to other regional organizations.

CHAPTER THREE

REGIONAL INTEGRATION EXPERIENCES

3.1 Introduction

This chapter discusses the financial benefits of regional integration in the global perspective. The chapter explores different experience of regional Integration and how the continent has gained financial benefits inform of the cost of Information Communication Technology (ICT) in Africa, energy costs, cross-listing of stocks on firm value, transport cost, creation of internal and external trade.

3.2 Integration In East Africa Community

Within the EAC on regional integration, countries generally have very efficient labour markets by both regional and international standards. Their financial markets are well developed, and they have relatively sound institutions as well as the capacity for innovation. However, the quality of infrastructure, macroeconomic stability, and health and education indicators in the bloc are poor, as is technological readiness. Some of the key factors hampering business in the region include access to financing, corruption, high tax rates, and inadequate supply of infrastructure (World Economic Forum, 2010)

COMESA includes two of the top five best performing countries in Africa Mauritius and Rwanda, and also performs well in relation to other African regions. COMESA countries, in general, have strong institutions and well-developed financial markets, as well as efficient goods and labour markets. Again, indicators in the health and education sectors, as well as technological readiness, are poor. Factors hindering business in the region include access to financing, corruption, high tax rates, and inefficient government bureaucracy (World Economic Forum, 2010). Overall, countries within ECOWAS perform worst on the GCI indicators in

comparison to other RIAs. They are strongest on institutions and innovation and weakest in the areas of health, education, and infrastructure development. Some of the most problematic factors for doing business in the bloc include access to finance, corruption, burdensome tax regulations, and inadequate supply of infrastructure (World Economic Forum, 2010)

Contract enforcement plays a role in firms' ability to have greater access to credit and to engage with new borrowers or customers. Well-functioning judicial systems and courts may therefore help businesses expand their networks and markets (World Bank, 2011). Within Africa, it is easiest to enforce contracts in the EAC and most difficult in ECCAS. All five RECs compare favorably to South Asia and the Middle East and North Africa in terms of the number of procedures involved, and to South Asia in terms of the length of time involved. However, the cost of enforcing contracts is generally more expensive in Africa, with the possible exception of Eastern Europe and Central Asia

3.2 European Union Integration

The European Union (EU) progresses at an uneven rate. On one hand, the great expansion worked wonderfully in May 2004 when 10 new members joined the group. On the other hand, the dream of a "United States of Europe" hit a roadblock in the summer of 2005 when France and the Netherlands voted down the proposed constitution for the European Union. Of course, it doesn't end there. To successfully grow and develop, the expanded European Union faces abundant challenges both major and minor⁷⁸. Three areas illustrate the complexity and significance of the decisions that must be made in the near future. First, there are a number of membership issues⁷⁹. The full integration of the 10 new members still needs to be accomplished. In addition, Bulgaria and Romania are on the threshold of membership, and Turkey and Croatia

⁷⁸ World Bank (2004), *Global Economic Prospects*, Washington D.C.

⁷⁹ Frankel, Jeffrey, Ernesto Stein, and Shang-Jin Wei, 1995, "Trading Blocs and the Americas: The Natural, the Unnatural, and the Super-Natural," *Journal of Development Economics*, Vol. 47 (June), pp.96.

are at the beginning of the accession process with much to be accomplished before they join. Equally important will be confronting a European Union with member states vastly different in economic and social development and trying to integrate each one at the same level. Already there has been talk of a two-tier membership⁸⁰.

The rigidity of the economic and welfare systems in many of the member states, and continuing high levels of unemployment, are only two of many areas needing continuing attention. While there is widespread agreement on protection of the environment, case after case continues to emerge pitting environmental concerns against economic development⁸¹. On the international level, continuing EU objections to removal of agricultural subsidies have thwarted the World Trade Organization (WTO) free-trade agreement at the Doha Round and no comprehensive compromise has developed either within the EU or between the EU and the WTO nations, despite recent budget compromises. Within the EU, ongoing disregard of stringent deficit requirements by some of the main powers threatens the continued financial stability of the whole organization⁸².

Despite these obstacles, the European Union's development into a new kind of supranational organization continues to be a path-breaking adventure of ongoing interest to researchers and politicians alike. The goal of Europeanization is now considered widely in the literature, but has proven harder to achieve in fact⁸³. The addition of 10 new members in 2004 has added an even greater variety of people and ideas to the mix. This second edition of *The European Union and the Member States* assesses the new, enlarged Europe of 25 countries (soon

⁸⁰ Vamvakidid, A. (1998), "International Trade and Economic Growth", the World Bank Economic Review, Vol.12, No.2.

⁸¹ Fragmented Power: Europe and the global economy, Bruegel think tank, Sapir A. ed. 2007.

⁸² Regional Innovation Strategies in Europe (EFMN), Hafner-Zimmermann S. 2008.

⁸³ Proposal for a Regulation of the European Parliament and of the Council: establishing a European

to include 27 member states), in order to shed some light on the direction of its policies and the progress it has made toward Europeanization⁸⁴.

Greece was living beyond its means even before it joined the euro. After it adopted the single currency, public spending soared. Public sector wages, for example, rose 50% between 1999 and 2007 - far faster than in other eurozone countries. And while money flowed out of the government's coffers, its income was hit by widespread tax evasion. So, after years of overspending, its budget deficit - the difference between spending and income - spiralled out of control. When the global financial downturn hit, therefore, Greece was ill-prepared to cope.

Debt levels reached the point where the country was no longer able to repay its loans, and was forced to ask for help from its European partners and the International Monetary Fund (IMF) in the form of massive loans. In the short term, however, the conditions attached to these loans have compounded Greece's woes⁸⁵. In May 2010, the European Union and IMF provided 110bn euros (\$140bn: £88bn) of bailout loans to Greece to help the government pay its creditors. It soon became apparent that this would not be enough, so a second, 130bn-euro bailout was agreed earlier this year. As well as these two loans, which are made in stages, the vast majority of Greece's private creditors agreed to write off more than half of the debts owed to them by Athens. They also agreed to replace existing loans with new loans at a lower rate of interest.

However, in return for all these loans, the EU and IMF insisted that Greece embark on a major austerity drive involving drastic spending cuts, tax rises, and labour market and pension reforms. These have had a devastating effect on Greece's already weak economic recovery. The European Commission expects the Greek economy to shrink by another 4.7% this year. Greece has already been in recession for four years.

⁸⁴ Report of the High-Level Group on Financial Supervision in the EU, Jacques de Larosière 2009.

⁸⁵ Vamvakidid, A. (1998), *"International Trade and Economic Growth"*, The World Bank Economic Review, Vol.12, No.2.

Without economic growth, Greece cannot boost its own income and so has to rely on aid to pay its loans. European Union believe even the combined 240bn euros of loans and the debt write-off will not be enough to combat this risk, European leaders agreed a 700bn-euro firewall to protect the rest of the eurozone from a full-blown Greek default. For example, Greece owes French banks \$38bn, German banks \$5.5bn, UK banks \$8.2bn and US banks \$3.5bn. This problem would be exacerbated by savers and investors taking money out of banks in vulnerable economies, such as Greece, Portugal and Spain, and moving it to banks in safer economies such as Germany or the Netherlands. This could lead to more banks defaulting on their loans. These potential scenarios would be made immeasurably worse if Greece were to leave the euro. The country would almost certainly reintroduce the drachma, which would devalue dramatically and quickly, making it even harder for Greece to repay its debts⁸⁶.

European financial integration is leading to profound changes in the structure and operation of the financial services sector throughout the continent. Through a more open and effective European financial market a number of benefits are expected for both investors and the corporate sector. Investors will benefit from higher risk-adjusted returns on savings, through enhanced opportunities for portfolio diversification and more liquid and competitive capital markets⁸⁷. The corporate sector will benefit from generally easier access to financing capital. Competition in the financial intermediation sector will offer corporations a wider range of financial products at attractive prices.

The economy-wide improved allocation of financial resources to investment projects should impact positively on the equilibrium level of GDP and potentially also on GDP growth.

⁸⁶ Vamvakidid, A. (1998), *"International Trade and Economic Growth"*, The World Bank Economic Review, Vol.12, No.2.

⁸⁷ Cooper, R.N. (1968) *The Economics of Interdependence: Economic Policy in the Atlantic Community* (New York: McGraw-Hill for the Council on Foreign Relations).

Economic and Monetary Union takes the EU one step further in its process of economic integration, which started in 1957 when it was founded. Economic integration brings the benefits of greater size, internal efficiency and robustness to the EU economy as a whole and to the economies of the individual Member States. This, in turn, offers opportunities for economic stability, higher growth and more employment – outcomes of direct benefit to EU citizens. In practical terms, EMU means: Coordination of economic policy-making between Member States, coordination of fiscal policies, notably through limits on government debt and deficit, an independent monetary policy run by the European Central Bank (ECB) and the single currency and the euro area⁸⁸.

3.3 Latin America Integration

The presence of strong macroeconomic synchronization is regarded as a rationale for creation of Regional Trade Agreements (RTAs). The concept of RTAs in Latin American context dates back to 1960 when the Latin American Free Trade Association (LAFTA)⁸⁹ was created. The goal of LAFTA was to create a common market in Latin America and it was perceived as a first step to economic integration in Latin America. Many Latin American economists took it as a promising vehicle for enhancing economic and social development in their respective countries. But, the initial enthusiasm gradually faded away and a general air of pessimism regarding integration spread. Over the course of the past three and half decades, the process of economic integration has suffered numerous setbacks. Frequent abrupt political changes have been a deterrent to economic cooperation. During the 1960s, LAFTA was disrupted by military coups in Argentina and Brazil. Integration movement could not make any

⁸⁸ Commission of the European Communities (1985) 'Completing the internal market'. COM(85) 310 final, 14 June.

⁸⁹ Michael Schulz- Fredrik Söderbaum- Joakin Öjendal (eds), *Regionalization in a Globalizing World*, London/New York: Zed Books, 2001. p. 235.

progress and obviously could not reap the benefits of greater extension in the region. In addition to that the Latin American countries were left out of this line of research mainly for lack of stability and lack of data.

However, the movement toward Latin American economic integration is gaining momentum. The formulation of the Common Market of the south or MERCOSUR a largest regional trade area signed in 1991 between Argentina, Brazil, Paraguay, Uruguay (and more recently Venezuela), with Bolivia, Chili, Peru, Colombia, and Ecuador as associates is taken as momentum gain. As a matter of fact, more than 14 agreement free trade areas or custom unions since 1990 have been made in the region. Hence, with this renewed interest this is of extraordinary relevance to investigate macroeconomic interdependence for Latin American countries⁹⁰.

The decade of the 1990s was characterized by an intense parley of regional trade agreement in Latin America. More than 14 agreements of free trade areas or custom unions creating Trading association, MERCOSUR and the Andean Community signed in 2004 a free trade agreement which, together with Chile, Guyana and Suriname shall lead to the formation of a South-American Union of Nations, Bolivarian Alternative to Latin America and the Caribbean (known by its Spanish acronym ALBA) / People's Trade Agreement the Bolivarian Alternative is an initiative led by Venezuela and Cuba as an alternative to the negotiations for a Free Trade Area of the Americas (FTAA)⁹¹. In December 2004 these two countries signed a bilateral agreement. In April 2006 Bolivia joined in the People's Trade Agreement, and in January 2007 Nicaragua joined in. Observer members are: Antigua & Barbuda, Dominica, Ecuador, Haiti,

⁹⁰ Myriam Martins Gistelink, *The Influence of Brazil's Developmental Projects on its Positioning in the Negotiation of Regional and Bi-regional Trade Agreements*, IIEB Working Paper 19, October 2005.

⁹¹ Chagas, L. and R. Baumann. 2007. "Integração Monetária no Mercosul: Ganhos com Menores Custos de Transação?", *Economia Aplicada*, 11 (1): 95-112.

Honduras, St Kitt & Nevis, St Vincent & Grenadines and Uruguay. The People's Trade Agreement comprises trade facilities and complementarities in the energy sector. In January 2008 the ALBA Bank was created, adding a new dimension to the initiative. However, Latin America seems to be far behind in its endeavor to formulate regional integration and enjoy the benefits of greater integration. What are the main hurdles that have suppressed all the initiatives that have emerged so far? Or how feasible it is to imitate the European style integration model in Latin America. The Latin American Integration Association (LAIA) was created in August 1980, Latin American Free Trade Association), created in 1960(LAFTA), created in 1960. It is formed by Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela⁹². Its objectives are to create a Latin American common market in the long run and in a gradual manner, by means of tariff preferences, as well as the signing of regional agreements. According to Mundell⁹³ the overall degree of economic integration can be judged by looking at the integration of product markets, that is the extent of trade between the joining country and the currency area, and at the integration of factor markets, that is, the ease with which labor and capital can migrate between the joining country and the currency area. The real GDP and intra-regional trade captures the integration of product markets and private investment represents the factor market (i.e. capital). Additionally, we further investigate the short-run and long run behavior of consumption in these countries. Hence, selection of our variables for this study is relevant and justifiable⁹⁴.

⁹² Devlin, R. and P.Giordano. 2004. "The Old and New Regionalism: Benefits, Costs and Implications for the FTAA". In Estevadeordal, A., D. Rodrik, A.M.Taylor and A. Velasco (orgs), *Integrating the Americas – FTAA and Beyond*. Cambridge, Massachusetts: Harvard University Press

⁹³ Mundell, R. (1961). "A theory of optimum currency areas". *The American Economic Review*, 51, p657-665.

⁹⁴ Batra, Amita. 2004. India's global trade potential: The gravity model approach, Indian Council for Research on International Economic Relations, Working Paper No. 151.

Latin American countries account for more than 90 percent of the continent's GDP and about 93 Percent of its population in 2008. More importantly, these seven countries' real GDP always maintain more than 89% of their five year averages in the region from 1980-2008 . Similarly, their trade share in the region is also significant and growing⁹⁵. Argentina has a higher trade share in the region during 1980-2008. On five years average its exports plus imports for the region almost doubled the last decade from its eighties share. Mexico, being the second largest economy after Brazil, has the smallest regional trade share. Obviously, Mexico trades more with its northern partners USA and Canada. The rest of the countries in this study have an average of about one fourth of the trade share in the region⁹⁶. Therefore, these countries are leading economies in the region and we believe that the possible integration of these leading seven countries would bring the other countries in. Our rationale for this choice is that if macro variables in the leading economies are synchronized then the smaller economies will catch up with them, which will result in a complete integration in the entire continent.

Unlike the case of European integration, sufficient amount of empirical studies have not been devoted for the case of Latin America, only marginal attention has been paid to in this regard. Hence, this study will have great policy implication in context of economic integration in Latin America. Past studies have examined economic integration based on the observed similarities of the economies and the correlation analysis of the business cycles. The problem with these methodologies is that the degree of correlation between shocks does not accurately

⁹⁵ Behrman, J., N. Birdsall and M. Székely. Economic reform and wage differentials in Latin America. Working Paper of the Research Department, No. 435. Inter-American Development Bank, Washington, D. C. 2000.

⁹⁶ Robert Devlin - Antoni Estevadeordal, *What's New in the New Regionalism in the Americas?*, Institute for the Integration of Latin America - Integration, Trade and Hemispheric Issues Division - Statistics and Quantitative Analysis Unit / Inter-American Development Bank, Working Paper 6, May 2001.

follow short-run output co-movements. Hence, we complement our analysis by both testing cointegration (to assess the existence of long-run movements in real output among countries) and for the existence of common short-run cycles as suggested by Vahid and Engle. Sharing similar short and long run macro trends necessitates few or no country-specific policies that may hinder the stability of the union⁹⁷.

Association formed by Argentina, Brazil, Paraguay and Uruguay, by the Treaty of Asunción, signed in March, 1991. Associate members are Bolivia, Chile, Colombia, Ecuador and Peru. Venezuela signed a membership agreement in June, 2006, but before becoming a full member its entry has to be ratified by the national parliaments of the four original members. Its objectives are to create a common market with free movement of goods, services and productive factors; adopt a common external policy; coordinate common positions in international forums; coordinate sector and macroeconomic policies⁹⁸.

Its Common External Tariff (CET) covers some 85% of intra-regional trade. Great exceptions remain the sugar and automobile sectors. The CET is effective and equal to national tariffs for 35% of total trade by Mercosur countries. From those, products stemming for 20 percentage points have zero tariffs. That is, only 15% of Mercosur adopt CET (Veiga/Rios 2007). A number of non-tariff barriers remain in regional trade⁹⁹.

The sub regional initiatives that comprise integration schemes in the Americas are varied. Some have ambitious purposes, such as the creation of common markets, whereas others are

⁹⁷ Michael Schulz- Fredrik Söderbaum- Joakin Öjendal (eds), *Regionalization in a Globalizing World*, London/New York: Zed Books, 2001. p. 235.

⁹⁸ Glick, Reuven, and Andrew K. Rose. 2001. Does a Currency Union Affect Trade? The Time Series Evidence. NBER Working Paper No. 8396.

⁹⁹ Robert Devlin - Antoni Estevadeordal, *What's New in the New Regionalism in the Americas?*, Institute for the Integration of Latin America - Integration, Trade and Hemispheric Issues Division - Statistics and Quantitative Analysis Unit / Inter-American Development Bank, Working Paper 6, May 2001.

essentially free trade agreements. They can be presented in a geographical sequencing. Moving from the Southern Cone towards the Arctic Sea we find the following initiatives¹⁰⁰.

The process has already begun among the Mercosur (Southern Common Market) countries Argentina, Brazil, Paraguay and Uruguay with binational projects and interconnections that “avert conflicts,” promote energy security, and bring down costs because they more than compensate for investment in power lines and plants, Ventura Filho said. And integration with Argentina will be given an enormous boost with the construction of two binational hydroelectric plants, Garabí and Panambí, on the Uruguay River, which forms part of the border between Brazil and Argentina and between Argentina and Uruguay. The plants will have a combined capacity of 2,200 MW by the end of the decade. Mercosur em Folhas (Newspaper), reports that, like the European Union (EU) on which it was modelled, ran into difficulties. Brazil’s devaluation in 1999 caused Argentina to seek, and obtain, emergency restraints on imports from there. Politically negotiated exceptions to the block’s rules became the norm. Nevertheless, a dispute-settlement body and a small secretariat were eventually set up. In 2010 the presidents finally agreed on a common customs code, to avoid outside goods having to pay tariffs more than once. This led to an economic integration of South America countries.

3.4 Integration in Asia

In the 1980s the region began to undergo fundamental change. First Sri Lanka (in the 1970s) and then the other countries began to open their economies to international trade and dismantle industry regulations. International trade volumes began to increase, particularly following the Indian financial crisis of 1991 and the set of reforms that followed. Trade as a share of GDP generally rose in the 1990s and into the 21st century especially for the larger

¹⁰⁰ ECLAC. 2007. *Latin America and the Caribbean in the World Economy – Trends 2007*. Economic Commission for Latin America and the Caribbean: Santiago, Chile.

economies. The bulk of these exports were bound for industrial countries. With the exception of Bhutan and India, South Asia did not share in the growth of trade in the region. Of Bangladesh's exports in 2004, only 1% went to India, 4% to Sri Lanka, and 0.5% to Pakistan. On the import side, things were a bit brighter. 19 % of Bangladeshi imports came from India 19% and 14 % from Sri Lanka¹⁰¹. A simple gravity model suggests that trade should be much greater. Contiguous countries in the rest of the world have considerable trade with each other. Canada and Mexico, for instance, are the biggest trading partners of the United States. All countries in Europe trade with each other, and 65% of European Union trade is intraregional.

Despite the many early agreements in ASEAN's history that were mainly political and token in nature, its first major initiative was AFTA (1992). The AFTA is already in effect in the original ASEAN countries but the transitional ASEAN countries (Vietnam, Laos, Myanmar, and Cambodia) have been granted more time, with Vietnam having finished by the end of year 2006 and others given a few more years¹⁰². ASEAN has also made significant strides in the area of investment cooperation, e.g., in the form of ASEAN one-stop investment centers and the ASEAN Investment Area (AIA). These efforts at investment cooperation have been designed with essentially the same goal in mind as AFTA: reduce transactions costs associated with intra-regional economic interaction¹⁰³.

The region has seen an explosion of bilateral FTAs, all of which being between an ASEAN member-country and another country in Asia. That is, there is currently no bilateral

¹⁰¹ Frankel, Jeffrey A., and Andrew K. Rose. 2000. Estimating the Effects of Currency Unions on Trade and Output. NBER Working Paper No. 7857.

¹⁰² Caprio, G., and D. Klingebiel (2003). Database of systemic and borderline financial crises. World Bank, Washington D. C.

¹⁰³ Rose, Andrew K., and Charles Engel, Currency Unions and International Integration. *Journal of Money, Credit and Banking* 34(4): 1067–1089. 2002

agreement between the main economies in East Asia independent of ASEAN member countries, that is, between China, Japan, South Korea, Taipei-China, and Hong Kong¹⁰⁴.

There are several mechanisms and modalities for increasing intraregional trade and fostering regional cooperation. There are three general areas where there is scope for greater economic integration. They are cross-border infrastructure, international trade and investment (including¹⁰⁵ services), and financial sector cooperation. Major cross-border initiatives are being undertaken through the South Asia Sub regional Economic Cooperation (SASEC) program. This program was initiated by four members of the South Asian Association for Regional Cooperation (SAARC) (Bangladesh, Bhutan, India, and Nepal) that formed the South Asian Growth Quadrangle (SAGQ) in 1996. The SASEC program was launched in 2001 with support from the Asian Development Bank and its aim was to accelerate economic cooperation within SAGQ. Six priority sectors were identified: transport; energy and power; tourism; environment; trade, investment, and private sector cooperation; and information and communications technology (ICT). Business facilitation has been promoted through the recently established South Asia Business Forum and commissioned studies on private sector cooperation to lower trade barriers, boost human resources, and increase connectivity in ICT.

SAARC, with its trade initiatives SAARC Preferential Trading Arrangement (SAPTA) and South Asia Free Trade Agreement (SAFTA), is the major institutional entity charged with promoting free trade in South Asia. SAARC is an association of seven countries of South Asia: Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. SAARC encourages cooperation in agriculture, rural development, science and technology, culture, health, population

¹⁰⁴ World Bank. 2004. Trade Policies in South Asia: An Overview. Report No. 29929, Washington, DC.

¹⁰⁵ Batra, Amita. 2004. India's global trade potential: The gravity model approach, Indian Council for Research on International Economic Relations, Working Paper No. 151.

control, narcotics control, and antiterrorism¹⁰⁶. SAFTA set out a series of objectives in discussions that started in 1995 and continued into the next decade. The objectives were the following: eliminate all tariffs and import restrictions; harmonize customs procedures; facilitate intraregional banking, and port and land transport facilities; develop a program to facilitate trade-related services; establish a review and monitoring mechanism; ensure equitable benefits to all member countries; and remove structural impediments to regional trade. Representatives from the members of SAARC meet yearly to discuss progress and ensure that the benefits from trade expansion resulting from the implementation of the agreement are distributed equitably.

Bandara and Yu use the Global Trade Analysis Project (GTAP) computable equilibrium model to analyze the impact of SAFTA on the countries in South Asia. They find that India gains more than the other countries but that the rest of the region also benefits. Increased intraregional trade possibilities will be created but will be small relative to gains from unilateral liberalization by all SAFTA countries, shows strong evidence of trade creation in the region under SAPTA and Srinivasan (1994) uses a gravity model to show that complete removal of tariffs would result in a 3% increase in India's gross national product (GNP). Using an expanded gravity model, Batra finds positive trade potential in SAARC¹⁰⁷, mainly from increased trade between India and Pakistan. The estimates of Frankel, Stein and Wei¹⁰⁸ indicate that trade between India and Pakistan is 70% lower than that between two other economies that are otherwise identical.

Two bilateral free trade agreements (FTAs) involve South Asian countries: those between Sri Lanka and India and between Nepal and India. The Sri Lanka–India FTA took effect in

¹⁰⁶ Glick, Reuven, and Andrew K. Rose. 2001. Does a Currency Union Affect Trade? The Time Series Evidence. NBER Working Paper No. 8396.

¹⁰⁷ Batra, Amita. 2004. India's global trade potential: The gravity model approach, Indian Council for Research on International Economic Relations, Working Paper No. 151.

¹⁰⁸ Frankel, Jeffrey, Ernesto Stein, and Shang-Jin Wei, 1995, "Trading Blocs and the Americas: The Natural, the Unnatural, and the Super-Natural," *Journal of Development Economics*, Vol. 47 (June), pp.96.

March 2000. The agreement provides for duty-free status as well as duty-preference access for goods manufactured in the two countries. Both countries have prepared a list of products that will be duty-free and have agreed to phase out tariffs on a number of other items¹⁰⁹.

The Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation (BIMSTEC) started as BISTEC in June 1997 at a meeting of the trade ministers of Bangladesh, India, Sri Lanka, and Thailand. Several institutional developments in the past decade were designed to promote greater monetary and financial integration in South Asia. In 1998, SAARC heads of state agreed in principle to establish a network of central bank governors and finance secretaries of the SAARC region. Dubbed SAARCFINANCE, its basic objective of the network is to discuss macroeconomic policy issues and establish closer links among the members. This is achieved through semi-annual meetings of central bank governors and finance secretaries, staff visits and regular exchange of information, and harmonization of banking legislations and practices¹¹⁰.

With this in mind, financial integration within Asia can be studied from several points of view. Looking at the background conditions required for a monetary union similar to the European Union, there are good prima facie reasons for moving forward with plans to pursue a monetary union. The region has begun to exhibit greater convergence for a number of macroeconomic indicators like the inflation rate, interest rates and exchange rates, public debt, and fiscal deficits¹¹¹. The patterns of shocks experienced tend to be similar. Agricultural volatilities tend to be correlated since the monsoon patterns are similar across the region. The

¹⁰⁹ Caprio, G., and D. Klingebiel (2003). Database of systemic and borderline financial crises. World Bank, Washington D. C.

¹¹⁰ Bandara, Jayatilleke S. and Wusheng Yu. 2003. How Desirable is the South Asian Free Trade Area? A Quantitative Economic Assessment. World Economy 26 (9): 1293–1323.

¹¹¹ Saxena, Sweta Chaman and Mirza Allim Baig. 2003. Monetary Cooperation in South Asia: Potential and Prospects, RIS (New Delhi)/SACEPS (Dhaka) Workshop on Monetary Cooperation in South Asia: Potential and Prospects, 23 December, 2003, RIS, New Delhi.

countries also have similar mixes of production, and a similar variety of agricultural products including sugar, wheat, and rice, and labor-intensive manufacturing including textiles, cotton fabrics, and garments. India is the exception. Its economy is more diverse and it produces a variety of manufactured goods¹¹². Because of its small share of international trade, the region has not been subject to strong external shocks like Southeast Asia and East Asia. Exchange rates have tended to move together and the major currencies are closely aligned with the US dollar in a managed float while the small countries are tied to the Indian rupee. Pursuing a basis for a common currency could strengthen fiscal and monetary policy coordination and create more incentives for greater intraregional trade and the establishment of a single market. Labor mobility would be encouraged and fiscal transfers could provide insurance by diversifying risk among several countries.

3.5 Africa's Integration

Regional integration in Africa has been the main focus of African Countries since the establishment of the then Organisation of the African Unity (OAU). A number of declarations have been made by Member States to move the integration process in Africa forward. Similarly, the Abuja Treaty, Lagos Plan of Action, African Private Sector Forum among others, emphasize the need to promote regional integration in Africa. The Economic Community of West African States (ECOWAS) is a regional group of fifteen countries that was founded by treaty in May 1975¹¹³. It was conceived as a means toward economic integration and development intended to lead to the eventual establishment of an economic union in West Africa, enhancing economic stability and enhancing relations between Member States.

¹¹² Frankel, J. A., E. Stein, and S. Wei. 1995. Trading Blocs and the Americas: The Natural, the Unnatural and the Super Natural. *Journal of Development Economics* 47(1): 61–95.

¹¹³ Economic Community of West African States (ECOWAS),” M.A Thesis, The Norman Paterson School of International Affairs, Carleton University, Ottawa.

Regional economic integration in Africa is pursued as a result of the small markets of the member states and the impact it might have on economic development, which would result in an improvement in the welfare of the African people. African countries are not able to confront the forces of globalisation alone, hence the necessity to integrate the economies of the African regions so that these regions may benefit as a result of the increased market that will lead to scale production¹¹⁴. According to Viner and Lipsey, competition from abroad should stimulate innovation among import-competing industries, and this would lead to increased production efficiency. Enterprises in Africa face supply-side constraints such as transport costs and technology and these affect their ability to respond quickly to increased competition from abroad. The resultant loss in market share often leads to the closure of firms in the affected industries.

Africa's economic geography is particularly challenging. Regional integration is likely the only way to overcome these handicaps and participate in the global economy. Integrating physical infrastructure is both a precursor to and an enabler for deeper economic integration, thereby allowing countries to gain scale economies and harness regional public goods. For successful regional integration, countries must start small; build on successes; think globally, linking Africa to more external markets; and compensate the least fortunate, recognizing that benefits are not always evenly distributed.¹¹⁵

Regional approaches can address the infrastructure backlog in Africa and propel economic growth, overcoming the region's difficult geography.¹¹⁶ Sub-Saharan Africa has 48

¹¹⁴ Frankel, Jeffrey, Ernesto Stein, and Shang-Jin Wei, 1995, "Trading Blocs and the Americas: The Natural, the Unnatural, and the Super-Natural," *Journal of Development Economics*, Vol. 47 (June), pp.96.

¹¹⁵ Coulibaly, S., Roberts, A., Foster, V. and Deichmann, U. (2010). Africa's Infrastructure: A Time for Transformation, A report submitted to Infrastructure Consortium of Africa on Deepening Regional Integration.

¹¹⁶ Nuno, L. and Venables, A. (1999). Infrastructure, Geographical Disadvantage, and Transportation Costs. Policy Research Working Paper 2257, World Bank, Washington, DC.

countries; most with small populations more than 20 countries have a population of less than 5 million. Economies are also very small 20 countries have a GDP of less than \$5 billion.¹¹⁷ The small scale means governments have difficulty funding the large fixed costs associated with infrastructure development. In addition, 15 African countries are landlocked, depending on their neighbors for access to global markets.

In descending order of export potential, these include the Democratic Republic of Congo, Ethiopia, Guinea, Sudan, Cameroon, and Mozambique. The first three accounts for 74 percent of potential investments needed to realize these export volumes is daunting. Each of the top three would invest more than \$700 million a year for the next decade to develop the generation capacity for export, or more than 8 percent of their GDP. Thus, supporting such investments would be difficult without extensive cross-border financing arrangements that allow importing beneficiaries to make upfront capital contributions.¹¹⁸

Most infrastructure investments share characteristics of public goods, and all benefit to varying degrees from scale economies. Infrastructure sharing addresses the problems of small scale and adverse location. Regional integration increases the scale of infrastructure construction, operation, and maintenance. It reduces costs, pools scarce technical and managerial capacity, and creates a larger market. Economies of scale are particularly important in the ICT and power sectors. Big hydropower projects that would not be economically viable for a single country make sense when neighbors share their benefits.

The discussion on RECs in Africa will be presented in terms of four geographical areas, namely Eastern and Southern Africa, Central Africa, West Africa and North Africa. Furthermore,

¹¹⁷ World Bank (2009). World Development Report 2009: Reshaping Economic Geography. Washington, DC: World Bank.

¹¹⁸ Tahari, A., P. Brenner, E.D Vrijer, M. Moretti, A.S. Senhadji, G. Sensenbrenner, and J. Sole, (2007). Financial Sector Reforms, Prospects for Financial Integration in Maghreb Countries," IMF Working Paper 07/125 (Washington: International Monetary Fund).

the discussion will focus on the structures of RECs as well as the evaluation of the economic effects of regional integration on member countries.

3.5.1 Eastern and Southern Africa regions

Chipeta and the Economic Commission for Africa point out, regional economic integration in Eastern and Southern Africa (ESA) has been actively pursued with the twin objectives of fostering economic and political development, and arresting the further marginalization of the region and its communities. These communities are, in the main, poor, underdeveloped and vulnerable to the harsh realities of globalisation. Deeper regional integration is of the outmost importance if Eastern and Southern Africa are to achieve meaningful industrialization, develop higher levels of intra-regional trade and investment flows, reduce poverty and participate effectively in the evolving global economic linkages.

A further examination of the various regional structures and agreements in Eastern and Southern Africa highlights the potential problems of overlapping membership, particularly among those members with commitments to forming a customs union and those who are negotiating economic partnership agreements (EPAs) with the EU. The problems of road/rail/port infrastructure inhibit the potential of the countries in the sub region to trade efficiently. Even in cases where the tariff barriers have been reduced significantly amongst member states, non-tariff barriers of all sorts continue to constitute an obstacle to trade.

3.5.2 Regional economic integration in West Africa

The Economic Community of West African States (ECOWAS) has been designated as the building block for the AEC for West Africa. The following countries are members of ECOWAS: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo. With the exception of Guinea all French-speaking members of ECOWAS (namely Benin, Burkina Faso, Cote d'Ivoire,

Mali, Niger, Senegal, and Togo), together with Guinea Bissau, have formed a customs union and a monetary zone through the West African Economic and Monetary Union (WAEMU). This move led to further reform as a result of the involvement of the regional central bank, namely, the BCEAO¹¹⁹.

WAEMU has generally been perceived to have been successful (Economic Commission for Africa, 2005). There has been a significant increase in the development of convergence criteria with harmonisation in such areas as public finances, public sector reform, budgetary and accounting classifications of local governments. The most significant progress has been in the harmonisation of indirect taxes, namely, value-added tax (VAT) and excise tax. Since November 1997, the Union has implemented the harmonisation of the West African accounting system (SYSCOA). The West African Development Bank (BOAD) is the financial arm of WAEMU. It concentrates on such activities as investment projects and integration-promoting infrastructure.

There has been significant progress with respect to the free movement of people and the implementation of a CET for trade. A common commercial policy has harmonised national efforts within such frameworks as the World Customs Organisation (WCO), the WTO, bilateral arrangements such as within AGOA and with the EU. A compensation mechanism has been introduced to compensate for revenue loss resulting from harmonisation. At the sectoral level the Commission has commissioned regional programmes in the areas of energy, agriculture, environment and infrastructure (Economic Commission for Africa, 2005). Despite the progress made in deepening regional integration in West Africa economic development and poverty remains a problem. This could be attributed to the absence of a trickle- down effect of the

¹¹⁹ Frankel, Jeffrey, Ernesto Stein, and Shang-Jin Wei, 1995, "Trading Blocs and the Americas: The Natural, the Unnatural, and the Super-Natural," *Journal of Development Economics*, Vol. 47 (June), pp.96.

economic benefits to touch the lives of the ordinary citizens¹²⁰.

3.5.3 Regional economic integration in Central Africa

The Economic Community of Central African States (ECCAS) is the recognised regional bloc for Central Africa. ECCAS comprises Angola, Burundi, Cameroon, Central African Republic, Chad, Congo Democratic Republic, Congo Republic, Equatorial Guinea, Gabon, Rwanda, and Sao Tomé and Príncipe. There is also a variable geometry approach within the ECCAS region with six members having belonged to a customs union and monetary zone, the Economic and Monetary Community of Central Africa (CEMAC) since 1994. These members of CEMAC are Cameroon, Central African Republic, Congo Republic, Gabon, Equatorial Guinea, and Chad.

CEMAC also shares several economic institutional cooperation arrangements with other French speaking West African countries on such policies as exchange rates, insurance, business law and intellectual property rights. In the Central African region intra-regional trade is insignificant at less than 10 per cent of total trade. In the world's fastest-growing regions, the largest increase in trade has been within industries, for parts and components produced in one location and assembled in another¹²¹. Manufacturing is more about specialized "tasks" than finished products. Splitting up manufacturing processes during regional integration in Africa allows much more specialization, which gives rise to scale economies and, thus, to cost advantages.¹²²

Trading between members follows a hub-and-spoke pattern a situation where smaller and

¹²⁰ Frankel, Jeffrey, Ernesto Stein, and Shang-Jin Wei, 1995, "Trading Blocs and the Americas: The Natural, the Unnatural, and the Super-Natural," *Journal of Development Economics*, Vol. 47 (June), pp.96.

¹²¹ The World Development Report 2009: Reshaping Economic Geography identifies three principles for regional infrastructure: start small, think global, and compensate the least fortunate (World Bank 2009)

¹²² World Bank (2008). Africa Regional Integration Assistance Strategy. World Bank, Washington, DC.

poorer members of the regions rely on regional trade from wealthier and larger members who trade primarily with non-members. There is a lack of complementarities in the exportable as member countries produce the same products, namely, petroleum, minerals and agricultural products, for export outside the region.

3.5.4 Regional Economic Integration in North Africa

According to the Africa Economic Commission (2005) and Bensouiah (2002) the Arab Maghreb Union (UMA), comprising Algeria, Libya, Morocco, Mauritania, and Tunisia, is the building block for North Africa. A particular feature of the AMU is that Arab countries outside Africa may apply for membership.

This region is not negotiating Economic Partnership Agreements (EPA) although separate agreements do already link certain of the countries to the European Union. The union exists more as an Arab solidarity forum than a regional economic integration arrangement and has closer links with the Middle East than with sub-Saharan Africa.

The economies of the Maghreb countries are sustained by large contributions from customs duties imposed on foreign trade, and any reduction in these tariffs would decrease the revenues available to their governments. In Tunisia, for example, customs tariffs account for 22 percent of government revenues, while imports from European countries represent 71.5 percent of the total imports.

A reduction in tariffs by adopting a lower CET than the prevailing one would result in significant reduction in the revenue from custom duties. A reduction in the value of customs duties would lead to a decrease in the level of public expenditure. Unless fiscal reform, such as a broadening of the tax base (to reduce the dependency on tariffs as a source of revenue), is introduced, countries will continue to maintain their external tariffs and this will slow down the

process of regional economic integration in Maghreb ¹²³.

Labor mobility leads to remittances from migrants who find jobs in dynamic growth centers. Specialization means that even small players can find a niche in the integrated regions in Africa¹²⁴. For instance, car assembly is possible only in some large African countries such as Nigeria and South Africa. However, smaller countries such as Cameroon or Zambia specialize in components.¹²⁵ For this approach, regional transport and communication costs have reduced. The benefits of regional integration are visible across all aspects of infrastructure networks. For information and communication technology (ICT) and power, regional infrastructure provides scale economies that substantially reduce the costs of production. Thus, continental fiber-optic submarine cables could reduce Internet and international call charges by one-half¹²⁶.

3.6 Conclusion

This chapter has discussed the financial benefits of regional integration globally. Economic and Monetary Union intergration takes the EU one step further in its process of economic integration, which started in 1957 when it was founded. Economic integration brings the benefits of greater size, internal efficiency and robustness to the EU economy as a whole and to the economies of the individual Member States European financial integration is leading to profound changes in the structure and operation of the financial services sector throughout the

¹²³ Brown, O. (2005) 'EU Trade Policy and Conflict', Geneva: International Institute of Sustainable Development (IISD).

¹²⁴ Nye, J.S. (1963): East African Economic Integration; "Journal of Modern African Studies, vol. 1 No. 4 PP 475 - 502.

¹²⁵ Leigland, James Collier, P and Venables, A. (2007). Rethinking Trade Preferences: How Africa Can Diversify Its Exports. *World Economy* 30 (8): 1326–45., and Andrew Roberts. 2007. The African Project Preparation Gap: Africans Address a Critical Limiting Factor in Infrastructure Investment." Gridlines, Note 18 (March), Public-Private Infrastructure Advisory Facility, World Bank, Washington, DC.

¹²⁶ Collier, P and Venables, A. (2007). Rethinking Trade Preferences: How Africa Can Diversify Its Exports. *World Economy* 30 (8): 1326–45.

continent. Through a more open and effective European financial market a number of benefits are expected for both investors and the corporate sector¹²⁷.

There are several mechanisms and modalities for increasing intraregional trade and fostering regional cooperation. There are three general areas where there is scope for greater economic integration. They are cross-border infrastructure, international trade and investment (including services), and financial sector cooperation. Major cross-border initiatives are being undertaken through the South Asia Sub regional Economic Cooperation (SASEC) program. This program was initiated by four members of the South Asian Association for Regional Cooperation (SAARC) (Bangladesh, Bhutan, India, and Nepal) that formed the South Asian Growth Quadrangle (SAGQ) in 1996. The SASEC program was launched in 2001 with support from the Asian Development Bank and its aim was to accelerate economic cooperation within SAGQ.

Countries in Africa have gained economic benefits as a result of regional integration. The chapter explores Africa's Economic Integration and how the continent has gained financial benefits in form of the cost of Information Communication Technology (ICT) in Africa, energy costs, cross-listing of stocks on firm value, transport cost, creation of internal and external trade.

The regional integration of ICT infrastructure has benefited local and domestic communications by lowering marginal transmission costs. The most immediate direct benefits of enhanced connectivity in African countries are reduced prices and better service for international voice and Internet connectivity. Prices for most services in countries with underwater cable access are half those in countries without access. The benefits realized in the energy sectors are pooling together of energy resources and leveraging of scale economies in power sector development. The resulting overall potential savings of regional power trade amount to about \$2

¹²⁷ Collier, P and Venables, A. (2007). Rethinking Trade Preferences: How Africa Can Diversify Its Exports. *World Economy* 30 (8): 1326–45.

billion a year in the costs of power system development and operation. The largest potential power-importing countries have reduced their long-run marginal cost of power by \$0.02–\$0.07 per kilowatt-hour. However full exploitation of energy related benefits in the regional integration is hampered by the fact that the region's most cost-effective energy resources are far from major centers of demand in countries too poor raise the billions of dollars needed to develop them¹²⁸.

Regional integration is a solution to stock market development in smaller emerging countries. The benefits that result from regional cross-listing between stock markets include large economies of scale, increased foreign flow of funds, diversification of financial risk, impetus to financial sector reforms, minimization of the risks of financial instability; facilitation of capital market development and economic growth. Regional trade blocks have increased external trade among African countries. Regional integration also serves as an economic avenue for reduction of transport across African countries. However, regulatory and administrative hurdles continue to inflate costs and prolong delays for freight movements along these strategic arteries.

¹²⁸ Collier, P and Venables, A. (2007). Rethinking Trade Preferences: How Africa Can Diversify Its Exports. *World Economy* 30 (8): 1326–45.

CHAPTER FOUR

DATA ANALYSIS

4.1 Introduction

This chapter presents analysis of data obtained from the respondents in the survey carried out in commercial banks in Nairobi Kenya that are operating in East African Region to establish the impact of regional integration in banking industry. Fifteen banks were visited 3 interviewees were interviewed from each bank totalling to forty five but only 40 respondents filled the questionnaire which is 88% of the respondent. The results have been presented in tables, figures and content delivery to highlight the major findings of the study.

4.2 Demographic factor

4.2.1: Distribution of gender of respondents

The percentage distribution of gender of respondents is presented in Table 4.1

Table 4.1: Gender of respondents

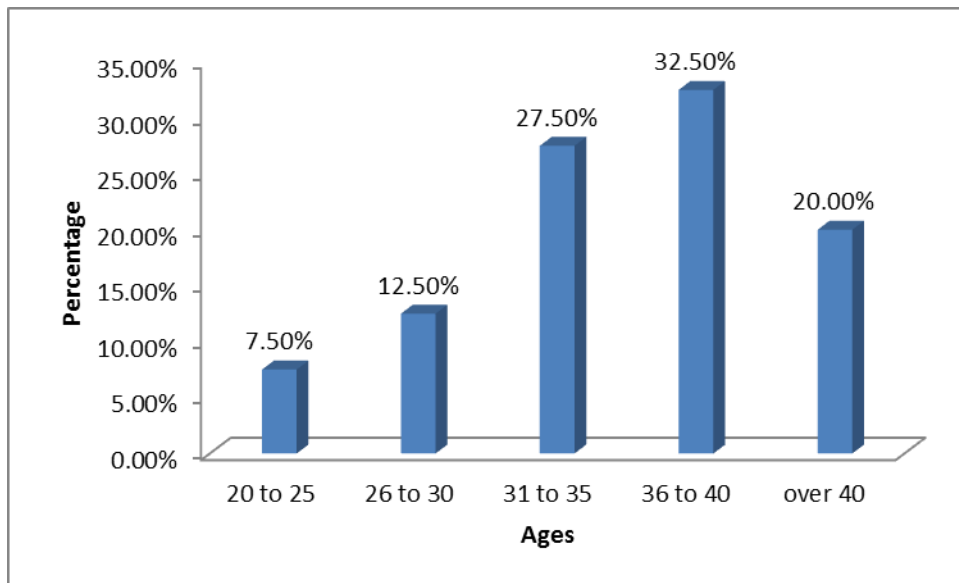
Gender	Frequency(N)	Percentage
Male	24	60.0%
Female	16	40.0%
Total	40	100.0%

Source: Author, 2013

The results as in the figure 4.1 show that majority of the respondent were male at 60% while female was 40% implying that most of the workers were male

4.2.2 Distribution of Age Group

The respondents were asked to disclose their age. The figure below shows the study finding.

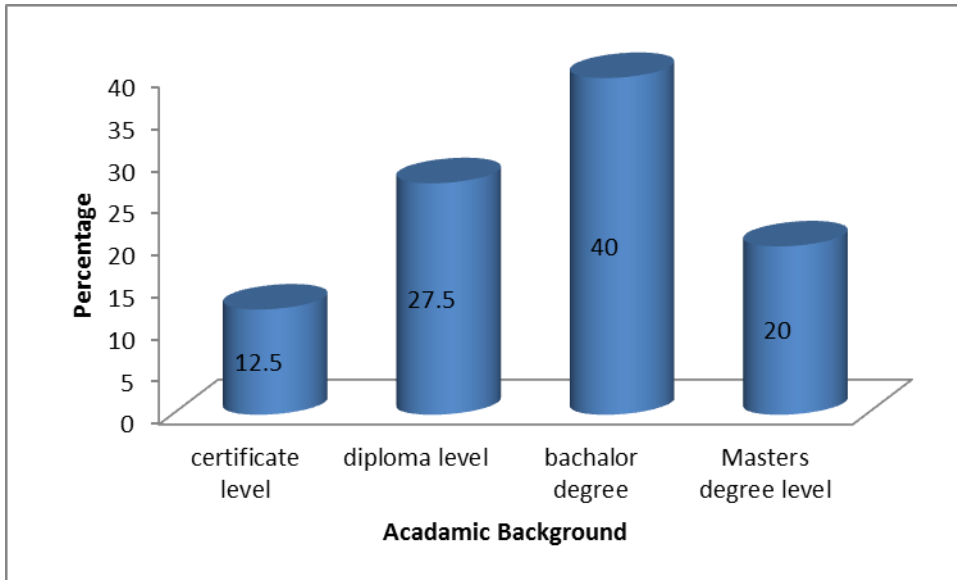


The results presented in figure 4.2.2 show that a large proportion of 32.50% the respondents were aged from the ages of 36 to 40 years; this was followed by a significant percentage 27.50% that were aged from 30-35 years, 12.50% were aged between 26 to 30, 7.50% were aged between 20 to 25 while 20% of the respondents were aged above 40 years. The age composition shows that most of the respondents were of the 30 to 40 years and therefore had rich experiences, could also appreciate the importance of the study.

4.2.3 Academic background

The respondents were asked to indicate their academic background. Figure 4.3 shows the study findings.

Figure4.1: Academic background



From the table, majority of the respondents 40% indicated they had undergraduate degree. This was followed by those who indicated they had a diploma 27.5%. 20% of the respondents indicated they had a postgraduate degree while 12.5% indicted they had attained a certificate.

4.2.4 Length of service

The respondents were asked to indicate the number of years worked in the bank. Figure 4.4 below show the results of the study.

Figure 4.2 Length of service

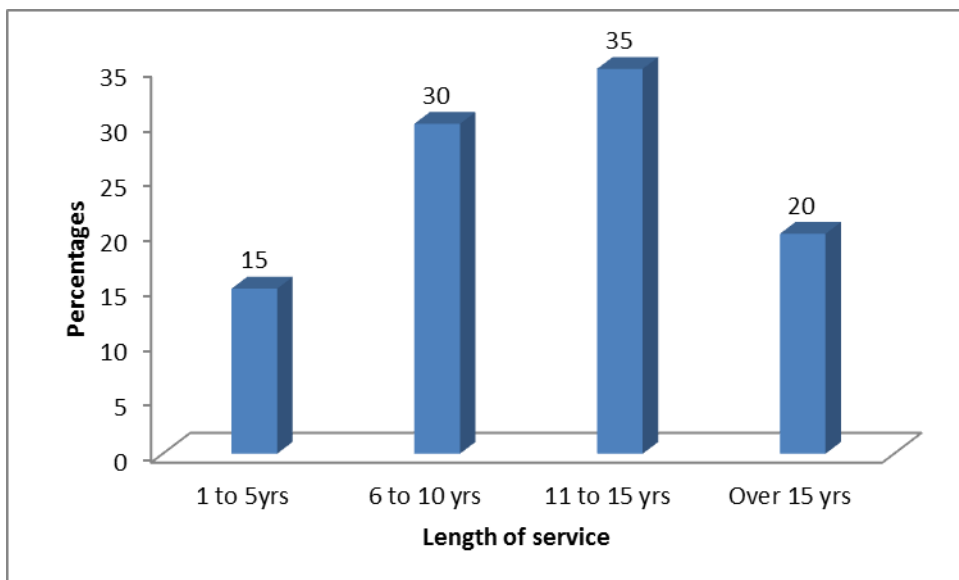


Figure 4.4 presents the findings on length of service of the respondents. From the figure, 15% indicated that they had been in the present bank for 1 to 5 years. 30% indicated a period of 6 to 10 years, 35% indicated a period of 11-15 years while 20% indicated that they had worked for over 15 years.

4.2.5 Management skills

The respondents were asked to indicate whether they have ever served in managerial level or not this was to assess the percentage of managerial among the respondents. Figure 4.4 below shows the results of the study.

Figure 4.3 managerial skills

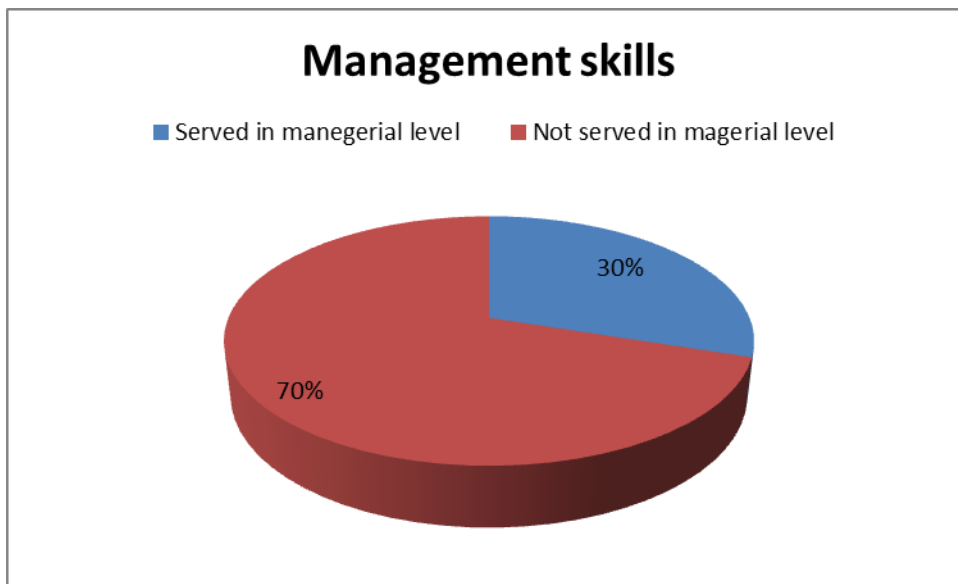


Figure 4.4 presents the findings on managerial skill of the respondent 30% percent indicated that they have managerial skills while 70% indicated that they have no managerial skill.

Figure 4.4 Length of service in managerial level

The respondents were that admitted that they served in managerial level were asked to indicate the number of years served in the bank. Figure 4.5 below shows the results of the study.

Figure 4.5 Length of service in managerial level

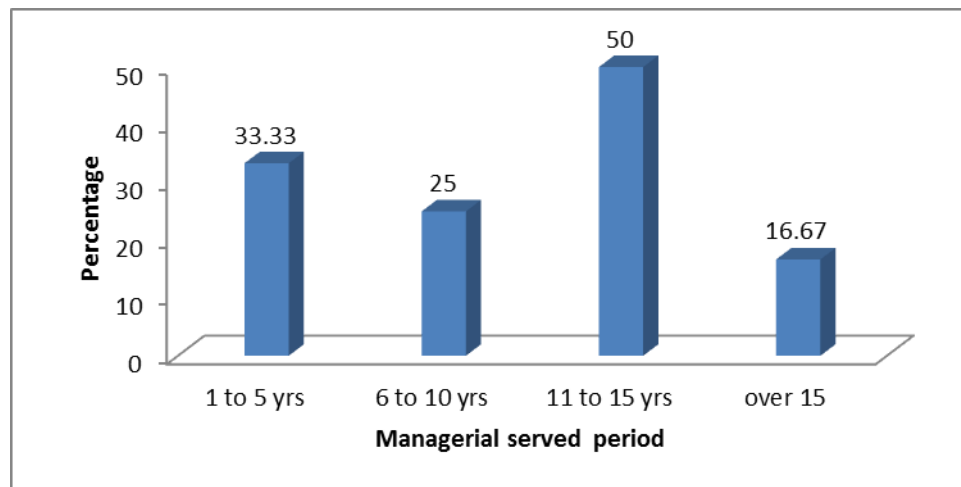


Figure 4.5 presents the findings on length of service of the respondents in managerial levels. From the figure, 33.3% indicated that they had served in managerial level for 1 to 5 years. 25% indicated that they have served in managerial level for a period of 6 to 10 years, 50% indicated a serving period of 11-15 which revealed that the service length of managerial staffs while 16.67% indicated that they had served as at managerial over 15years.

4.3 Impact of Regional Integration on Banking Industry

4.3.1 Political Influence on Policy Making

The respondents were asked to give and explain their views on political influence on policy making for the development on banking industry in East Africa Community, below show the results of the study. Majority of the respondent agreed that policy making rest on political will, they also indicated that political stability is fundamental for policy making, the political relationship between head of state in the region is vital in policy making according to many. Majority of the respondent also agreed that the spectrum policy on governance is politically instigated thus influences banking policy. Majority of members agreed that monetary policy decisions are driven by politics as much as economics and Monetary policy is susceptible to

political influence because monetary policy actions have important distributional implications. Majority of respondent argues the banking industry, has an especially strong interest in monetary policy and attempt to influence monetary policy through public statements, demonstrations, and lobbying of members to counter political influence. The respondent agitated that the public interest view is that politics is irrelevant to the day-to-day monetary policy actions and thus the effect is highly negative.

4.3.2 Attribute to growth and smooth running banking industry in the region

The respondents were asked to explain their views on political influence on policy making for the development on banking industry in East Africa Community, below show the results of the study Majority of the respondent agreed that the world approach on region integration and market expansion has promoted a steadfast and coherent regional integration. Others also said the common ancestry depicted in common language has also promoted smooth banking in the region. The common problems facing the region have attracted a common goal in the region that has promoted smooth region of banking industry. Majority of the respondent agreed that the spread out of the English language in the region has promoted growth and smooth operation of banking. Majority of respondent have agreed that regional integration have appear to respond to signals from non-financial pressure groups or public opinion occasionally in support of banking industry development and smooth running across borders. Majority of respondents agreed that deregulation on efficiency and productivity change, to the sources of productivity growth and to the effect of deregulation on different kinds of ownership and on the risk-taking behaviour of banks have been instrument in banking industry growth.

4.3.3 Economic Integration and the Current Developments in East Africa Community

Description	N	Mean	Standard deviation
Regional integration promotes investment in east Africa region	40	4.456	0.654
Regional integration will promote development spectrum of economic development policy	40	3.657	0.712
Regional integration sourcing of expertise across borders	40	2.243	0.7269
Regional integration eases regional economic pressure associated with insecurity	40	1.987	0.618

The results in the table above show that majority of the respondents strongly agreed that Regional integration promotes investment in east Africa region $m= 4.456$. The respondents agreed that Regional integration will spectrum promote development of economic development policy $m= 3.657$, respondent fail to agree that Regional integration will promote sourcing of expertise across borders $m=2.243$ and. The respondents disagreed that Regional integration eases regional economic pressure associated with insecurity $m= 2.1357$.

4.3.4 Attractive Features in EAC Regional Integration

When respondents were asked to identify the most attractive features of the EAC as an investment location in banking industry, the following were mentioned most frequently: political stability, the location and the climate. Stability was particularly important to banking industry. The location was important to all investors. When investors speak of location in the EAC

context, they have in mind such things as the 2,000-km coastline, Nairobi’s status as an East African air-traffic hub and Tanzania’s sharing of its borders with eight other countries. As to the climate, it is the temperate highland climate that is so appealing for investors in both agriculture and tourism which backups banking industry. In addition, there are specific attractions in the individual countries: the skilled and enterprising workforce in Kenya, the enormous natural resources of Tanzania and the business-friendly regime in Uganda are supportive to banking industry.

4.3.5 Importance Prior Research in Banking

The respondents were asked to indicate whether importance to carry prior research in banking industry of similar region on integrations is vital to development of banking industry of the region. Figure 4.5 below show the results of the study.

Figure 4.5 Importance Prior Researches in Banking

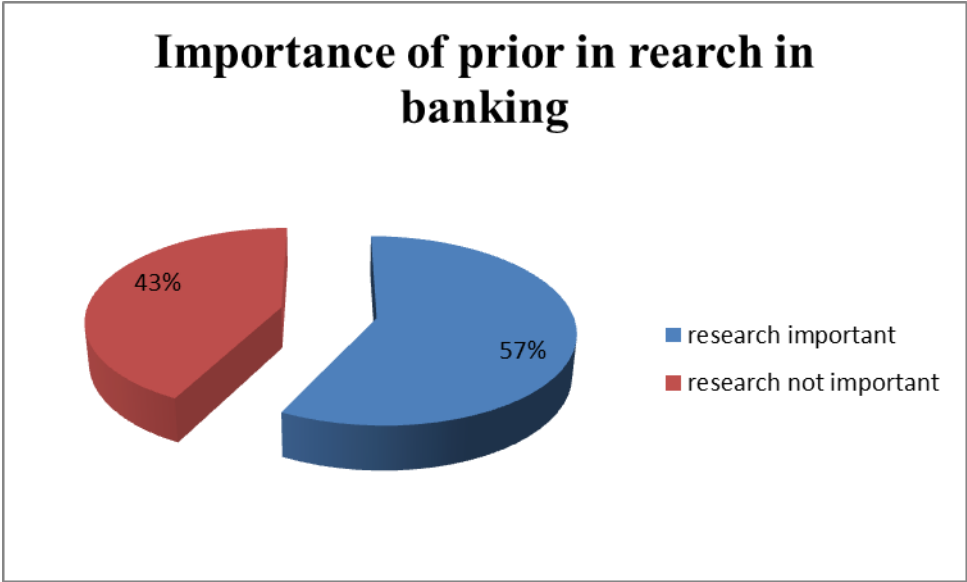


Figure 4.5 presents the findings on importance of prior research in banking whereby 57% of the respondent agreed that a satisfactory and realistic research is required before establishment of

banking branches at any location or town in the region. 43% of the respondent down looked the impact of research on banking on the regional integration.

4.3.6 Effects of Regional Integration to Financial Institution

Table 4.3 Effects of Regional Integration to Financial Institution

Description	N	Mean	Standard deviation
Regional integration will facilitate fast transaction in banking industry	40	4.6658	0.6653
Regional integration necessitate regional licensing in banking industry	40	3.4029	0.8688
Regional integration facilitates accessibility of banking services in the region	40	4.0517	0.7541
Regional integration enhances free market in banking industry across borders	40	4.2154	0.6857
Regional integration increases amount lending's in terms of loans	40	4.145	0.6876
Regional integration reduces banking charges among the member states	40	2.1357	0.6648

The results in the table above show that majority of the respondents strongly agreed that Regional integration will facilitate fast transaction in banking industry $m = 4.6658$. The respondents agreed that Regional integration necessitate regional licensing in banking industry $m = 3.4029$, the respondents agreed that the Regional integration enhances free market in banking

industry across borders $m= 4.2154$ and Regional integration facilitates accessibility of banking services in the region $m= 4.0517$. More still a mean of 4.145 of the respondent agreed that Regional integration will increase amount lending's in terms of loans to the member state. The respondents disagreed that Regional integration reduces banking charges across the member states $m= 2.1357$.

4.3.7 Challenges Encountered in Banking Industry in the Region

The respondents were asked to indicate their views on the descriptions below on challenges encountered in the East Africa Community.

Table 4.4 Challenges Encountered in Banking Industry in the Region

Description	N	Mean	Standard deviation
Deficient road infrastructure	40	4.434	0.6764
Telecommunications networks	40	4.123	0.6873
High transport cost	40	3.456	0.7625
Communication costs,	40	3.989	0.7198
Lack of information on trade opportunities	40	3.567	0.7454
police checks and roadblocks	40	1.989	0.9875
customs procedures	40	2.983	0.832
Membership to different regional blocs	40	2.019	0.8407
licensing procedures	40	3.129	0.7638
duty and tax administration	40	3.109	0.7868

4.3.8 The effect of non-financial pressure groups on monetary policy

Majority of the respondent agreed that Non-financial business interests, labor, and the public also have an interest in monetary policy they said business and labor groups in the nonfinancial sector benefit from high levels of output and low unemployment. Majority of respondent also agreed that Non-financial business have an interest in low inflation as well, though the banking industry is probably more sensitive to inflation. Majority of the respondents agitated that unlike the banking industry, non-financial groups do not have a formal advisory role on monetary policy within the East Africa Community. Majority of the respondent indicated that some groups do make their views on monetary policy known through public statements, press releases, and regional testimony. Majority of respondent said that representatives of Non-financial business and labor organizations frequently offer monetary policy advice through the media in the weeks leading up to meeting and when important economic data are released. Majority of respondent acknowledge the media routinely report the reactions of such organizations to actions as well. The frequency of public advocacy from representatives of organizations with an interest in monetary policy relative to, say, academic economists, would seem to support this interpretation.

4.3.9 Regional Integration Benefits to the Banking Industry

Figure 4.6 Regional Integration Benefits

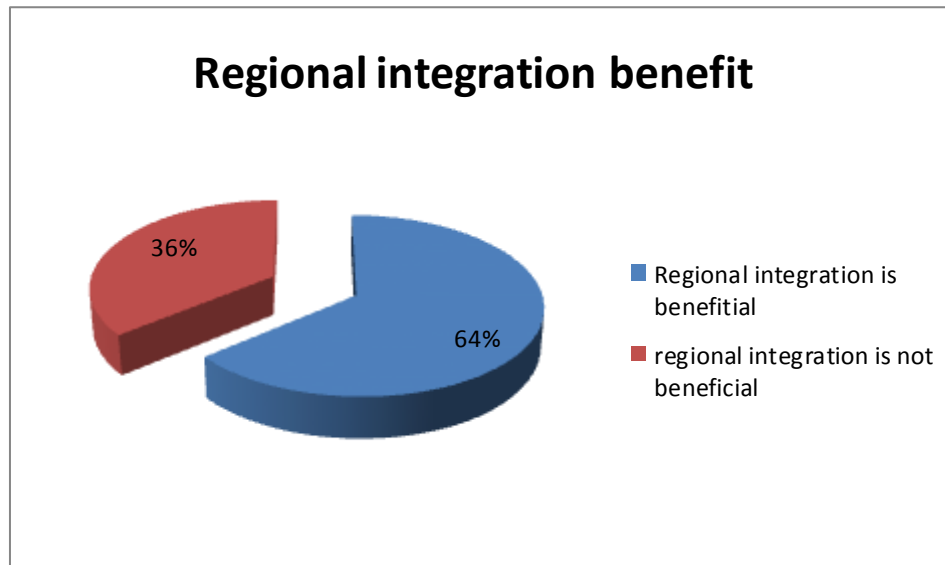


Figure 4.6 presents the findings on regional integration benefits whereby 64% of the respondent agreed that regional integration is benefits to the banking industry in the region while 36% of the respondent down said that regional integration is benefits to banking to regional integration.

4.3.6.1 Financial Benefits From regional integration to Banking Industry

The respondents were asked to give their views on financial benefit that banking industry may benefit from regional integration in an art-shell respondent were required to give an overview of in respect to regional integration that are monitory form. Majority of the respondent agree that banking industry will get more loans from the governments that form the regional body to invest across the region. Another majority said that regional integration will promote public investment in banking industry thus enhance share investment they said the market for banking industry has secured favourable ground for expansion. Majority of the respondents still agreed that due to currency exchange across the borders the banking industry will enjoy more financial benefits since it's the banking industries will facilitate this sale of currency transaction with a charge that makes the bank get profits. Majority of the respondents noted that the banking

industry will enjoy more return in term of profit from regional investment that the integration of the region has promoted. Finally majority of respondents agreed that due free and more movements across the borders will necessitate banking deposit and withdraws from one country to another thus resulting financial growth and benefits in banking industry.

4.3.10 Regional Integration Impact on Bank Development and Growth

Figure 4.7 Impacts on Bank Development and Growth

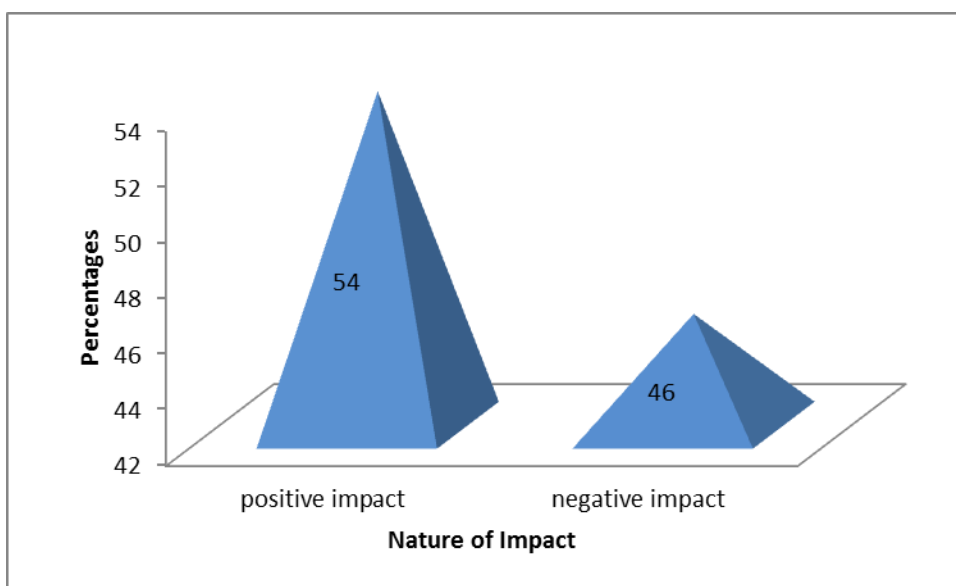


Figure 4.7 present the findings on the impact of Regional Integration Impact on Bank Development and Growth whereby 54% of the respondent agreed that regional integration has a positive impact for the growth and development of banking industry in the region. 46% of the respondents indicated that regional integration is not beneficial for the growth and development of banking industry in the region.

4.3.11 Improving Regional Policy

The respondents were asked to give their views on how the regional integration policy can be improved and majority of the respondent said that a comprehensive policy should be

enriched in consideration of the members' states policies. Majority of the respondent agreed that the policy should stipulate equitable sharing and distribution of common resources. Other respondent agreed that independence and state sovereignty should be enshrined in the policy. Majority of the members agree that the regional assembly and regional board on banking should be empowered in legitimate frame works from member states. In this regard majority of the members agreed that enforceability of the regional policy and law should enact and ratified by all member states. Majority of the members said that the banking industry need a forum for making its views concerning monetary policy and a regional Act should be in place specifically to provide the banking industry with a powerful voice in monetary policy deliberations. Majority of the respondents agreed that the banking industry council need be composed of representatives of primarily large banks appointed by the board of directors of each of the regional banks for one year terms and the council need to meets formally with the banks Board of Governors four times a year, at which meetings the Board of Governors explicitly asks for the bankers' opinion of the current stance of monetary policy. Majority of responded agreed that the primary objective in banking industry should be to improve productivity, efficiency and profitability of the banking systems and also to increase international competitiveness such as Financial deregulation

4.4 Conclusion

The goal of the regional integration agenda in East Africa is to create a fully integrated and internationally competitive based on regional and national needs and priorities, on the recognized positive impacts of infrastructure on regional integration, trade and, thus, growth, and on the Bank's acknowledged comparative advantage in infrastructure provision. At the same time, by assisting the Tripartite Arrangement, the Bank will be supporting the improvement of coordination among countries in the region and with other development partners in the region. The Bank will strive to play a catalytic role by encouraging private sector financing of regional

projects by increasing the quality and quantity of bankable projects and by improving the business environment

Regional integration in the banking sector is extremely important given the pivotal role that banks play in the provision of banking services, the transmission of monetary policy and the maintenance of systemic stability. Nonetheless, research on banking sector competitiveness includes very few SSA countries and only Kenya from the EAC sub-region. To further strengthen bank industry in the region and increase access to financial services, policy makers will need to aggressively pursue reforms aimed at eliminating the structural barriers to contestable banking systems in the region. Specific policies would strengthen the protection of property rights as inefficient property registration and enforcement systems serve to increase lending risk and raise the cost of borrowing. In addition, other policies would aim to: Modernize the legal infrastructure, particularly the laws governing collateral, foreclosure and bankruptcy, to allow borrowers to pledge relevant assets as security for credit. Contractual enforcement procedures are extremely difficult to navigate in the EAC countries, while the administration of company and insolvency laws is costly, inefficient, and subject to abuse.

In East Africa Community the countries in terms of the degree of banking system competitiveness are ranked in the following order: Kenya, Tanzania, Uganda, and Rwanda and the statistics show the banking system in the EAC as an aggregated unit can be categorized as monopolistic competition. This implies that although there are no formal regulatory barriers to entry as in a monopoly, there are structural impediments that enable some banks to continue to enjoy a degree of monopoly power. Broadly speaking, banks in the EAC are less competitive than other countries with a higher level of financial and economic development

Provide accessible financial infrastructure such as credit bureaus and payment systems to support the safe expansion of retail credit. The development of these services is critical to increasing regional integration in banking industry. A number of countries in the region have already started the process of payment system modernization. Adopt comprehensive microfinance policies that safely increase access to financial services for lower-income households and SME's. A more inclusive financial system will increase the demand for bank credit and minimize the cost of financial transactions. The mobile-banking revolution and the introduction of agency banking is an example of a banking industry integration initiative that is already accelerating financial deepening. Mobile-banking has advanced particularly rapidly in Kenya, but is also quickly gaining popularity in the other EAC countries. In addition, bank regulations should continue to promote contestable markets by leveling the playing field across the different types of banks and the products they offer. One way of doing this is to address market segmentation due to large state and foreign bank presence by privatizing the few remaining government owned banks in favor of domestic participation.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter presents summary of findings as discussed in chapter four and interpretations of the data analysis, conclusions and recommendations based on the findings.

5.2 Summary

Regional integration is a complicated process whose understanding cannot be quickly derived from mere theoretical postulations. Arrival at the most appropriate theoretical approach to explain regional integration needs to take into consideration the unique patterns followed by the particular region under study. For the EAC, functionalism is best placed in that it does not only constrain itself to regional integration exclusively but rather to the broader concept of international cooperation. This is where it differs from neo-functionalism which addresses particularly regional integration. Institutionalism and inter-governmentalisms are greatly limited in leading to an understanding of the EAC integration due to the great emphasis they place on the institutional formation process and the main political actors respectively. The customs union theory on the other hand best captures the particular stage that the EAC is going through with the coming into effect of the customs union and the common market. This is because the trade dynamics under this theoretical approach best fits into the integration process. Neo-functionalism on the other hand does not provide for an analysis of forms of cooperation outside the regional integration. This is a limitation since relations of EAC member states with other countries outside the integration area are vital due to their membership to other regional organizations.

The study has discussed the financial benefits of regional integration globally. Economic and Monetary Union integration takes the EU one step further in its process of economic integration, which started in 1957 when it was founded. Economic integration brings the benefits

of greater size, internal efficiency and robustness to the EU economy as a whole and to the economies of the individual Member States European financial integration is leading to profound changes in the structure and operation of the financial services sector throughout the continent. Through a more open and effective European financial market a number of benefits are expected for both investors and the corporate sector.

There are several mechanisms and modalities for increasing intraregional trade and fostering regional cooperation. There are three general areas where there is scope for greater economic integration. They are cross-border infrastructure, international trade and investment (including services), and financial sector cooperation. Major cross-border initiatives are being undertaken through the South Asia Sub regional Economic Cooperation (SASEC) program. This program was initiated by four members of the South Asian Association for Regional Cooperation (SAARC) (Bangladesh, Bhutan, India, and Nepal) that formed the South Asian Growth Quadrangle (SAGQ) in 1996. The SASEC program was launched in 2001 with support from the Asian Development Bank and its aim was to accelerate economic cooperation within SAGQ.

5.3 Conclusion

Countries in Africa have gained economic benefits as a result of regional integration. The chapter explores Africa's Economic Integration and how the continent has gained financial benefits inform of the cost of Information Communication Technology (ICT) in Africa, energy costs, cross-listing of stocks on firm value, transport cost, creation of internal and external trade. The regional integration of ICT infrastructure has benefited local and domestic communications by lowering marginal transmission costs. The most immediate direct benefits of enhanced connectivity in African countries are reduced prices and better service for international voice and Internet connectivity. Prices for most services in countries with underwater cable access are half

those in countries without access. The benefits realized in the energy sectors are pooling together of energy resources and leveraging of scale economies in power sector development. The resulting overall potential savings of regional power trade amount to about \$2 billion a year in the costs of power system development and operation. The largest potential power-importing countries have reduced their long-run marginal cost of power by \$0.02–\$0.07 per kilowatt-hour. However full exploitation of energy related benefits in the regional integration is hampered by the fact that the region's most cost-effective energy resources are far from major centers of demand in countries too poor raise the billions of dollars needed to develop them.

Regional integration is a solution to stock market development in smaller emerging countries. The benefits that result from regional cross-listing between stock markets include large economies of scale, increased foreign flow of funds, diversification of financial risk, impetus to financial sector reforms, minimization of the risks of financial instability; facilitation of capital market development and economic growth. Regional trade blocks have increased external trade among African countries. Regional integration also serves as an economic avenue for reduction of transport across African countries. However, regulatory and administrative hurdles continue to inflate costs and prolong delays for freight movements along these strategic arteries.

The regional integration of ICT infrastructure has benefited local and domestic communications by lowering marginal transmission costs. The most immediate direct benefits of enhanced connectivity in African countries are reduced prices and better service for international voice and Internet connectivity. Prices for most services in countries with underwater cable access are half those in countries without access. The benefits realized in the energy sectors are pooling together of energy resources and leveraging of scale economies in power sector development. The resulting overall potential savings of regional power trade amount to about \$2

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5.4 Recommendation

Regional integration the banking sector is extremely important given the pivotal role that banks play in the provision of credit, the transmission of monetary policy and the maintenance of systemic stability. Nonetheless, research on banking sector competitiveness includes very few countries and only Kenya from the EAC sub-region. Against this backdrop, we estimate two price-setting nonstructural measures of the degree of competitiveness in the banking systems within the EAC the Lerner index and H-statistic. We also identify factors that determine competitiveness in the EAC banking sector, and suggest policy recommendations to shape the design of competition policies. The Lerner index and the H-statistic ranks the countries in terms of the degree of banking system competitiveness in the following order: Kenya, Tanzania, Uganda, and Rwanda. Furthermore, the H-statistic show the banking system in the EAC as an aggregated unit can be categorized as monopolistic competition. This implies that although there are no formal regulatory barriers to entry as in a monopoly, there are structural impediments that enable some banks to continue to enjoy a degree of monopoly power. Broadly speaking, banks in the EAC are less competitive than other countries with a higher level of financial and economic development. Regarding the determinants of competition, empirical results from panel data regressions indicate the following higher levels of economic and institutional development increase banking sector competitiveness. Greater market concentration reduces competition.

Banks in larger markets proxy by population are more competitive perhaps, because of the economies of scale in transactions. Stronger market contestability lower degree of state intervention in the financial sector through ownership of financial institutions, as opposed to greater foreign ownership of banks matters for competition in the host country. Increased lending to the private sector fosters competition, while high bank profitability has the opposite effect. To further strengthen bank competition and increase access to financial services, policy makers will need to aggressively pursue reforms aimed at eliminating the structural barriers to contestable banking systems in the region. Specific policies would strengthen the protection of property rights as inefficient property registration and enforcement systems serve to increase lending risk and raise the cost of borrowing. In addition, other policies would aim to:

Modernize the legal infrastructure, particularly the laws governing collateral, foreclosure and bankruptcy, to allow borrowers to pledge relevant assets as security for credit. Contractual enforcement procedures are extremely difficult to navigate in the EAC countries, while the administration of company and insolvency laws is costly, inefficient, and subject to abuse.

Provide accessible financial infrastructure such as credit bureaus and payment systems to support the safe expansion of retail credit. The development of these services is critical to increasing competition in the loan market. A number of countries in the region have already started the process of payment system modernization

Adopt comprehensive microfinance policies that safely increase access to financial services for lower-income households and SME's. A more inclusive financial system will increase the demand for bank credit and minimize the cost of financial transactions. The mobile-banking revolution and the introduction of agency banking is an example of a microfinance initiative that is already accelerating financial deepening. Mobile-banking has advanced particularly rapidly in Kenya, but is also quickly gaining popularity in the other EAC countries.

In addition, bank regulations should continue to promote contestable markets by leveling the playing field across the different types of banks and the products they offer. One way of doing this is to address market segmentation due to large state and foreign bank presence by privatizing the few remaining government owned banks in favor of domestic participation.

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QUESTIONNAIRE:

THE IMPACT OF REGIONAL INTEGRATION ON BANKING INDUSTRY; A CASE STUDY OF THE EAST AFRICA COMMUNITY

SECTION A: BASIC BIOGRAPHICAL INFORMATION

Indicate your response by a tick (√) against the appropriate box at each question

For official use only

1. What is your Gender? Male Female

2. what is your Age

20-25yrs Age26-30yrs 31-35yrs

36-40yrs Over 40 years

3. What is your experience period in banking industry?

5 yrs 6-10yrs 11-15 yrs Over 15 yrs

4. Have you served in managerial level

YES

NO

5. If yes what is your experience period managerial level

1-5 yrs 6-10 yrs 11-15yrs

Over 15 yrs

6. What is the highest professional qualification you have attained?

Certificate level	<input type="checkbox"/>
Diploma level	<input type="checkbox"/>

Bachelors level	
Masters degree level	

SECTION B. IMPACT OF REGIONAL INTEGRATION ON BANKING INDUSTRY

7. Briefly explain your view on political influence on policy making for the development on banking industry in East Africa Community?

.....
.....

8. What factors could you attribute to the growth and smooth running in your bank in the region?.....

.....

9. To what extent are you satisfied with the following in respect to economic integration and the current developments in East Africa Community? Where very low extent =1, low extent= 2, Undecided = 3, high extent= 4 and Strongly extent =5

Statement	1	2	3	4	5
Regional integration promotes investment in east Africa region					
Regional integration will promote development spectrum of economic development policy					
Regional integration sourcing of expertise across borders					

Regional integration eases regional economic pressure associated with insecurity					
Regional integration promotes the regional banking industry					

10. Give your views on the effect of non-financial pressure groups on monetary policy in the region?

11. (a) Do you consider prior research in banking industry of similar regional integrations as vital to development of banking industry?

Yes [] No []

(b) If yes, give a few reasons why you consider it important

.....
.....

12. To what extent do you agree with the effects of regional integration on financial institution in East Africa according to the following statements? Where very low extent =1, low extent= 2, undecided = 3, high extent= 4 and strongly extent =5

Statement	1	2	3	4	5
Regional integration reduces banking charges among the member states					
Regional integration necessitate regional licencing in banking					

industry					
Regional integration facilitates accessibility of banking services in the region					
Regional integration enhances free market in banking industry across borders					
Regional integration will facilitate fast transaction in banking industry					
Regional integration increases amount lending's in terms of loans					

13. Please indicate the extent you agree to the following statement on challenges encountered banking industry in regional integration in the East African Community Where very low extent =1, low extent= 2, Undecided = 3, high extent= 4 and strongly extent =5

Statement	1	2	3	4	5
Deficient road infrastructure					
Telecommunications networks					
High transport cost					
Communication costs,					
duty and tax administration					

Lack of information on trade opportunities					
police checks and roadblocks					
licensing procedures					
customs procedures					
Membership to different regional blocs					

14. Is the banking policy in line with regional integration policy for the development of banking industry in the region

YES () NO ()

15. Is integration of the region beneficial to the banking industry?

YES () NO ()

If yes give your own view on how beneficial integration of the region is to the banking industry?.....

.....

16. According to you, what are the financial benefits from banking industry to the region

.....

.....

17. In your own view is your bank development and growth contributed by regional integration of East Africa.

YES () NO ()

18. Give suggestions as to how the East Africa Community policy could be improved for the development of banking industry in the region?

.....
.....