INDUSTRIAL AND TRADE IMBALANCES IN EAST AFRICAN COMMON MARKET: DYNAMICS AND CORRECTIVE MECHANISMS, 1962-1977

JAMES GAD KANIMBA, M.A.

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Abstract

This is a study of two causally related issues, industrial and trade imbalances in the former East African Common Market (EACM) from mainly 1962 to the break up of that Common Market in 1977. Industrial imbalances among the three member countries of the EACM, Kenya, Tanzania and Uganda, was the principal cause of the trade imbalances. And the two forms of imbalances were a source of political sensitivity in Uganda and especially in Tanzania. This sensitivity, which reflected a belief that the operation of the EACM had been inequitable, was a threat to the existence of that economic integration scheme in the early 1960s.

This study analyses the nature, the causes and the dynamics of the industrial and trade imbalances for the sixteen year period mentioned above. Both quantitative and qualitative evaluations are made in order to establish the effectiveness of the mechanisms which were devised to correct the two forms of imbalances. The study focuses on one of the corrective mechanisms, the East African Development Bank (EADB), which still operates today. It was expected to reduce industrial disparities between Kenya and the other two countries.

Four perspectives concerning the operation of the EADB are adopted for the purposes of evaluating the effectiveness of this instrument. The first is fund

allocation. The EADB was supposed to allocate the funds at its disposal according to a prescribed formula. The second perspective is about countries' capacity to absorb the funds allocated to them. The third concerns the relative importance of the EADB as a source of finance for projects, in comparison with the other sources of finance which the study calls the Non-Bank sources. Finally, the EADB's effectiveness as a mechanism for correcting industrial disparities is evaluated from the standpoint of the performance of the projects in Kenya, Tanzania and Uganda.

The EADB was also expected to make its three member countries increasingly complementary in industrial field. The measure of success it achieved in this direction is assessed.

It is found that the EADB was not an effective instrument for reducing industrial imbalances between Kenya and the other two countries. There are several explanations for this. First, the EADB did not have adequate funds. Second, finance absorption in Kenya was higher than in either Tanzania or Uganda and the EADB had hardly any power over that factor. Third, the EADB's contribution of finance to the cost of projects was small. The Non-Bank sources were a more important source of finance. Fourth, Kenya's capacity to generate investment greatly exceeded that of either Tanzania or Uganda. Therefore, given that the Bank was a minor source of finance for the projects it co-financed, its "balancing effect" was greatly offset by the "disparity effect" arising from Kenya's greater capacity to generate investment. Finally, Kenya had more successful projects than either of the two countries. And the amount of investment in those projects (effective investment) was far in excess of the amount of effective investment in either of the two countries. An examination of the determinants of the success and failure of projects revealed that the EADB had scarcely any control of those determinants.

The study concludes that the reduction of industrial imbalances objective was unrealistic. This conclusion is partly arrived at by evaluating the performance of the EADB. It is also reached by taking into consideration the findings that during the active lifetime of the East African Community (EAC), 1968-1977, there had been a general trend towards industrial disparity between Kenya and her two Partner States. Trade imbalances moved in the same direction. For Kenya and Uganda, that trend goes back to 1962.

The EADB was also ineffective as an instrument for making its member countries increasingly complementary in industrial field. This was chiefly because there was no agreement between these countries on the harmonization of industrial development in the EAC.

The principal lessons of this study are the following. To begin with, it is unrealistic to try to bring about balanced economic development among members countries of an economic integration scheme if conditions for economic growth in those members differ. Secondly, as long as those members accept a high degree of inter-country trade, imbalances in trade between those countries will exist. This should not, however, unduly raise political sensitivity of the member countries in trade deficit unless their share of trade in their economic block is falling and if they can not in the present or future induce investors operating in national boundaries to exploit the presence of a multinational market.

In connection with the EADB, it is argued that it could contribute more to the economic welfare of its member countries in two main ways. The first is that it should be able to mobilize more concessionary funds than it did in the past. The point is that the EADB should utilize increasingly soft loans such as those it obtained from the Scandinavian countries. The second way, is for the EADB to strive harder than it has done in the past to raise the number of successful projects in its member countries. Ways in which this goal may be achieved are found in the concluding chapter 8, of the thesis.

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CHAPTER 1

INTRODUCTION

1.1 Introduction

Economic integration schemes in the less developed world are expected, inter alia, to accelerate the rate of economic growth of member countries. It is also expected that the benefits derived from the operation of such schemes will be equitably distributed among members. These expectations are shown in agreements below about economic co-operation in certain parts of the under-developed world. The Treaty for East African Co-operation, which contains methods of regulating the operation of the former East African Common Market[1] (EACM) states that ..... "there shall be accelerated, harmonious and balanced development..... and sustained expansion of economic activities, the benefit whereof shall be equitably shared".[2] The Caribbean Treaty had a similar objective.[3] And two of the principal goals of the Andean Group Treaty were the reduction of the differences in development which existed among the member countries and equitable distribution of the potential benefits of that economic integration scheme among those members.[4]

This study has two broad objectives. First, it investigates the nature, the causes and the dynamics of the twin problem of industrial and trade imbalances in the former East African Common Market mainly between 1962 and 1977. Second, it carries out in-depth evaluations of the effectiveness of mechanisms which were designed to correct the two forms of imbalance. The focus of the study is on the effectiveness of the regional bank, the East African Development Bank, which was supposed to reduce industrial imbalances between Kenya and the other two countries.

The study was undertaken for two major reasons. The first was to highlight the problem of uneven distribution of industries among the member countries of a wholistic[5] form of economic co-operation in the developing world. Industrial imbalances in the East African Common Market had been the principal cause of trade imbalances. Kenya, which had more industries than Tanzania and Uganda, had had a persistent trade surplus with her two partners. These two partners had shown a high degree of sensitivity to their trade deficit with Kenya. That sensitivity was, in the early and mid-1960s, a threat to the economic co-operation which had existed between the three countries since the 1920s[6]. Tanzania, which was less industrialised than Uganda in the 1960s, had also been persistently in trade deficit with Uganda up to 1970.

The second reason for undertaking the study was to investigate the problems encountered in trying to correct industrial imbalances in the East African Common Market.

Here two forms of analysis are carried out. The first concerns an evaluation of the degree of effectiveness which could have been expected from the corrective mechanisms. The second is an actual evaluation of the effectiveness of one of the corrective mechanisms, the East African Development Bank (EADB). This exercise is expected to yield important insights into the effectiveness, or lack of it, of the Bank. Fieldwork research was done on the operation of this regional development bank-cum-financial corporation. In evaluating the effectiveness of "Bank" and the other corrective mechanisms, the causes of industrial imbalances are taken into account.

At the time of starting this study, it was assumed that at some date in the future some form of economic co-operation between Kenya, Tanzania and Uganda would be revived. It was also assumed that in the event such a decision was made, it would be helpful if policy-makers in the three countries had the results of analyses of how the Common Market had operated. It was considered important to show whether or not a balanced distribution of industries among the three partner states was a realistic objective in the absence of a joint policy on industrial development on the Common Market basis.

The decision to revive economic co-operation, on piecemeal basis, was taken by the Heads of States of the three countries in November, 1983[7]. The three States also showed interest in East African economic co-operation involving more than fourteen States[8]. Kenya, Tanzania and Uganda, as well as other Eastern African States, could benefit from the East African Community's experience.

The East African Development Bank, which still operates today, could play a useful part in assisting the realisation of regional co-operation. Its experience in successfully handling political issues which would have wrecked it (the Bank), is invaluable. Also its knowledge of the determinants of performance of projects is very important. According to the new Charter of the Bank, it is no longer expected to reduce industrial imbalances between Kenya on the one hand and Tanzania and Uganda on the other[9].

1.2 Indicators of Magnitudes of Industrial and Trade Imbalances in the EACM

The object of this short section is to provide some indicators of magnitude of industrial and trade imbalances mentioned above. Details concerning the two forms of imbalances and how they changed over the sixteen year period under study are found in Chapters 2, 4 and 5.

In Kenya, the manufacturing sector contributed K. shs. 460 million (the shilling was officially at par in East Africa until 1980) to the gross domestic product in 1962[10]. This was equal to 9.4 per cent of the GDP. In Tanzania and Uganda, their manufacturing sectors contributed T. shs 158 million and U. shs 196 million respectively in the same year[11]. These contributions formed 3.7 per cent of the Tanzanian GDP and 6.2 per cent of the Ugandan GDP. A noteworthy point is that while Kenya was more industrialised than the other two countries, all the three countries were still at very low stages of industrial development.

In 1977, the Kenyan manufacturing sector contributed K. shs 4107 million to the GDP[12]. This amount was equal to 12.7 per cent of the GDP. In Tanzania and Uganda, the manufacturing sectors contributed T. shs 2416 million and U. shs 1309 million to their respective GDP[13]. These contributions correspond to 9.6 per cent of the Tanzanian GDP and to 4.7 per cent of the Ugandan GDP. Notice that while the industrial imbalance between Kenya and Tanzania was smaller by 1977 than it had been in 1962, the imbalance between Kenya and Uganda had increased between the two years. This is explained by the fact that while industrial production in Kenya expanded, in Uganda it collapsed particularly during the Amin administration, from 1971 onwards.

The magnitudes of trade imbalances are shown starting from 1956. The reason for starting from 1956 and not from 1962 is that complaints by policy-makers in Tanzania and Uganda started being vocal in the late 1950s[14]. In 1956, Kenya had a trade surplus of K. shs 93 million with Tanzania and Uganda[15]. The surplus with Tanzania was shs. 39 million and that with Uganda was shs. 54 million. By 1962, Kenya's trade surplus with the two countries had risen to K. shs. 200 million, and Tanzania's trade deficit was T. shs 186 million[16]. In 1976 (the final full year of the operation of the East African Common Market before the closure of the Kenya-Tanzania border, this event virtually brought to an end trade between the two countries) Kenya's trade surplus with Tanzania and Uganda was K. shs 1037 million[17]. This time Tanzania's trade deficit was shs. 391 million and Uganda's was shs. 646 million.[18]

An important question which arises from these statistics is what they tell us about the relationship between industrial and trade imbalances. To begin with, it was seen above that Kenya was the most industrialised member of the East African Common Market. Secondly, it will be seen in Chapters 2 and 5 that manufactured products accounted for a disproportionately large part of Kenya's exports to Tanzania and Uganda. It follows, therefore, that manufactured goods accounted also for a disproportionately large part of Kenya's trade surplus. Tanzania's and Uganda's trade deficit with Kenya was largely due to the fact that they were not able to produce goods such as manufactures for which there was a high demand within these countries and in Kenya. This point is elaborated in Chapters 2 and 5.

Uganda's enormous trade deficit in 1976 was a result of the collapse of industrial production. This meant that the country was not only no longer able to satisfy some of her domestic demand, but she could not also no longer meet the demand for her traditional products in the other two countries.

In Tanzania, industrial production expanded steadily between 1962 and 1977. This led to an increase in the capacity to satisfy both the domestic demand and demand in the other two countries, especially in Kenya. Tanzania's trade deficit of shs. 391 million in 1976 (trade between Tanzania and Uganda was only shs. 7 million of Tanzania's exports to Uganda, nothing was imported from Uganda) was apparently not too alarming to revive the vocal complaints of the 1950s and 1960s. It seems that the absence of complaints was due to the facts that instruments to correct industrial imbalances, (which was the cause of trade imbalances) were in operation and because Tanzanian exports to Kenya had risen. Uganda had herself to blame for the loss of her share of the EACM market.

1.3 Attempts to Render the Operation of the EACM Equitable

Three attempts were made in the 1960s, to render the operation of the East African Common Market equitable. The first was an arrangement called the Distributable Pool which was proposed by the

Raisman Commission in 1960[19]. This arrangement involved the creation of a common fund to which Kenya, Tanzania and Uganda would contribute (see Chapter 4). Kenya, by virtue of being more industrialised and more economically developed, was expected to pay more money into the Distributable Pool than Tanzania and Uganda. Part of that money was expected to meet the costs of running services provided on an East African basis, and the other part was expected to be distributed to the three countries in equal shares. The scheme came into operation in 1961.

Policy-makers in Tanzania and Uganda did not find the Distributable Pool a satisfactory arrangement. This was mainly because it did not tackle the causes of industrial and trade imbalances. In other words, the arrangement did not go to the root causes of the inequitable operation of the Common Market.

Policy-makers in Uganda and especially those in Tanzania, wanted to have mechanisms which would regulate the operation of the Common Market in such a way that both industrial and trade imbalances would be eliminated. A search for such mechanisms started in 1964 (soon after the independence of Kenya in December, 1963) and by 1965 the necessary mechanisms had been found and accepted by the three countries. A document containing these mechanisms was called the Kampala Agreement[20].

This agreement contained two types of corrective instruments. The first type was concerned with the regulation of inter-country trade so that some degree of inter-country trade balance would be achieved. This entailed two methods of controlling inter-country trade. The first was to restrict, by a means of a quota system, the exports of a country which had had a trade surplus with another in the previous year. The second method was to encourage the country which had been in trade deficit with her partners in the previous year, to raise the volume of her exports to them. However, the methods of promoting exports were not specified.

The second type of corrective instruments concerned reducing industrial imbalances. There were two types of corrective mechanisms. The first involved the branching out of industries from Kenya to Tanzania and also from Kenya to Uganda. Firms which had traditionally operated from Kenya to supply the Tanzanian and Ugandan markets were requested to set up branch production units in these two markets. Actually, for some of the firms in question, the decision to establish branch units in Tanzania and Uganda had been taken long before the Kampala Agreement[21]. The motive behind that decision was to pre-empt other firms from gaining a foothold in the markets of Tanzania and Uganda[22]. This would ensure that the traditional suppliers from Kenya would retain their share of the Tanzanian and Ugandan markets. The impetus for the preservation of a captive market was provided by political pressure emanating from Uganda, and especially from Tanzania[23]. There was a threat that unless branch units were set up in the two countries to substitute products formerly imported from Kenya, other new firms willing to do so would capture the market share of the existing firms.

The second mechanism for reducing industrial imbalances was to allocate a number of "East African Industries" to the three countries in such a way that a country which was less industrialised would receive more industries than a country which was more industrialised. Tanzania, because of being the least industrialised member, was allocated the largest number of industries, three of them. Uganda was allocated two "East African Industries", and Kenya was allocated only one such industry. Each of these East African industries was expected to be the sole producer of a given product for the EACM market.

Six industries were too few to have a significant effect on reducing industrial imbalances. Moreover, they were not as large-scale as the East African Oil Refinery[24]. However, an agreement to have East African industries was an important step towards rationalising[25] industrial production on a Common Market basis. This was something that had previously eluded policy-makers in the East African Common Market.

Unfortunately, the Kampala Agreement was never ratified because of disagreement between policy-makers in Kenya and Tanzania over retaining the shilling as a common currency in the EACM[26]. However, some of the branches of industries which were supposed to shift from Kenya to Tanzania and Uganda did so.

The failure to ratify the Kampala Agreement was followed by restrictions of imports from Kenya by the other two countries. To a lesser extent Tanzania restricted imports from Uganda. There was concern in all the three countries that the interference with trade could lead to a serious disruption of all forms of economic co-operation between the three countries.

To avert this imminent disruption of co-operation, the Philip Commission was set up in 1965, the same year in which the Kampala Agreement should have been ratified[27]. The terms of reference for the Commission were to find ways in which economic co-operation between Kenya, Tanzania and Uganda could be strengthened. This involved finding ways in which the cause of trade imbalance, which was industrial imbalance, could be corrected. The Commission proposed two mechanisms for correcting industrial imbalances[28]. The two mechanisms came into operation in December, 1967.

A system of Transfer Taxes was one of the two corrective mechanisms. This was a system of import duties imposed on goods originating from Kenya and

Uganda. Tanzania was entitled to impose such duties on some industrial products from Kenya and Uganda because she was less industrialised than the two countries. Uganda was also entitled to tax some manufactures from Kenya because she was less industrialised than Kenya. The products on which Tanzania and Uganda could legitimately impose the Transfer Taxes were those for which the capacity to produce them domestically was either present or was likely to be installed in a period of three months. Other conditions which had to be fulfilled before the Transfer Taxes could be introduced are found in Chapter 5. Because Kenya was more industrialised than either of the two countries, she was not entitled to impose import duties on her imports from Tanzania and Uganda.

The purpose of the Transfer Taxes was to protect "infant" industries in Tanzania and Uganda so that in future there would be a balanced distribution of industries among the three countries. In other words, tariff protection provided by that system of taxes was supposed to enable a less industrialised member country to catch up with the more industrialised country.

It was expected that after fifteen years the Transfer Taxes would have achieved the objective of bringing about a balanced distribution of industries and would, therefore, be revoked. An *a priori* examination of the measure of success which could have been expected from the Transfer Taxes is carried out in Chapter 5. Because assessing the actual effectiveness of the system requires a lot of data which are extremely difficult to obtain, and whose reliability would be in any case questionable, it was decided not to undertake that exercise. As Hazelwood has observed, "..... admitted ignorance is preferable to a precisely calculated error"[29].

There was an implicit assumption that the presence of the Transfer Taxes would lead to a reduction in intra-EACM trade imbalances. Chapter 5 investigates whether or not in the lifetime of that system of protective tariffs, 1968 to 1977,[30] that goal was achieved. The result of that investigation should provide an idea about whether or not the Transfer Taxes had been effective in reducing the cause of trade imbalances in the EACM.

The other mechanism for correcting industrial imbalances was the East African Development Bank. This mechanism was expected to reduce industrial imbalance between Kanya and the other two countries by lending more money to Tanzania and Uganda. The prescribed formula was that at the end of five years of lending, Tanzania and Uganda should each have been allocated 38.75 per cent and Kenya 22.50 per cent of the total amount lent. This formula, which was a product of political bargaining,[31] did not bear any relation to the degree of industrial imbalance that existed between Kenya and other two countries.

The measure of success the Bank met with as an instrument for correcting imbalances is evaluated in Chapter 6. In that chapter the extent to which the Bank was able to fulfil its other major goal, to make the economies of its three member countries complementary in industrial field, is assessed. The Bank's effectiveness in the first objective is further investigated in Chapter 7 on the basis of performance of projects (whether or not they came into production and were profitable).

1.4 Political and Economic Framework of the Study

The Political Case

This section provides brief political and economic cases for correcting industrial and trade imbalances in the former East African Common Market. The main political case was to create political goodwill towards economic co-operation among the policy-makers in Tanzania and Uganda. It will be recalled that political sensitivity arising from industrial and trade imbalances threatened to disrupt the East African Common Market in the 1960s. In fact, policy-makers in Tanzania at one time issued a warning that they intended to pursue certain economic policies which were incompatible with economic co-operation unless the Common Market was made to operate in a more equitable manner than it had done in the past[32]. Tanzania's separatist stance was partly a result of disillusionment, because policy-makers in Kenya and Uganda could not accept the federation of the three countries which she had advocated[33].

In a federation, it is most likely that agreement on joint economic policies to be carried out among the member countries will be arrived at. One of such policies in the East African Common Market would have been a joint policy on industrial development on the Common Market basis. Such a joint policy might have made it possible to find ways in which a more even distribution of industries among the three countries could be brought about.

Federation had eluded Kenya, Tanzania and Uganda in spite of co-operation in many fields. The latter two countries had, at different times, found it to be against their economic and political interests to be involved in a close political co-operation. For instance, in the early colonial period, 1920s and 1930s, policy-makers in Tanganyika had complained that the protection of Kenyan industries which was enforced in the three East African territories, had harmed the consumers in Tanganyika. This complaint was found to be a legitimate one by Armitage-Smith, an independent investigator from the Colonial Office in London.[34]

In the 1920s and 1930s, Tanganyika did not have any industries which could benefit from the tariff protection enforced in the three East African territories. These tariffs were, therefore, seen by the policy-makers in Tanganyika as serving the economic interest of Kenya at the expense of Tanganyika. If the latter had also had industries whose products were protected in the East African market, it is probable that her policy-makers would have overlooked both the national income and import duty revenue which were being sacrificed. Import duty was sacrificed because the three territories did not levy import duty on the goods they imported from each other since the three territories were a customs union.

Economics and politics, as is often the case, were intertwined. Policy-makers in Tanganyika and Uganda had in the past feared that in a federation, the European settlers in Kenya would dominate the indigenous people who formed the vast majority. For Tanganyika, that fear seemed to have disappeared around the time of independence of the three territories in the early 1960s. Nyerere pressed for the federation of the three territories[35]. Policy-makers in Kenya seemed at first to be committed to the East African federation[36]. As will be explained in Chapter 6, policy-makers in Uganda were still opposed to an East African federation in the early 1960s. This was partly because of apprehension that the economic welfare of the small scale farmer in Uganda would deteriorate and, more importantly, because some influential ethnic groups in the country suspected that they would lose their political power in a federation[37]. There were also other obstacles concerning power sharing (see Chapter 6). Policy-makers in Tanzania and Kenya had not gone far in seeking to reach an agreement on that matter. Instead, the two countries had started accusing each other of being the cause of the delay of the federation[38].

In this connection, Nyerere observed in the early 1960s that the longer the time it took to federate, the more likely it was that a sense of patriotism (self-interest) would hinder federation in the future[39]. This observation turned out to be prophetic and it meant a loss of an opportunity to create an environment that would have facilitated the rationalisation of emergent industrial structure in the East African Common Market. This point is borne in mind when assessing the effectiveness of the Bank as an instrument for making its member countries increasingly complementary in industrial field.

While it would now be unrealistic to expect that there would be a federation of Kenya, Tanzania and Uganda in the foreseeable future, it must be stressed that some form of political co-operation between these countries is essential for exploiting the potential benefits from economic co-operation. The same argument applies also to other Eastern African and West African countries which have shown interest in regional economic co-operation.

The Economic Case

The economic case for correcting industrial imbalances in the former East African Common Market is examined from three angles. The first is that industries established in Kenya before Tanzania and Uganda began to promote their own industrial development forestalled the establishment of similar industries in those two countries. There is no evidence that this happened. On the contrary, Tanzania and Uganda in their drive to industrialise in the early and the mid-1960s, set up many industries to substitute for goods formerly imported from Kenya[40]. Kenya substituted some of industrial goods from the two countries, on a significant scale, later.

In any case, what policy-makers in Tanzania and Uganda ought to have placed high on their list of industrial development was to select those industries which would reap the benefits of economies of scale by producing for the East African market. Unfortunately, the history of the East African Licensing Board shows that an orderly development of industries which would have avoided duplication or triplication of industries in the EACM was not achieved.[41] Each country seemed to want to set up an industry similar to one already in existence in another country. The tendency for each country to be self-sufficient, which had been identified in the 1950s[42], was still present in the 1960s and 1970s[43]. A more detailed discussion of rationalisation of industrial production in the EACM is found in Chapters 4 and 6.

The second case for correcting industrial imbalances was to be found in anticipated benefits from the creation of employment for the resources of the less industrialised countries and in structural transformation of their economies. By setting up industries in Tanzania and Uganda, where relatively few existed, industrial growth poles would be created and future development of industries would depend on such growth poles[44]. This seems to have been a strong argument. The creation of industrial growth poles is closely related to the theory of circular and cumulative causation in the sense that a region which has a concentration of economic activities is likely to be a more attractive location for other new economic activities than a region where economic activities are sparse.[45] The theory of circular and cumulative causation and its relevance to the East African Common Market are discussed in Chapter 3.

The third case for correcting industrial imbalances by setting up industries in Tanzania and Uganda rested on the reduction in the price the consumer would pay for a good produced domestically. This applied to the types of industries whose products were bulky and expensive to transport from Kenya where they had traditionally been produced, to Tanzania and Uganda where they were consumed. Such industries included soft drinks, beer brewery and cement. It was advantageous, in terms of reducing the transportation costs, that those industries should be located near the main national markets[46]. However, the consumer would benefit if other major components of cost for producing a good were at least equal to those in Kenya.

The case for correcting trade imbalances was to be found in solving the balance of payments "problem". But the case for "solving" the balance of payments "problem" was a weak one because the solution proposed by the Kampala Agreement involved reducing the volume of intra-common market trade. In order for the member countries to attain rapid economic growth rates, fast expansion of the volume of trade was required. It must be realised that a balance of trade deficit does not necessarily inhibit economic growth, especially if these partner states are not each other's major trading partners, as was the case with Kenya, Tanzania and Uganda[47]. This point is demonstrated by the fact that the Kenyan economy grew faster than Tanzania's and Uganda's between 1954 and 1960, despite her persistent overall balance of trade deficit[48]. That point is further illustrated by the fact that despite America's massive trade deficit of $107 billion in 1984, her GNP grew at a very high rate of 6.8 per cent.[49]

1.5 Plan of Thesis and Contributions

This chapter tried to create a framework for the thesis by outlining the major issues related to the two themes of this study, industrial and trade imbalances in the former East African Common Market (EACM). The major issues are discussed in detail in the rest of the thesis.

Chapter 2 does three main things. First, it examines some of the major economic indicators of the EACM economies and analyses the changes in those indicators which occurred between 1954 and 1961. The main areas of interest in this exercise are the changes which took place in industrial and trade imbalances in the EACM. Second, the historical origin of industrial disparities are examined. Third, a causal relationship between industrial imbalance and trade imbalance is examined. The findings in chapter 2 serve two purposes. To begin with, some are used in the assessment of the relevance of the customs union theory to the EACM in the next chapter. The other function is to provide inputs when measures designed to correct industrial imbalances are critically examined in chapters 4 and 5.

Chapter 3 reviews several strands of economic theory in which the study is placed. The relevance of those theories to the situation that obtained in the EACM is examined.

Chapter 4 carries out four types of analyses designed to shed more light on industrial and trade imbalances. First, it examines critically the Distributable Pool as an instrument for making the EACM more equitable than it had been in the past. Second, other corrective mechanisms in the Kampala Agreement are subjected to a close and critical examination. This examination utilizes some of the findings in chapters 2 and 3. The third type of analysis involves investigating the role market forces played in cross-border flow of investments into the manufacturing sectors of Kenya, Tanzania and Uganda. The primary point of interest is what motivated such flow of investments. Finally, the changes in both industrial production and inter-country trade imbalances which took place during the period covered by this chapter, 1962-1967, are analysed. The aim is to show whether or not the two forms of imbalances widened.

Chapter 5 also carries out analyses intended to offer further insights into the twin problem of industrial disparities and trade imbalances in the EACM. The chapter covers the 1968-1977 period when the two instruments meant to reduce the two forms of imbalances were in operation. The first type of analysis undertaken is the examination, on an a priori basis, of the degree of effectiveness which could realistically be expected from the Transfer Taxes. Secondly, the changes which occurred in industrial production in Kenya, Tanzania and Uganda during the ten year period are analysed. The object of this exercise is to establish whether or not the general trend was one of a reduction in industrial imbalances. A general hypothesis here is that there was too strong a trend towards the divergence of industrial imbalances which could not be substantially offset by the results of the Transfer Taxes.

The fourth type of analysis is an examination of the changes in the intra-EACM trade also between 1968 and 1977. The aim of this exercise is to show the relationship between the industrial performance of the three countries and the pattern of their imports and exports. The expected relationship is that as industrial production of a country increased, so did her export capacity. It is also expected that due to the collapse of industrial production in Uganda, her exports to Kenya and Tanzania would decline but her imports from them would increase.

Chapter 6 evaluates the effectiveness of the East African Development Bank (EADB) in its two principal goals, the reduction of industrial imbalances and making the economies of its member countries industrially complementary. In evaluating how effective the EADB was as an instrument for reducing industrial imbalances, its performance is viewed from three perspectives. The first is whether or not it allocated funds to the three member countries according to the formula prescribed by its Charter. The second is the "fund absorptive achievement" of each country. This term refers to that fraction of the total funds allocated to each country which had been disbursed at the end of a given period. The third perspective is a comparison of the Bank's (EADB) "balancing effect" and the Non-Bank (sources of finance other than the Bank) "disparity effect". The results of this analysis should show how important or how marginal the EADB was in offsetting a common tendency for unequal capacity among members of an economic integration scheme to generate investments.[50]

Chapter 7 further investigates the effectiveness of the EADB, but from two new angles. The Bank's measure of success it achieved in reducing industrial imbalances is this time assessed on the basis of the performance of projects it cofinanced. Performance refers to whether or not a project came into operation as had been planned and also whether or not the project became profitable. All the projects are classified into three, large, medium and small scale. The main consideration in that classification is to study how the success or failure of projects in the three classes and in the three countries affected the Bank's achievement of its primary task of reducing industrial imbalances between Kenya and the other two countries. It is the amounts of investment in the successful projects in Kenya vis a vis the amount of investment in similar projects in either Tanzania or Uganda which are the focus of comparison.

Chapter 7 also examines the factors which determined the performance of projects. An important question which will be answered in the course of this examination is the extent to which the EADB controlled the determinants of success of projects. Its effectiveness is dependent on it having very significant influence over the success of projects.

Chapter 8 summarises the main findings of the study. Important lessons of experience from the operation of the East African economic integration scheme are highlighted. Existing or future economic blocks in the developing world could benefit from such lessons. The chapter also contains suggestions on how the EADB could in the future contribute more to the economic growth of its member countries than it has done in the past.

Contributions

A broad contribution of this study is to fill the existing gap in the knowledge about the nature, the causes and the dynamics of industrial and trade imbalances in the EACM from 1962 to 1977. The author is not aware of any other study that has dealt with these two causally related issues in the EACM for a sixteen year period.

The following specific contributions have been made. First, the study shows how unrealistic it is to try to bring about balanced industrial development and to eliminate intra-EACM trade imbalances in an environment which is predominantly competitive.

Second, it is shown why the EADB was an ineffective instrument for reducing industrial imbalances and for bringing about industrial complementarity among its three member countries. To begin with, it is demonstrated that the availability of finance, per se, does not lead to a reduction in effective investment differentials among members of an economic integration scheme. The term effective investment refers to the amount of finance involved in the successful projects.

The study also shows that the EADB's "balancing effect" was overwhelmingly offset by the "disparity effect" of the Non-Bank (the two terms are defined in chapter 6).

The final set of contributions also arise from the evaluation of the performance of EADB as shown by the success or failure of projects. A careful examination of the determinants of success and failure of projects offers insights of how the EADB could contribute to the economic growth of its member countries.

Notes

1. Economic co-operation between countries is usually classified in four stages. The first is where there exists agreement on free trade and where there are no restrictions on trade between some countries. The second stage, which is called a customs union area, involves, in addition to free trade between certain countries, the presence of a common external tariff. The third stage is a common market which, in addition to having the elements of the second stage has, involves also a free movement of factors of production between member countries. The fourth stage is an economic union. This is characterized by free trade, a common external tariff, free movement of factors between member countries, and an agreement on fiscal, monetary and other instruments of economic policy. The East African economic integration scheme was at the third stage and also had a leg in the fourth stage because of monetary integration between the three partner states from 1929 to 1966. There was also some co-operation in the fiscal field. For the four stages of economic co-operation cited above, see P. Robson (1968), Economic Integration in Africa, (London: George Allen and Unwin), p. 25.

2. Treaty for East African Co-operation, (Nairobi: Kenya Government Printer on behalf of the East African Common Services Organisation, 1967).

3. K. Hall and B. Blake (1974), "The Caribbean Community: Administrative and Institutional Aspects", Journal of Common Market Studies, Volume 16, p. 212.

4. B. Balassa (1973), "Tariff and Trade Policy in the Andean Common Market", Journal of Common Market Studies, Volume 12, p. 177.

5. Vaitsos uses a term wholistic to describe a comprehensive form of economic co-operation between member countries. It is the opposite of piecemeal co-operation, which involves selecting a few specific economic fields in which co-operation will take place. See C.V. Vaitsos (1978), "Crisis in Regional Economic Co-operation among Developing Countries: A Survey", World Development, Volume 6, pp. 719-769.

6. For a summary and analysis of the early history of the East African economic co-operation, see T.A. Kennedy (1959), "The East African Customs Union: Some Features of its History and Operation", Makerere Journal, Number 3.

7. See Financial Times (London), 15 and 18 November, 1983. The prospects of economic co-operation in 1987 are now remote. But it would be a foolhardy person to predict that there is no hope at all in the future.

8. See The Times (London), 10 July, 1984.

9. See Charter of East African Development Bank, 23rd July, 1980.

10. Computed from United Nations (1964), Yearbook of National Accounts Statistics, 1963, (New York: United Nations).

11. Ibid.

12. Computed from United Nations (1978), Yearbook of National Accounts Statistics, 1977, (New York: United Nations).

13. Ibid.

14. See D.A. Low and A. Smith (eds.) (1976), History of East Africa, Volume III, (Oxford: Clarendon Press), p. 347.

15. Computed from Economic and Statistical Review of East African Statistical Department, 1956.

16. Computed from Economic and Statistical Review of East African Statistical Department, 1962.

17. Computed from Economic and Statistical Review of East African Statistical Department, 1976.

18. Ibid.

19. Colonial Office, East Africa: Report of the Economic and Fiscal Commission, Cmnd 1279 (London: HMSO, 1961).

20. "Document: The Kampala Agreement", East African Journal, April, 1965.

21. For instance, a factory manufacturing cigarettes had been set up in Dar-es-Salaam in 1961, around that time, the existing brewery plant in Dar-es-Salaam was also expanded and re-equipped.

22. F.I. Nixson (1973), Economic Integration and Industrial Location, (Longman: London), p. 70.

23. See J.S. Nye (1966), Pan-Africanism and East African Integration, (London: Harvard University Press), pp. 155-158 and p. 205.

24. This industry contributed nearly 25 per cent of the total industrial production in Kenya. See P. Zajadacz (ed.) (1970), Studies in Production and Trade in East Africa, (New York: Humanities Press), p. 176.

25. The term "rationalisation" which was often used in the 1930s meant reorganising industries where there was excess capacity due to a fall in demand for a given product or where the economies of large scale production were so significant that it was economically advantageous to concentrate production at a smaller number of plants - see J.L. Hanson (1974), A Dictionary of Economics and Commerce, (London: Macdonald and Evans), p. 402.

26. The East African Currency Board which issued the shilling to Kenya, Tanzania and Uganda, ceased to do so in 1966 when the central banks of the three countries started to issue national currency. However, the shilling issued by those banks remained officially at par. Policy-makers in Tanzania found the Currency Board too rigid an instrument of monetary control because it severely restricted the amount of local currency which could be issued. Those policy-makers argued that the restriction of issue of currency would retard the economic development of Tanzania. Hazlewood has pointed out the difficulties arising from one member country of common market pursuing an expansionary monetary policy when other members do not. See A. Hazlewood (1967) African Integration and Disintegration, (London: Oxford University Press), p. 108.

27. The Philip Commission comprised Professor Kjeld Philip, a Danish expatriate, and representatives of Kenya, Tanzania and Uganda.

28. See Treaty for East African Co-operation, op. cit., Chapter 5 for Transfer Taxes and Annex 6 for the Charter of the East African Development Bank.

29. A. Hazlewood (1964), Rail and Road in East Africa, (Oxford: Blackwell), p. 82.

30. The Transfer Taxes came into operation in December, 1967, and came automatically to an end when the East African Community broke up in July, 1977.

31. I learnt from my correspondence with Professor R.H. Green that the original formula was 20:40:40. Political bargaining changed it to 22.50:38.75:38.75, a reduction which was in the interest of Kenya.

32. See F.I. Nixson (1973), Economic Integration and Industrial Location; An East African Case Study, (London: Longman), p. 35.

33. There were two broad factors which hindered political federation. One was that because influential ethnic groups in Uganda were opposed to the East African federation, the Ugandan Prime Minister was not enthusiastic about the idea. The second factor is that there were a number of important issues concerning power sharing and other matters for which no agreement had been reached. See D. Rothchild (1968), Politics of Integration: An East African Documentary, (Nairobi: East African Publishing House).

34. Armitage-Smith found out that the consequence of protecting Kenya-based industries was to deplete Tanganyika's revenue and impoverish her citizens. See British Parliamentary Papers, Cmd. 4182, 1932, p. 25.

35. See Rothchild, op. cit., pp. 68-75.

36. See Nye, op. cit., pp. 183-186.

37. Ibid., p. 189.

38. Rothchild, op. cit., pp. 162-3.

39. See C. Leys and P. Robson (eds.) (1965), Federation in East Africa: Opportunities and Problems, (Nairobi: Oxford University Press), p. 4.

40. Examples of such industries are brewery, shoes, glass, paint, soap, safety matches, and oil refinery. See Zajadacz, op. cit., pp. 135-198. However, industries were also set up in Kenya to substitute for products which were formerly imported from Tanzania. Cases in point are sugar, textiles, iron and steel and motor car tyres and tubes. The substitution mentioned above was a testimony of the failure to rationalise industrial production in the East African Common Market. Vested interest groups (businessmen) contributed to that failure. See Y.P. Ghai (1974), "East African Industrial Licensing System: A Device for the Regional Allocation of Industry?", Journal of Common Market Studies, Volume 12, p. 285.

41. Ibid., pp. 265-295.

42. See Low and Smith, op. cit., p. 337.

43. The tendency towards self-sufficiency in the 1970s was largely due to the scarcity of foreign exchange, especially before the tea and coffee "boom" of the mid 1970s. See D.P. Ghai (1974), "State Trading and Regional Economic Integration: The East African Experience", Journal of Common Market Studies, Volume 12, pp. 312-315.

44. For a discussion of "growth poles", see A.O. Hirschman (1958), The Strategy of Economic Development, (New Haven: Yale University Press), Chapter 10.

45. See G. Myrdal (1957), Economic Theory and Underdeveloped Regions, (London: Duckworth).

46. For the transport costs as determinants of location costs in the East African context - see Nixson, op. cit., pp. 39-47.

47. The interterritorial trade as a percentage of total external trade in the East African Common Market was in 1962, 22, 22 and 16 per cent for Kenya, Uganda and Tanganyika, respectively. See East African Common Services Organisation, Economic and Statistical Review, June, 1963, Table D. 19.

48. The growth rates in Kenya, Uganda and Tanganyika, in current prices, were 6, 2.5 and 4.6 per cent, respectively. See C.P. Haddon-Cave, "Real Growth of East African Territories, 1954-60", East African Economics Review, June, 1961, p. 37.

49. The Guardian (London), 11 April, 1985.

50. Even in a very advanced economic integration scheme, such as the European Economic Community, there are significant differences in capacity to generate investment. See European Investment Bank, Investment in the Community in 1975 and its Financing, EIB Research Department, p. 4.

CHAPTER 2

THE BACKGROUND

2.1 Introduction

This chapter provides the background information which should facilitate more understanding of the two themes of this study, the industrial and trade imbalances in the former East African Common Market (EACM). The main cause of the trade imbalances among the members of the EACM, as was explained in chapter 1, was the uneven distribution of manufacturing industries. This is because a disproportionately large share of the goods entering the intra-EACM trade were manufactures.

The background information supplied falls into three categories. First, major economic characteristics of the three economies of the EACM are discussed. Second, the changes in industrial and trade imbalances which occurred between 1950 and 1961 are analysed. Third, the origins of industrial imbalances in the EACM are examined with a view to identifying the factors which brought about the industrial disparities in the EACM. The circular and cumulative causation theory, which is explained in chapter 3, is borne in mind in the course of that examination.

The period covered by this chapter is from 1945 to 1961. But the focus is on the 1954-61 period during which time complaints about the unsatisfactory operation of the EACM were often expressed. It was mentioned in chapter 1 that those complaints were vociferously expressed by policy-makers in Tanzania. Policy-makers in Uganda also wanted the EACM to be regulated in a manner which would bring more benefits to their country than had been the case in the past.

For Tanzania, the unsatisfactory operation of the EACM had been voiced on her behalf in the past by two prominent outsiders. Sir Sydney Armitage-Smith, as was seen in chapter 1, after a fact-finding mission to Tanganyika in the early 1930s, recommended that ..... "Tanganyika should cease to deplete her revenue and impoverish her citizens by protecting the products of her neighbours"[1]. And Viner (1950) in his famous study of customs union arrangements observed that Tanganyika was primarily brought into the East African Customs Union ..... "to provide an expanded field for the tariff protection of industries of another territory"[2] (Kenya).

By the mid 1950s, policy-makers in Tanzania were more actively involved in a scheme to ensure that in future industries to be set up in the EACM would be equitably distributed among the three member countries.[3] Also around this time, plans designed to improve the economic welfare of Tanzanians were in place. As will be seen in section 2.3, similar plans had been implemented in both Kenya and Uganda earlier.

2.2 Some Economic Characteristics of the East African Common Market Economies

The economic characteristics to be analysed and discussed in this chapter are the gross domestic product, the role of the agricultural and the manufacturing sectors, the employment provided by the latter sector and the effect of intra-EACM trade as well as the external trade of Kenya, Tanzania and Uganda on their balance of payments position. Analyses carried out are comparative; results for Kenya are compared with those for Tanzania and Uganda. This approach is adopted because complaints about both industrial and trade imbalances arose mainly from the fact that Kenya had a more industrialised sector and was always in balance of trade surplus with the other two countries.

Gross Domestic Product

Table 2.1 below shows, *inter alia*, the gross domestic products of Kenya, Tanzania and Uganda between 1954 and 1961. Throughout this period, the Kenyan GDP was greater than that of either of the two countries, and Tanzania's GDP was greater than Uganda's. The disparity between Kenya's GDP and that of Tanzania almost doubled between 1954 and 1961. In the former year, the disparity in favour of Kenya was shs. 328 million and in the latter year it was shs. 624 million. The disparity between Kenya and Uganda increased even more substantially.

TABLE 2.1: GDP and Contributions of Agriculture and Manufacturing Sectors in EACM, 1954-1961

(in millions of shillings and in percentages)

Year	KENYA:			TANZANIA:			UGANDA:		
	GDP (1)	AGRIC (2) as % of (1)	MFR (3) as % of (1)	GDP (1)	AGRIC (2) as % of (1)	MFR (3) as % of (1)	GDP (1)	AGRIC (2) as % of (1)	MFR (3) as % of (1)
1954	3160	46.8	8.9	2832	62	2.6	2574	69	5.3
1956	3863	43.0	9.4	3048	61	4.0	2832	64	7.1
1958	4162	41.9	9.5	3342	59	4.0	2936	62	6.0
1960	4510	40.0	8.9	3701	60	3.9	3042	61	5.9
1961	4494	38.5	9.6	3870	59	4.1	3128	61	6.4

Sources: Computed from data obtained from:

1. Republic of Kenya, Statistical Abstracts, various years.
2. United Republic of Tanzania, Statistical Abstracts, various years.
3. Republic of Uganda, Statistical Abstracts, 1961 and 1965.

In 1954, it stood at shs. 586 million and by 1961 it had risen to shs. 1366 million.

These divergencies indicate, of course, the unequal expansion of the national economies in the East African Common Market. The expansion which took place in the three economies between 1954 and 1961 were shs. 1334, 1038 and shs. 554 million for Kenya, Tanzania and Uganda, respectively.

Agricultural Sector as the Foundation of EACM Economies

The importance of the agricultural sector as the foundation of the economies of Tanzania and Uganda can be seen from Table 2.1. Column 2 under each country shows that this sector contributed, in 1954, 62 and 69 per cent to the gross domestic products of Tanzania and Uganda, respectively. By 1961, the importance of that sector had slightly declined in Tanzania; its contribution this time was 59 per cent. The decline in Uganda was more substantial from 69 per cent in 1954 to 61 per cent in 1961. In spite of the fall in importance of the agricultural sector in percentage terms, this sector's contribution in absolute terms increased between the two years. The increase in Tanzania was shs. 527 million and in Uganda it was shs. 132 million.

In Kenya, the agricultural sector was also the backbone of the economy. It was the single most important sector in the economy. The fact that its contribution to the GDP in both 1954 and 1961, as Table 2.1 indicates, was the least in the East African Common Market was because the Kenyan economy was not only more diversified than the other two countries' economies, but also because it had other important sectors, such as commerce and trade.[4]

Table 2.1 also indicates that the importance of the agricultural sector declined from 46.8 per cent in 1954 to 38.5 per cent by 1961. However, its contribution, in absolute terms, to the Kenyan gross domestic product increased between the two years by shs. 251 million, in current prices. This magnitude of increase was greater than had been achieved in Uganda, but it was also less than a half of what had been gained in Tanzania.

Despite the fact that the agricultural sector performed best in Tanzania, her policy-makers were not satisfied. They wanted to increase the contribution of the manufacturing sector to the economy. Section 2.3 shows that the plan to achieve that objective had been implemented in 1956. Kenya and Uganda, as will also be seen in that section, had tried to develop their industrial sectors before Tanzania did.

The Manufacturing Sector

Table 2.1, column 3 under each country, shows the contribution of the manufacturing sector to the gross domestic product. It is noteworthy that the contribution of that sector was in all the three countries under 10 per cent; a fact which underscores how underdeveloped that sector was in the EACM. The degree of its underdevelopment, as the table indicates, was uneven. In Kenya, the share of the manufacturing sector in the GDP in 1954 was 8.9 per cent in Tanzania and Uganda, the shares of that sector in their GDP were 2.6 and 5.3 per cent, respectively. Kenya had, therefore, the most developed industrial sector, Tanzania was the least industrialised economy in the EACM and Uganda occupied an intermediate position. Uganda was slightly nearer Tanzania than Kenya on the scale of industrial underdevelopment.

It may be seen from 2.1 that the share of the manufacturing sector in the GDP rose in all the three countries between 1954 and 1961. Kenya registered 0.7 per cent rise, the increase in Tanzania was 1.5 per cent and in Uganda it was 1.1 per cent. However, in absolute terms, the greatest expansion was achieved in Kenya, shs. 150 million, compared to shs. 85 million in Tanzania, and shs. 64 million in Uganda.

For Kenya and Tanzania, there had been a movement towards the reduction of industrial imbalances. The disparity ratio in favour of Kenya had been in 1954 3.8 to 1. By 1961 the ratio had come down to 2.7 to 1.[5] This reduction in industrial imbalances was largely due to two factors. The first is the active Tanzanian Government's involvement in the second half of the 1950s in the development of the manufacturing sector. The second is the decline of investment in the Kenyan manufacturing sector in the late 1950s. These two factors are discussed again in section 2.3.

For Kenya and Uganda, the industrial imbalance in favour of the former hardly changed between 1954 and 1961. The ratio of disparity was 2 to 1 in 1961 and 2.1 to 1 in 1961, marginal divergence in industrial imbalance.

Employment Provided by Manufacturing Sectors of EACM

Industrial imbalances seen above are also reflected in employment provided by the manufacturing sectors of the three countries. Table 2.2 below indicates that the Kenyan manufacturing sector employed more people than did the Tanzanian or the Uganda manufacturing sectors. In 1954, 41 thousand people were employed in the Kenyan manufacturing sector, while 20 thousand people were employed by the similar sector in Tanzania.

In Kenya, the employment in the manufacturing sector formed, as Table 2.1 indicates, 9.1 per cent of

TABLE 2.2: Employment in Kenya, Tanzania and Uganda, 1954-61 (in thousands)

Year	KENYA:			TANZANIA:			UGANDA:		
	Total (1)	Mfr (2)	(2) as % of (1)	Total (1)	Mfr (2)	(2) as % of (1)	Total (1)	Mfr (2)	(2) as % of (1)
1954	448	41	9.1	388	20	5.1	207	32	15.6
1956	498	46	9.2	371	17	4.6	205	34	16.6
1958	490	46	9.4	374	21	5.6	207	31	15.0
1960	513	43	8.4	343	19	5.5	202	31	15.3
1961	489	36	7.4	362	24	6.6	195	25	12.8

Sources: Computed from statistics supplied by:

1. East African Statistical Department, Quarterly Economic and Statistical Bureau for 1950-58.
2. East African Economic and Statistical Reviews for 1959-62.
3. Tanganyika Central Statistical Bureau, Statistical Abstract, 1963 for 1961.

the total employment recorded for 1954. The corresponding percentage in Tanzania was 5.1. These low percentages once again underscore the extent of industrial underdevelopment. The percentages would have been even lower had every member of the labour force been recorded. A large proportion of the labour force in the subsistence, the non-monetary sector, was not included in the labour statistics.

The disparity in the manufacturing sector employment between Kenya and Uganda in 1954 was only 9 thousand people. It is noteworthy that employment provided by the Ugandan manufacturing sector formed 15.6 per cent of the total labour force recorded for 1954. The main explanation for this relatively high proportion (in comparison with Kenya and Tanzania) is that the labour force registered in Uganda was about 46 per cent of that in Kenya and about 53 per cent that of Tanzania. In other words, there were far fewer people in gainful employment in Uganda than in the other two countries.

By 1961 employment in both the Kenyan and the Ugandan manufacturing sectors was below the 1954 level. The fall in Kenya was 5 thousand and it was 7 thousand for Uganda. In both countries, as Table 2.2 shows, there had been an increase in employment between 1954 and 1956. For Kenya, the same level of employment was maintained in 1958 and then there was a steady decline in the subsequent three years. For Uganda, employment fell between 1956 and 1958, remained at that level in 1960 and then sharply fell in 1961. This poor performance in Uganda was an integral part of the unsatisfactory performance of the entire economy.

Tanzania was the only country which experienced an increase in employment in the manufacturing sector between 1954 and 1961. The increase was 4 thousand people. However, it may be seen from Table 2.2, that the number of people employed in that sector had fluctuated between the two years.

The fact that Kenya had more people who had acquired experience in factories than the other two countries, would be expected to lead to the persistence of industrial disparities in the EACM. An industrialist intending to produce for the EACM would be interested to set up a plant in a country with a larger pool of experienced industrial workers. This would be particularly the case for investors who had no programmes for training their own staff. It will be seen in chapter 7 that the availability of skilled workers was one of the determinants of the success or failure of projects.

Balance of Trade Position of EACM Countries

As a prelude to examining the intra-East African Common Market trade position of individual country, its trade position with the external world is discussed.

This helps to put the intra-EACM trade in the overall context.

Kenya had, in 1954, a balance of trade deficit with the external world (countries other than her two partners in the EACM) of shs. 753 million.[6] Tanzania and Uganda on the other hand, had trade surplus of shs. 98 and shs. 317 million, respectively.[7] By 1960, Kenya was still in trade deficit, but the magnitude of the deficit was substantially lower than it had been in 1954; it was now shs. 600 million.[8] This reduction was due mainly to the fact exports had risen faster than imports.

Tanzania and Uganda had not only maintained their trade surplus by 1960, but the magnitudes of surplus were also higher than they had been in 1954. The increase for Tanzania was by shs. 253 million, and that for Uganda was shs. 21 million.[9] The Tanzanian impressive performance is attributable to the increase in volume of both the exports of agricultural produce and some other items such as diamonds. It was also due to the fact that exports grew faster than imports. Although Tanzania's balance of trade position with the external world improved spectacularly more than Uganda's between 1954 and 1960, there was little difference in their overall balance of trade surplus. Tanzania's surplus in 1960 was shs. 351 million while Uganda's was shs. 338 million.[10]

It is noteworthy that the two countries trade surplus with the external world was persistent between 1954 and

1960. One may, therefore, wonder why their policy-makers were concerned about trade deficit in the intra-EACM trade. An examination of the effect of individual country's intra-EACM trade position on its balance of payments position will throw light on that question.

Kenya had a persistent trade surplus with both Tanzania and Uganda, an obverse position to that seen above concerning her trade position with the external world. Kenya's trade surplus with her two partners was modest in 1954, shs. 31 million.[11] This marginally offset her huge trade deficit of shs. 753 million with the external world seen above. By 1960, her trade surplus with Tanzania and Uganda had risen to shs. 135 million.[12] This time, Kenya's trade deficit with the external world (shs. 600 million) was substantially offset.

Tanzania had a persistent trade deficit with Kenya and Uganda. For example, in 1954 her trade deficit was shs. 71 million.[13] This meant that the overall balance of trade was shs. 27 million. It will be recalled that her balance of trade position with the external world had been, in the same year, one of surplus, shs. 98 million. In other words, Tanzania's trade with Kenya and Uganda caused a deterioration in her balance of payments. By 1960, Tanzania's trade deficit with her two partners had gone up to shs. 137 million. The consequence of this deficit on Tanzania's balance of payments was to reduce the surplus of shs. 351 million she had with the external world to shs. 214 million.

In order to understand why policy-makers in Tanzania targeted complaints about trade imbalances on Kenya, her (Tanzania's) deficit in intra-EACM trade must be split between Kenya and Uganda. In 1960, Tanzania's deficit with Kenya was shs. 114.7 million and Tanzania's deficit with Uganda was only shs. 22.5 million. This meant that 84 per cent of that country's trade deficit was due to her trade position with Kenya. Therefore, Tanzanian policy-makers were correct in identifying the Kenya - Tanzania trade as the primary problem to be tackled.

Uganda was, in 1954, the only country in the EACM which enjoyed trade surplus with both the external world and her partner states. Her surplus with Kenya and Tanzania was shs. 91.6 million.[14] And her trade surplus with the external world, as was noted above, was shs. 317 million. With an overall trade surplus of shs. 408.6 million, Uganda's balance of payments position was the strongest in the EACM. It is not surprising, therefore, that Ugandan policy-makers were not vocal with regard to the intra-EACM trade imbalances.

By 1960, Uganda's position in intra-EACM trade had sharply deteriorated. Her trade surplus with Kenya and Tanzania had shrunk to a mere shs. 1.6 million.[15] There are two main explanations for this deterioration. The first is that Uganda's exports to her partner states shrunk, while those partners' exports to her, particularly Kenya's, expanded. The second explanation which is closely bound up with the first, is that there was a transfer of a cigarette plant from Uganda to Kenya in 1956. Cigarettes used to form a substantial part of Uganda's exports to the other two countries. By 1960, Uganda was instead importing such products from Kenya. Despite the deterioration in Uganda's trade position in the intra-EACM trade, she was in 1960 in trade surplus with Tanzania to the tune of shs. 22.5 million. Moreover, her balance of payments position in 1960 was still that of surplus, shs. 339.6 million. This may explain why the Ugandan policy-makers did not complain much about the intra-EACM trade imbalances.

From the standpoint of balance of payments, the freedom of intra-EACM trade was most beneficial to Kenya, was harmful to Tanzania, and beneficial to a small extent to Uganda. This state of affairs had arisen because of the uneven distribution of industries between Kenya, Tanzania and Uganda. It will be recalled that because most goods entering the intra-EACM were manufactures, a country with more export-oriented industries than others was always in trade surplus. It will also be recalled that there was a high degree of inter-country trade, as is to be expected in a common market.

2.3 The Origins of Industrial Imbalances in EACM

This section explains how industrial imbalances between Kenya, Tanzania and Uganda came about. Factors which helped or hindered industrial development in the three countries are discussed. An important point which the section tries to bring out is that the industrial development in the three member countries of the East African Common Market seems to fit in the pattern of early-late starter.

2.3.1 Industrial Development in Kenya, 1945-1963

Kenya was ahead of the other two countries in industrial development as early as the 1920s.[16] She had more industries processing domestic agricultural produce for the East African market than the other two countries did.

Those industries were started mainly by the European settlers in Kenya and British firms. By the end of the Second World War, Kenya had extended her industrial lead.[17] This was partly because before that War the colonial policy which generally discouraged industrial development in the colonies, did not strictly apply to Kenya as it did to Tanzania and Uganda.[18] The other part of the explanation is that during the War, the Colonial Office was even more liberal than before towards Kenya's attempt to substitute the manufactured products which were difficult to obtain in East Africa because of the general risks to ships.[19] Tanzania and Uganda were not yet involved in such an import substitution of manufactured goods.

After the War, the Colonial Office adopted a policy of encouraging administrators in the colonies to promote economic growth in all fields of the economy.[20] In the East African Common Market, the Kenyan Government was the first to take steps to comply with the new colonial policy. The Government decided to promote industrial development and it chose to rely on private enterprise as the main agent for industrialisation. The choice of private enterprise as the main agent of economic growth was not a new strategy; it had started at the beginning of the century.[21]

After the War, the Kenyan Government undertook to provide facilities and incentives designed to attract investors to the industrial sector. For instance, factory sites were offered at concessionary prices, roads to those sites were built, and water was supplied.[22] Also, low company tax and high rates of depreciation were promised to investors in industry.[23] Furthermore, the Government publicized Kenya abroad as a promising place for investment.[24] In this connection, Tinbergen (1958) has observed that the Government can play a very important role in facilitating economic development.[25]

The measure of success the Kenyan Government's efforts to promote industrial development met with is illustrated by the following quotations and statements. "The attractiveness of the colony to capital investment from overseas was well illustrated by the fact that East African Power and Lighting Company's issue was subscribed twelve times".[26] This was in the late 1940s. Another report around that time states that: ".... very considerable investment of capital had flowed into the country from overseas".[27] The sectors to which that capital had flowed were not specified. This lacuna is somewhat filled by the 1950 Report which states that ".... there continued to be a large scale capital investment flow into secondary industries".[28] That report also mentioned that local manufactures were starting to play an important role in the economic stability of the Kenyan economy. This stabilising effect was what policy-makers in Kenya were seeking when they embarked on promoting the industrialisation of the economy after the Second World War.

The 1953 report mentioned that there had been an increase in capital invested in industries.[29] In 1955, it was reported that the industrial expansion had continued with new industries being established and some of the existing industries being expanded.[30] The 1957 Report stated that ".... industrial activities continued to expand with most of the new capital coming from overseas".[31]

Between 1958 and 1963 (the latter was the date of Kenyan independence) investments in the country generally declined.[32] This was largely due to the uncertainty about the political stability of Kenya after becoming independent. However, some investors did not hold a pessimistic view about the political future of the country. These included four petroleum companies which undertook, in 1959, to build the first oil refinery in the East African Common Market.[33] This industry was to play a large role in the East African Common Market inter-country trade imbalances. Also, because that industry made a substantial contribution to the Kenyan manufacturing output,[34] its existence contributed substantially to the widening of industrial imbalances between Kenya, on the one hand, and Tanzania and Uganda on the other. Both the industrial and trade imbalances between Tanzania and Kenya were partially offset after an oil refinery was built in Dar-es-Salaam in 1966.[35]

The account given in the previous three paragraphs indicates that there was a good measure of positive response to the Kenyan Government's effort to industrialise. In addition to Government's active involvement in industrial development, factors which contributed to that response included better prospects of gaining from the external economies[36] by locating an industry in Kenya rather than in the other two countries;

Kenya's purchasing power was higher than Tanzania's and Uganda's; the facts that Kenya was the financial centre for East Africa and the main centre for repairing and servicing machines.[37] Furthermore, because the Kenyan Highlands, which was the region of industrial concentration in the country, was in a strategic position to supply some of the areas of high purchasing power in the EACM was an additional reason why industrialists were likely to choose Kenya as an industrial site. This region was actually well linked to some of the regions of high purchasing power in the EACM by a good network of transportation systems.[38]

2.3.2 Industrial Development in Uganda, 1952-1962

By the late 1940s the Ugandan Government, like the Kenyan one, had shown intentions of promoting industrial development in the country. For instance, by 1949, the Government had committed itself to building a hydro-electric power station to provide power to potential industries.[39] The availability of electric power was expected to encourage the establishment of industries in the country, and in particular in the area near the power station. The Ugandan Government was attempting to play a facilitating role for industrial development as the Kenyan Government had done by undertaking to provide industrial sites, roads and water.

However, unlike the Kenyan Government, the Ugandan one was not as active in the late 1940s in promoting industrial development. The Ugandan Government also seemed to lack a clear cut strategy for industrial development in the 1940s. For instance, while it seemed that the Government intended to rely on private enterprise as the main agent for industrialisation, no special efforts were made to attract foreign investors. Considering that the country had very limited savings of her own to channel into the manufacturing sector, and also considering that there was hardly a pool of industrial entrepreneurs, special effort should have been made to attract both foreign capital and foreign industrial entrepreneurs.[40]

The Government's failure to attract foreign investors is understandable because some influential ethnic groups feared that foreign investors would be "Trojan horses" of political domination.[41] In the absence of a policy to attract foreign investors, it was to be expected that, at best, there would be a trickle of foreign investments into the Ugandan industrial sector. A careful examination of Uganda's annual reports between 1946 and 1952 did not reveal any mention of foreign investment into the Ugandan industrial sector. This was in contrast to what occurred in Kenya. The Ugandan reports did not also mention any investment from domestic industrialists either.

Given that Kenya was industrially ahead of Uganda and given that in the late 1940s and early 1950s she (the former) attracted more investment in her industrial sector, it is reasonable to conclude that the existing industrial imbalances between the two countries widened between 1945 and 1952. Because of lack of data, the extent to which the industrial imbalance widened cannot be estimated.

The Ugandan Government, rather belatedly, adopted a clear strategy for industrial development in 1952. It chose public enterprise as the main agent of industrialisation. An institution known as the Uganda Development Corporation (UDC) was created as an instrument for bringing about industrial development.[42] This Corporation was wholly Government owned. Its objective was not only to promote the industrial development of Uganda but it was also expected to promote the development of several other sectors of the economy. Its capital was only £5 million (sterling).

In relation to its broad objective, the Corporation was undercapitalised. The extent of its undercapitalisation is demonstrated by the fact that a cement plant, which the Corporation inherited in 1952, had cost £1.5 million (sterling) in 1949.[43] This amount was 33 per cent of the capital of the Corporation. If the Corporation had to be the sole financier of projects, it would have financed about three projects costing the same amount of money as the cement plant (ignoring the erosion in value caused by inflation between 1949 and 1952).

The Uganda Development Corporation was hailed as a model for promoting industrial development in the developing world. The World Bank mission to Uganda in 1960 described the performance of that Corporation as having been impressive.[44] The author thinks that this evaluation took into consideration the constraints of industrial development such as the limited capital of the Corporation, the shortage of workers with industrial skills, the low purchasing power of the economy and other bottlenecks which prevailed in the 1950s. Without taking those factors into account, one would wonder why the Corporation was praised. It financed only six industries between 1952 and 1961.[45] This is not surprising given its undercapitalization mentioned above. It is conceivable that if foreign investment had been encouraged, the Corporation would have been in a better position to play a role of a catalyst. It could have used little amounts of its capital in many projects to attract larger amounts from private investors.

The following observation by Hanson (1959) explains why, contrary to what happened, the Ugandan Government needed to be more actively involved in promoting industrial development than the Kenyan Government:

> "In Kenya, industry was so sufficiently advanced to be largely self-financing, whereas in Uganda, it was still necessary for the government to take part in supplying finance to promote the first steps in industrial development".[46]

Because the amount of finance the Ugandan Government supplied was limited, it is no surprise that the "initial steps" in industrial development which were taken were few. This is in contrast with several reports of success, seen above, which were achieved in Kenya.

The evidence seen in this sub-section and in the preceding one, suggests that the private enterprise strategy was more successful than the public enterprise. Bearing in mind that Kenya was an earlier starter in industrialisation than Uganda, and that when Uganda started she did not become as successful as Kenya, it seems right to conclude that the industrial imbalance between the two countries widened further between 1952 and 1961. It was seen in section 2.2 that there was a slight divergence in industrial disparity between the two countries between 1954 and 1961.

2.3.3 Industrial Development in Tanzania, 1956-1961

The Tanzanian Government started to play an active role in the development of manufacturing industries in 1956. It was seen that the Kenyan and Ugandan Governments were active in promoting industrial development in the late 1940s and the early 1950s. The Tanzanian Government's late start may be explained in the following ways. First, as Hatch (1972) observed, the Tanzanian administration in colonial times ".... was usually desultory and weak.... with a tendency towards inefficient planning".[47] Second, the Tanzanian Government , unlike those of Kenya and Uganda, was after the Second World War still seeking to develop the economy, mainly through agriculture. For instance, a gigantic agricultural scheme to produce groundnuts was started in the late 1940s.[48] As was seen above, it is around this time that the Kenyan and Ugandan Governments were trying to promote industrial development as a means of structurally transforming the economies of the two countries. The third explanation is that prior to 1956, the Government gave priority to developing the communication and education sectors which it considered to be of central importance to the economic development of the country.[49]

The Government appointed a Commissioner for Commerce and Industry for the first time in 1956. One of his principal duties was to promote the development of manufacturing industries.[50] The strategy chosen to bring about this objective was very much similar to the Kenyan one. For example, private enterprise was selected as the main agent for industrialisation. Even the incentives which were offered to potential industrialists were similar to those which the Kenyan

Government had introduced several years earlier. They included low company tax, high rates of depreciation, no restrictions on the repatriation of foreign investors' capital and its earnings, protection of domestic industries from imported products and making available industrial estates.[51] In one of the annual reports for Tanganyika, it was mentioned that effort was made to attract foreign investors to industry and to other sectors of the economy.[52] This was similar to the publicity campaign which the Kenyan Government had carried out earlier to attract overseas investors.

The Tanzanian Government's efforts to promote industrial development were met with some measure of positive response. Several large scale industries were established between 1956 and 1960. These included cigarette manufacturing by the British American Tobacco Company, shoe production by Bata (a Canadian based shoe firm) and a flour milling plant (a British-Swiss venture).[53] These industries represented inflow of foreign capital to Tanzania, but a careful examination of annual reports between 1956 and 1960 does not reveal any mention of as large a scale of inflow of foreign investment to the Tanzanian industrial sector as that reported in Kenya.

There were several reasons for this. First, Tanganyika's legal position as a protectorate rather than as a colony meant that there was always uncertainty about her political future.[54] Second, that uncertainty increased after the mid 1950s when it became clear that in a matter of a few years the country would be independent. It is well-known that foreign investment shuns an area of political instability because the risks to investment are high in such a situation. The third factor is that because of limited experience in industrial development, Tanzania lacked a pool of managerial and skilled workers. The Tanzanian government cites this as one of the obstacles to industrial development in the 1960s.[55] The fourth factor was the country's low level of *per capita* income. This meant a low level of purchasing power. Finally, because of the large geographic size of the country and the underdevelopment of the transport system, the market for an investor's products was limited. A way out of this would have been for an investor to locate an industry in a strategic place where he could serve areas of high purchasing power in Tanzania and in the other two countries. This strategy had not yet been adopted in the 1950s.

In spite of the above obstacles to foreign investment inflows, Tanzania achieved expansion in industrial production between the time the Commissioner for Commerce and Industry was appointed, 1956, and 1960. Value added increased by shs. 40 million between 1957 and 1960, which represented a respectable 5.6 per cent annual growth rate[56] (these computations are based on Table 2.1). It will be recalled that in section 2.2 it was seen that industrial imbalances between Kenya and Tanzania were reduced between 1954 and 1961. A point which has to be stressed is that the correlation between the government's involvement in industrial development and the positive results achieved lends support to Tinbergen's observation that governments can play an important role in the development of a nation.

2.4 The Relationship between Industrial and Trade Imbalances in EACM, 1954-61

It was mentioned in chapter 1 that a causal relationship between industrial and trade imbalances existed in the East African Common Market (EACM). That relationship is demonstrated in this section. This is done by analysing intra-EACM trade flows between 1959 and 1961. A hypothesis that industrial imbalance was the principal cause of trade imbalances in the EACM will be tested.

As a prelude to examining the trade flows, goods entering intra-EACM trade are classified into two, non-manufactures and manufactures. The latter are defined as those products falling under sections 5 to 8 of the Standard International Trade Classification, and beer and cigarettes which belong to S.I.T.C.1. Beer and cigarettes are included in order to reduce the degree of understatement of the capacity of some countries to export manufactures.

Kenya, as was seen in section 2.2, was in persistent trade surplus with Tanzania and Uganda in the late 1950s. For the moment the focus will be on the Kenya-Tanzania balance of trade position. Tanzania was in trade deficit with Kenya in each year between 1959 and 1961. Her total deficit in 1959 was shs. 93 million and she was in deficit in manufactures by shs. 78.2 million.[57] This means, therefore, that the deficit in manufactures was responsible for 84 per cent of Tanzania's total deficit. She was also in trade deficit in non-manufactures by shs. 14.8 million which accounted for the remaining 16 per cent of the deficit in both types of products.

Tanzania continued to be in trade deficit in both types of products in 1960 and 1961. Her deficit in 1960 was shs. 115 million.[58] Manufactures this time accounted for 81 per cent of that deficit. In 1961, the deficit had increased further to shs. 141 million.[59] This time manufactures accounted for 77 per cent of that trade deficit. The fall in the importance of the manufactures was due to the increase in the value of exports of non-manufactures rather than the expansion of Tanzania's exports of manufactures to Kenya.[60]

The fact that Tanzania was less industrialised than Kenya, coupled with the above findings that manufactures accounted for between 77 and 84 per cent of her trade deficit with Kenya, support the hypothesis that industrial imbalance was the principal cause of trade imbalances.

Uganda, like Tanzania, was in trade deficit with Kenya between 1959 and 1961. In 1959, her deficit was shs. 43 million.[61] Also like Tanzania, Uganda was in that year in deficit in both manufactures and non-manufactures. The former accounted for 81 per cent of the deficit in both types of products. In 1960, Uganda's deficit was down to shs. 21 million.[62] But the imbalance in trade in manufactures had risen from shs. 35 million in the previous year to shs. 55 million (1960) in favour of Kenya. Uganda's trade surplus of shs. 34 million in non-manufactures helped to bring down the deficit to shs. 21 million. A similar situation occurred in 1961. Kenya was in trade surplus in manufactures, shs. 65 million, and Uganda had a shs. 27 million surplus in non-manufactures.[63] This means that Uganda's deficit was shs. 38 million.

Considering that Uganda was less industrialised than Kenya, the above finding also supports the hypothesis that the principal cause of trade imbalances in the EACM was industrial imbalance. This is because when Uganda was in trade deficit with Kenya in both manufactures and non-manufactures in 1959, the former products accounted for 81 per cent of the trade deficit. In the subsequent two years, Uganda's growing deficit in manufactures was partially offset by her surplus in non-manufactures.

Summary

This chapter discussed some of the major characteristics of the EACM economies between 1954 and 1961. It was seen that according to the contributions of the manufacturing sector to the gross domestic product, industrial imbalances between Kenya on the one hand and Tanzania and Uganda on the other, widened. Trade imbalances between Kenya and the other two countries moved in the same direction.

The chapter also traced the historical origin of the industrial imbalances in the EACM. It was found that Kenya's industrial lead had been due to a number of factors such as government active participation in the development of industrial sector, positive response of foreign investors, level of income which was higher in Kenya than in other two countries, and the facts that Kenya was the headquarters of most financial institutions and technical services in the EACM. In this chapter, the causal relationship between industrial and trade imbalance in the EACM was demonstrated using inter-country trade flows.

Notes

1. See British Parliamentary Papers, Cmd. 4182, 1932, p. 25.

2. J. Viner (1950), The Customs Union Issue, (New York: Carnegie Endowment for Peace), p.70.

3. The scheme in question was called the East African Industrial Licensing Council. This organisation had been created chiefly to match production capacity in certain industries with demand in the East African Common Market. It was not designed to distribute industries evenly among the three member countries of that Common Market. Policymakers in Tanzania tried in the 1950s to steer the E.A.I.L.C. in that direction.

4. The contribution of that sector to the Kenyan gross domestic product was the second largest to the agricultural sector.

5. This reduction in industrial disparity was largely attributable to the fact that the Tanzanian Government had played an active role in promoting industrial development from 1956 onwards.

6. Calculated from statistics in East African Statistical Department (EASD), Economic and Statistical Review, 1957.

7. Ibid.

8. Calculated from EASD, Economic and Statistical Review, 1962.

9. Ibid.

10. Ibid.

11. Calculated from EASD, 1957, op. cit.

12. Calculated from EASD, 1962, *op. cit.*

13. Calculated from EASD, 1957, *op. cit.*

14. Ibid.

15. EASD, 1962, *op. cit.*

16. See E.A. Brett (1973), *Colonialism and Underdevelopment in East Africa: The Politics of Economic Change, 1919-1939*, (London: Heinemann), Chapter 9.

17. R.M.A. Zwanenberg with A. King (1975), *An Economic History of Kenya and Uganda*, (London: MacMillan), p. 123.

18. Brett, *op. cit.*, Chapter 9.

19. M.W. Forrester (1962), *Kenya Today*, (Grovenhage: Mouton), pp. 90-92.

20. C. Jeffries (1956), *The Colonial Office*, (London: George Allen and Unwin), Chapter 12.

21. R.D. Wolff (1974), *The Economics of Colonialism*, (New Haven: Yale University Press), p. 48.

22. Colonial Office, *Colonial Annual Report*, 1949, p. 6.

23. Ibid.

24. F.S. Joelson (1958), *Rhodesia and East Africa*, (London: East Africa and Rhodesia), p. 318.

25. J. Tinbergen (1958), *The Design of Development*, Baltimore: Johns Hopkins), pp. 4-5.

26. Colonial Office, *Colonial Annual Report*, Kenya, 1948, p. 2.

27. Colonial Office, *Colonial Annual Report*, Kenya, 1949, p. 33.

28. Colonial Office, *Colonial Annual Report*, Kenya, 1950, p. 1.

29. Colonial Office, *Colonial Annual Report*, Kenya, 1953, p. 59.

30. Colonial Office, *Colonial Annual Report*, Kenya, 1955, p. 2.

31. Colonial Office, *Colonial Annual Report*, Kenya, 1957, p. 71.

32. Colonial Office, *Colonial Annual Reports*, Kenya, 1958-1963.

33. Colonial Office, *Colonial Annual Report*, Kenya, 1959, p. 50.

34. That oil refinery contributed more to the Kenyan gross domestic product than any other commercial business. It contributed about one quarter of industrial output in Kenya. *See* P. Zajadacz (ed.) (1970), *Studies in Production and Trade in East Africa*, (New York: Humanities Press, p. 176).

35. This refinery was less than a third ($^1/3$) of the capacity of the one set up in Kenya, 600,000 and 2,000,000 tons per annum respectively. *See* A. Coulson (1982), *Tanzania: A Political Economy*, (Oxford: Clarendon), pp. 172.

36. The presence of external economies, the pecuniary economies, can lead to the fall in unit costs of production. These economies result from the general development of industry. For a detailed discussion of these economies, *see* T. Scitovsky (1954), "Two Concepts of External Economies", *Journal of Political Economy*, Volume 62, pp. 143-151.

37. These advantages Kenya had over Tanzania and Uganda are discussed at length by Van Arkadie and D. Ghai, "The East African Economies", _in_ P. Robson and D.A. Lury, (eds.) (1969), _The Economies of Africa_, (London: George Allen and Unwin), pp. 316-383.

38. _See_ A. Hazlewood (1964), _Rail and Road in East Africa_, (Oxford: Blackwell).

39. Colonial Office, _Colonial Annual Report_, Uganda, 1949, p. 6.

40. The scarcity of people with business managerial know-how in the underdeveloped world of the 1950s and how that retarded their economic development are discussed by Hanson. He relates some of that discussion to Kenya, Tanzania and Uganda. _See_ A.H. Hanson (1959), _Public Enterprise and Economic Development_, (London: Routledge and Kegan Paul), Chapter 6.

41. K. Ingram (1958), _The Making of Modern Uganda_, (London: George Allen and Unwin), pp. 220-1.

42. Colonial Office, _Colonial Annual Report_, Uganda, 1952, p. 6.

43. Colonial Office, _Colonial Annual Report_, Uganda, 1949, p. 3.

44. World Bank (IBRD) (1962), _The Economic Development of Uganda_, (Baltimore: Johns Hopkins), p. 273.

45. _See_ Colonial Office, _Uganda Colonial Annual Reports_, 1952-1961.

46. Hanson, _op_. _cit_., p. 222.

47. J. Hatch (1972), _Tanzania_, (London: Pall Mall), p. 102.

48. Ibid, The Project was a complete failure.

49. P. Cranford (1976), The Critical Phase in Tanzania, 1945-1968, (Cambridge: Cambridge University Press), p. 20.

50. Colonial Office, Colonial Annual Report, Tanganyika, 1956, paragraph 71.

51. Colonial Office, Colonial Annual Reports, Tanganyika, 1956-60.

52. Colonial Office, Colonial Annual Report, Tanganyika, 1958, p. 51.

53. Colonial Office, Colonial Annual Reports, op. cit., 1956-60.

54. N.E. Clark (1978), Socialist Development and Public Investment in Tanzania, 1964-1973, (London: University of Toronto), pp. 32-33.

55. United Republic of Tanzania, Tanzania Second Five Year Plan, (Dar-es-Salaam: Government Printer) p.60.

56. The formula used for calculating the growth rate is that one used by the United Nations,

$$r = \left(\sqrt[t]{\frac{V_n}{V_o}} - 1\right) \times 100.$$

57. Calculated from statistics in East African Statistical Department (EASD), Economic Statistical Review, 1960.

58. Calculated from EASD, Economic Statistical Review, 1961.

59. Calculated from EASD, Economic Statistical Review, 1962.

60. In 1961 Tanzania's exports of manufactures to Kenya were worth Shs. 4 million as opposed to Shs. 5 million in the previous year. And Kenya's exports of the non-manufactured products were Shs. 62 million which was Shs. 8 million higher than they had been in the previous year, 1960. Calculated from EASD, Economic and Statistical Reviews for 1960 and 1961.

61. *See* EASD, *Economic Statistical Review*, 1960.

62. ________ ______________________ 1961.

63. Calculated from EASD, *Economic Statistical Review*, 1962.

CHAPTER 3

THE THEORETICAL FRAMEWORK

3.1 Introduction

This chapter attempts to provide several aspects of economic theory in which the study is placed. The approach is to review several aspects of the received theory, extend some of those aspects and later knit together the more salient pieces. In this exercise, an observation by Lipsey (1960) to the effect that the purpose of a theory is to facilitate the interpretation of the real world data is borne in mind.[1] It is of interest also to point out that a theory which is closer to what obtains in the real world could be used to predict economic outcomes at certain periods in the future.

3.2 A Review of Some Aspects of Customs Union Theory

It was mentioned in both Chapters 1 and 2 that there had existed free trade between Kenya, Tanzania and Uganda for a long time. It was also mentioned in Chapter 1 that the three countries had had a common external tariff. The presence of free trade and a common external tariff meant that the form of economic co-operation between the three countries was a customs union one. Because of this fact, the first relevant field of economic theory which will be reviewed is that of customs union.

Viner (1950) laid the foundations for a systematic development of the customs union theory by his study of the customs union issue.[2] The study focused on how resources would be reallocated after some countries had decided to form a customs union. Krauss (1972) points out that Viner's analysis intended to show whether or not resources would be efficiently used in a post customs union period.[3] The foundation of his (Viner's) analysis was the comparative advantage doctrine. According to this doctrine, a member country of the union whose production costs are lower than those of another member, in a given product, should be the sole producer of the product in question for the customs union market. This way, resources in a customs union would be efficiently utilised.

The efficient utilisation of resources had two interrelated beneficial effects in Viner's study. The first was that since less resources would be required to produce the same quantity of a given good than before, more of other goods could be produced using the saved resources. The second was the possibility of a consumer surplus where more quantities of a given good would be produced in the post customs union period than in the pre-customs union period. Viner originated a term "trade creation" to describe the two beneficial effects of efficient utilisation of resources. The term "trade creation" refers to the new volume of trade between member countries of a customs union which takes place as a result of the formation of the union.

He also originated the term "trade diversion" to describe the consequence of inefficient utilisation of resources. Resource allocation in this case is considered from a global standpoint. The costs of production of one member country are compared with those of other countries outside the customs union. Resources are inefficiently utilised if the production costs of a producer of a given good in the union are higher than the production costs of a producer of a similar good outside the union. According to the comparative advantage doctrine, it would have been better for the customs union producer to shift his resources to another line of production where his production costs would be lower than those of his competitor in the outside world. This would mean that the customs union would be supplied by more efficient producers in the outside world, and, from a global standpoint, that would ensure that a waste of resources would be avoided.

The theoretical advantages and disadvantages of a customs union need to be explored further in order to shed light on the issue of equity. Insights gained from this exploration will provide a framework in which a critical examination of the measures taken to make the East African Common Market more equitable than it had been in the past will be conducted in the next two chapters.

Five major benefits may result from the creation of a customs union and they may not necessarily be equitably distributed among member countries. The first benefit arises from economies of scale which are made possible by market enlargement. The pooling together of national markets of member countries through the removal of hindrances to trade flows between members is expected to lead to the setting up of optimal plants to satisfy the demand for certain goods in more than one partner state. Such plants are expected to be faced with falling unit costs of production. In a customs union where producers compete with one another to sell their products, the fall in costs of production should lead to a reduction in the price a consumer pays. A higher price would have been paid in the absence of a customs union because sub-optimal plants would have been built.

The second benefit which one of the members or all of the members could get is an increase in investment as a result of market enlargement.[4] This benefit is related to the first one. The prospects of a fall in unit costs of production may induce investors, both domestic and foreign, to set up optimal plants which will satisfy demand in more than one member countries' market. For the potential investors, the fall in unit costs may benefit them in two ways. First, their profit margin may go up.[5] Second, the fall in unit costs may result in an increase in demand for a product which now costs less than it did before the creation of a customs union.

The third advantage which may be bestowed on a member of customs union is efficient utilization of resources through rationalisation of production in the union. Where an agreement exists among member countries, the production of certain goods in the union may be rationalised. After establishing the magnitudes of demand for a given product in the current period and after predicting how that demand will change in the future, productive capacity commensurate with that demand may be allocated equitably among member countries. Attention would be given to avoiding too much excessive capacity. Such rationalisation would, of course, interfere with the distribution of productive capacities by market forces. This interference would, however, be better than a situation where competing investors set up plants and later some of them discover that there is not enough demand for their products. Such plants would close down and part or all the capital invested in the machinery would be wasted if an alternative use for it cannot be found.

The fourth advantage from the existence of a customs union is the increase in employment of domestic resources which the presence of a large market may induce. This is likely to be particularly significant if the economies of the member countries have substantial quantities of unemployed or underemployed resources. It is reasonable to expect that more employment will be created if large scale plants which use mainly domestic resources are built. Greater employment opportunities can be created if these large scale plants result in either backward or forward linkages, or in both.

Finally, market enlargement may broaden the export base of member countries, thus contributing to an improvement in their balance of payments position. A member country with a greater capacity than others to satisfy demand in their economic block and who is in trade surplus with her partners, will experience greater improvement than other members. Those members in trade deficit may be faced with a deterioration in balance of payments.

One of the major prices members of a customs union pay for belonging to such an economic organisation, is a fall in economic welfare arising from consuming expensive goods produced in the union. This is a result of trade diversion seen earlier. This price is paid by all members if a uniform price is charged for a given good in all members of the union, and if all members consume equal quantities of that good. If, however, the quantities of the good purchased in the members differ - the price remaining uniform - then the deterioration in economic welfare will be greater where larger quantities of the good are bought. If a greater share of a plant's output is consumed in a member country where the plant is located, then the deterioration in welfare will be higher in that country. However, this deterioration will be compensated by employment created and an improvement in the balance of payments arising from the export of some of the plant's output to other member countries.

Members of a customs union also suffer a loss of revenue. This is because goods traded between members are supposed to have no import duty on them. The extent of the loss of revenue will depend on how large are the quantities of goods a member country imports from its partners. There is, however, some compensation for this loss of revenue. It comes from the presence of a common external tariff. If it is higher than individual countries' import duty was on a given good before the customs union was formed, then higher revenue will be collected on the quantities of that good which continues to be imported. This compensating element will be bigger, the higher the price elasticity of an imported good is, and the more there is unsatisfied demand for a given good because of inadequate production capacity.

Another disadvantage of a customs union, for some members, is that it may encourage the concentration of industries in a member or members which are already more developed than other members. This is likely to be particularly so in a higher form of economic integration such as a common market where, in addition to a free movement of goods, the presence of a common external tariff, factors of production also move freely among member countries.

Viner's theory is silent on the possibility of industries concentrating in one of the member countries of the customs union. The failure to consider this distributional aspect was due to the fact that Viner focused attention on the effects of efficient or inefficient resource allocation.

As an attempt to fill that lacuna, the contributions of several people in the context of the developing countries' economic integration schemes are discussed. Cooper and Massell (1965) made a realistic assumption that member countries of a customs union in the developing world prefer manufacturing activities (industries) to any other form of economic activity.[6] They also made another realistic assumption that an industry will survive in a customs union if it is offered tariff protection. This protection, viewed from a standpoint of global utilisation of resources, means that resources are not being efficiently utilised. That means that there is "trade diversion". Actually, Philip (1972) points out that customs unions in Africa were mechanisms for promoting industrial development behind protective tariff walls.[7] The question then becomes how the inefficient industries are to be distributed in a customs union.

Cooper and Massell show how industries could be distributed but within the framework of allocative efficiency. Their analysis does not differ from that of Viner; the more efficient member becomes the industrial site of industries which supply the customs union market. If a country is not able to attract custom union-oriented industries, Cooper and Massell propose that they should be compensated. It seems reasonable to assume that the authors had in mind income compensation. Bearing in mind the experience of the East African Common Market, income compensation did not satisfy policy-makers in Tanzania and Uganda because it did not tackle the root cause of industrial disparities in that Common Market. Market forces needed to be directed so that they could play a part in the even distribution of industries among the members of the East African Common Market. It seems that a trade-off between efficiency and equity is often inevitable in order for an economic integration scheme in the developing world to hold together. This reduces the type of political sensitivity about inequality seen in Chapter 1.

Dosser et al. (1971) advanced a theory which reflects the need not to make allocative efficiency the exclusive criterion for the location of industries.[8] They suggest that even distribution of industries may be brought about using a criterion which is not comparative advantage. They do not, however, specify what that criterion should be. The East African Common Market experience suggests that the even distribution of industries may be brought about by arbitrary reallocation of the existing industries, the allocation of new industries and by allowing the less industrialised countries to protect their "infant" industries from mature industries with ones in the more industrialised countries.

Mead (1968) also recognised the need to have a mechanism for controlling the distribution of industries among the members of an economic integration scheme. He observed: "Some form of interventionism is normally required to control this distribution in such a way as to make it acceptable to all parties...."[9]. Robson (1971) spelt out the consequences of not intervening to make an economic integration equitable. He remarks: "But if equity is not assured the operation of existing groupings may easily be rendered ineffective or in extreme cases they may collapse".[10] While he appreciated the importance of equity, Robson (1980) also points out that there is a need for rationalising production of emergent structure of production.[11] This calls for an agreement among national policy-makers on mechanisms to bring about rationalisation. In order for the existing industrial imbalances to be corrected, it may be necessary for the mechanisms agreed on to discriminate in favour of the less industrialised member countries.

3.3 Some Aspects of Locational Theory

The theory of customs union on which the above discussions were based, does not mention factors other than comparative advantage which may cause uneven distribution of industries among the member countries. The author considers filling that gap to be very important for this study. The gap is filled by reviewing locational theories.

Hall (1900) argued that the location of industries in specific places was accidental.[12] He also argued that once industries had collected in a particular locality, economies of concentration developed there. This tended to dissuade entrepreneurs from locating industries in other places since that would mean foregoing the economic advantages from the economies of concentration. This theory is very closely related to the circular and cumulative causation hypothesis which is discussed in the next but one section.

Weber (1909) sought to explain the determinant of the location of industries in terms of costs of production.[13] He contended that the minimisation of costs was the overriding consideration of an investor when he was trying to choose an industrial site.

Weber recognised that there were other factors which determined the location of industries. These included the level of taxation, the availability of managerial skills and climatic factors. These factors, as was seen in Chapter 2, explain how Kenya came to be ahead of Tanzania and Uganda.

Fetter (1924) offered demand as a determinant of the location of industries.[14] He advanced a theory of "market area" which attempts to provide a definite idea of the size and shape of the market tributary with respect to any given level of market prices and freight rates. The theory stresses the monopolistic nature of space by arguing that a producer exercises control over specific buyers in a particular space of the economy. One of the major assumptions of this theory is that the market is monopolistically competitive because firms are geographically dispersed.

There are two ways in which the notion of a monopoly market is relevant to what obtained in the former East African Common Market. First, there was a period when Kenya and Uganda were the sole suppliers of certain products to the Common Market because the two countries were early-starters in certain industries. Second, there was also a time when a producer in the East African Common Market, though he was not a sole supplier in that Common Market, he had a disproportionate share of that market.[15] Therefore, he had a near monopoly of the market.

Another contributor to the locational theory was Losch (1954).[16] He put forward a model of an economy which functions under monopolistic competition. The model was that of a broad, homogeneous plain (economy) with uniform transport features in all directions and with even scatter of raw materials in sufficient quantity for production to take place. In this model, there was also a uniform distribution of agricultural population with uniform tastes and preferences, uniform technical knowledge and production opportunities being disseminated through the plain.

A criticism which may be given about Losch's model is that it implicitly suggests that there will be an even distribution of industries in the economy. This interpretation is made because of the assumption that there is a uniform distribution of agricultural population, technical knowledge and production opportunities. The latter two factors may not be evenly distributed in the regions of an economy (the East African Common Market is considered as one economy and

Kenya, Tanzania and Uganda are taken as three regions of that economy). The model does not mention the role domestic (regional) demand may play in influencing the location of industries. It is most likely that a region with higher purchasing power will attract more industries than a region with lower purchasing power. The gravitation of industries to the region with higher purchasing power is likely to be exacerbated where that region has infrastructural and geographical (centrality to the Common Market) advantages over other regions. This situation is likely to exist where a wholistic form of economic co-operation exists. That is where free trade, a common external tariff and free movement of factors of production exist. In such a form of economic co-operation, high demand for industrial products of the more industrialised region by the less industrialised regions may lead to regional economic disparities.

3.4 Circular and Cumulative Causation and Regional Economic Disparities

Myrdal (1957) offered a theory of circular and cumulative causation as an explanation of why regional economic disparities may persist.[17] The theory stipulates that a region which has acquired an economic lead over other regions is likely to maintain that lead.

This is because both economic and social forces tend to interact to promote further growth in the economically more advanced region. Market forces, as the quotation below indicates, is the cause of regional economic disparities:

> That there is a tendency inherent in the free play of market forces to create regional inequalities, and that this tendency becomes the more dominant the poor a country is, are two of the most important laws of economic underdevelopment and development under laissez-faire..... [18]

Notice that regional economic inequalities tend to be more dominant in a poor country. Myrdal originated a term "backwash" to describe the tendency for the persistence of regional inequalities. He also originated a term "spread effects" to describe a reduction in regional economic disparities. This was expected to occur where there was "pressure" of demand exerted by the more economically advanced region for the products of the less economically advanced region. "Spread effects" meant a transmission of prosperity from the richer region to the poor one. Myrdal considered the "spread" effects to be weaker than the "backwash" effects, hence the persistence of regional economic disparities.

Hirschman (1958) also tried to explain what causes regional economic disparities and what happens over time to those disparities.[19] He argued, in the same vein as

Myrdal, that a region which has acquired an economic lead over other regions may experience "polarisation" effects. By this, he meant that the more economically advanced region would become a nucleus for further growth and that this may forestall growth in the less developed region. But, he also argued that because of the demand for the products of the less developed region by the more developed one, growth was likely to be stimulated in the former region. He used the term "trickling-down" to describe such growth. Unlike Myrdal, Hirschman attached greater weight to the effectiveness of the "trickling down" effects.

Myrdal's and Hirschman's theories of regional inequalities are largely relevant to what existed in the former East African Common Market. As was seen in Chapter 2, Kenya maintained her industrial lead over Tanzania and Uganda. This is consistent with backwash or polarisation notions. The spread effects or trickling down effects are represented by the fact that Kenya was a bigger market for Tanzanian and Ugandan goods than the two countries were for each other's goods. It is important, however, to point out and stress that because Tanzania and Uganda imported more from Kenya than she imported from them, the transmission of growth was, on balance, from the two countries to Kenya. This leads the author to conclude that Myrdal was right in suggesting that the "spread" effects were likely to be weaker than the "backwash" effects.

It is very important that in trying to predict the extent of transmission of growth to consider the products which will be traded. It is generally accepted that the income elasticity of demand for manufactured goods is higher than that of the non-manufactured goods.[20] Therefore, a country which has a greater capacity to export manufactured goods is likely to grow faster than one which exports a higher proportion of non-manufactured goods. Perhaps, if Hirschman had considered the type of products entering into inter-regional trade, he would not have attributed as much potency to the "trickling down" effects as he did.

Kaldor (1966) also tried to explain why regional economic disparities tend to persist. He used the theory of circular and cumulative causation to explain why economic disparities among some industrially advanced countries had persisted. He argued that it was the difference in productivity which had been responsible for the persistence of economic disparities. Furthermore, he made the following observation:

> .... relatively fast growing areas tend to acquire a cumulative advantage over a relatively slow growing area.[21]

And he argued that left to market processes alone, tendencies towards regional concentration of industrial activities will proceed further.[22] This being so because of the cumulative causation process.

Thirlwall (1974) clarifies this remark by Kaldor by observing that in dynamic situation output is subject to increasing returns.[23] Because of the so-called "Verdoorn effect", a region which experiences an advantage in the production of goods with a high income elasticity of demand, will tend to have a higher rate of output and productivity than other regions. Thirlwall (1978) also points out that the more economically advanced region by definition will be more competitive in goods with high income elasticity of demand than the other regions.[24] This means that the relatively backward regions are likely to be adversely affected by the competitiveness of the more advanced region. In other words, development of certain economic activities in the less competitive regions may be forestalled. This may happen because there is no protection of economic activities in the less competitive regions.

3.5 Capital Absorptive Capacities and Regional Economic Disparities

There is a link between circular and cumulative causation process and capital absorptive capacities. The link is revealed by reviewing what several people consider to be the definition of capital absorptive capacity. An important point which emerges from their definitions, shown below, is that capital absorptive capacities of countries differ. In view of this, it would be unrealistic to expect that there would be an even distribution of industries among the members of an economic integration scheme.

There is no single definition of capital absorptive capacity which is generally accepted. One of the early attempts to define capital absorptive capacity was made by Horvat (1958). He defined it as the ability of individuals and society to manipulate the stream of output increment.[25] By this he meant the ability of individuals and society to undertake investments which would result in an increase in the flow of output to satisfy the demand. At this stage, it seems reasonable to assume that the ability to manipulate the increase in output was likely to differ between countries. Actually, the findings in Chapters 5 and 6 support this assumption.

Hirschman (1958) did not define capital absorptive capacity as such, but he made several useful observations on that issue.[26] First, he observed that capital absorptive capacity was determined by the capacity to invest. It seems reasonable to interpret this observation to mean that if an economy had a high capacity to invest, then its capital absorptive capacity would also be high. This interpretation is consistent with empirical findings in Chapter 6 about fund absorptive capacities in Kenya, Tanzania and Uganda. Second, Hirschman observed that the ability to invest grows with the act of practising to invest. This observation reflects an element of cumulative causation. For instance, a region which has practised to invest more than other regions is likely to have higher capital absorptive capacity than regions which have had less practice in investing. The third observation is that the size of the modern sector of an economy determines the amount of investment which will be undertaken. This means that for economies like the East African Common Market ones, a country which has a bigger section of its economy in the monetary sector, may be expected to invest more than an economy whose monetary sector was smaller. This expectation is supported by the empirical findings in Chapter 6.

Higgins (1962) defined capital absorptive capacity as the amount of investment which could be undertaken in a five year period without reducing the marginal contribution of the last unit of capital.[27] This definition reflects the notion of diminishing returns. The extent to which this definition approximated to the real situation in the East African Common Market would require a careful empirical investigation. The data available to us do not permit such an investigation.

Mikesell (1962) defined capital absorptive capacity as the ability of a country to use financial capital in such a way that there will be a net national product whose discounted value equals the value of the financial capital that had been invested.[28] This definition reflects two interrelated issues, the cost and benefit notion and the efficient utilisation of resources. The cost benefit criterion was used by the East African Development Bank in its evaluation of projects it financed.

A point which is often missed but which is so important that it should not be missed, is that national policy-makers may so intervene that the result of cost benefit may be misleading. For example, national policy-makers may decide to attach an artificially low rate to discounting future benefits from industrial activities that very many projects may be accepted which would otherwise have been rejected. Findings in Chapter 7 indicate that Kenya (the more industrially advanced region) was more willing than the other two countries not only to sacrifice some of the net national product in return for industrial expansion, but she was also willing to render more assistance to industrial development than the other two countries.

Chenery (1964) defined capital absorptive capacity as the amount of increase in total investment which could be carried out at an acceptable minimum level of productivity over a given period.[29] The East African Common Market experience indicates that the minimum acceptable level of productivity may largely be determined by the weight which national policy-makers attach to investments in certain sectors. For instance, investment in the industrial sector was given a greater weight than investment in other sectors in the three member countries of the Common Market. The East African experience also suggests that the level of minimum productivity differs between countries. Furthermore, the extent to which national government will go towards rendering assistance that may facilitate industrial development differs. In the light of these factors, it seems unrealistic to expect that there could be a balanced distribution of industries between Kenya, Tanzania and Uganda.

Adler (1965) defined capital absorptive capacity as the amount of investment or rate of gross domestic investment expressed as a proportion of the gross national product that can be undertaken at an acceptable rate of return where the co-operant factors are present.[30] It is conceivable that where policy-makers attach heavy weight to certain economic activities a low rate of return may be acceptable. The inclusion of the co-operant factors in the definition is an important contribution. These factors may include the availability of competent managerial personnel and a skilled labour force in industrial production, the availability of foreign exchange and the necessary local inputs and a healthy state of the national economy. The effect of these factors on fund absorptive capacity is discussed in depth in Chapter 6. A point which needs to be made now is that the extent to which the co-operant factors were present in Kenya, Tanzania and Uganda differed. In view of this, it may be expected that it would have been very difficult to have a balanced distribution of industries between the three countries.

Gulhati (1967) in contributing to factors likely to affect capital absorptive capacity, stressed the non-financial factors.[31] While this is true for the East African Common Market where managerial know-how was a major constraint to the commercial success of projects, financial factors were also serious constraints. Inadequate supply of local currency and in particular of foreign currencies, caused the failure of a number of projects financed by the East African Development Bank.

The definitions of capital absorptive capacity discussed above looked exclusively at the supply side. Stephens (1971) examined capital absorptive capacity from the demand side.[32] He did not define the term. He argued that constraints to capital absorptive capacity originated largely from the demand side because the demand for capital was a derived demand. He argued that the attempt to satisfy the existing or potential demand was the cause of the demand for capital. He concludes that any investment will prove unproductive if there is no adequate demand. Stephens not only identified demand as a determinant of capital absorptive capacity, but he also contended that it is more important than the factors from the supply side.

The experience of the East African Common Market indicates that the main constraints to capital absorptive capacity arose from the supply side. Therefore, the argument by Stephens that the demand is a more important determinant of capital absorptive capacity than factors arising from the supply side, is not relevant to that Common Market.

In concluding the discussion on capital absorptive capacity, an attempt is made to highlight the salient points which have a bearing on industrial imbalances in East African Common Market. The ability to manipulate the stream of output is a very relevant point. As long as the abilities of the countries differ, it seems reasonable to suppose that there will be industrial imbalances between member countries of an economic integration scheme. The point that the capital absorptive capacity depended on the capacity to invest is also relevant. As long as the capacity to invest is different in member countries of an economic integration scheme, industrial imbalances are likely to exist. It is also noteworthy that the size of the modern sector may determine the amount of investment which will be undertaken. It follows from this that if the size of modern sectors differs in the member countries of an economic integration scheme, the amount of investment undertaken may also differ. In such circumstances, industrial imbalances would be expected. This is actually what happened in the East African Common Market, as will be seen in Chapter 5. Finally, it was mentioned that co-operant factors affect capital absorptive capacity. These factors were not uniform in the three countries of the East African Common Market. Because of that, the existence of industrial imbalances between the three countries would be expected to persist.

3.6 Synthesis

This section seeks to knit together or to synthesise the various salient strands of theory discussed in this chapter. Two questions are borne in mind. The first is what do the strands of theories to be synthesised tell us about the real world. The second is what is the predictive power of those theories. Two other considerations are also borne in mind. One is what insights the strands of theories seen in this chapter offer concerning the operation of a wholistic form of economic co-operation, like the East African Common Market. The other consideration is the insights which those theories offer for a non-wholistic form of economic co-operation. The latter form of co-operation is likely soon to be in existence between Kenya, Tanzania, Uganda and other countries.

The orthodox customs union theory, as represented by Viner, postulates that if member countries reallocate resources in accordance with comparative advantage, then resources will be efficiently utilised. In other words, specialisation according to the comparative advantage doctrine leads to a better utilisation of resources. This is likely to lead to more goods being produced than in the system where there is no specialisation.

There is, however, a probability that adherence to the comparative advantage doctrine could lead to the uneven distribution of industries among the member countries of the customs union. It was seen that through historical accidents, which may have had little connection with comparative advantage, some countries may acquire an industrial lead over other countries. This lead is likely to be maintained or even expanded through the cumulative causation process. This process may, actually, lead to a lowering of costs in one country, while in another they remain high. The cumulative causation process may also lead to an ever increasing development of industrial growth poles in the country which is more industrialised than others. Furthermore, the country which is more industrialised than others may have greater capacity to invest in industries than other countries. As already noted, great capacity to invest goes hand in hand with high capital absorptive capacity. Under these circumstances, industrial imbalances between member countries of a custom union are likely to persist.

It was seen that because co-operant factors, which influence capital absorptive capacity, are likely to be different in member countries of a customs union, the levels of industrial development are also likely to be different in those countries. In a non-wholistic form of economic co-operation, (which is what the former members of the East African Common Market are likely to have in the near future) balancing industrial contribution makes sense only in the context of rationalising industrial production on a regional basis. For this to happen, there is need to have an agreement on the development of some industries on a regional basis. Such an agreement exists in the Andean Group.[33] For industries in which rationalisation is contemplated to success, it is essential to draw on past experience concerning what were the determinants of success and failure of industrial projects. The determinants of success (drawn from Chapters 2, 4, 5 and 7) included national government intervention, the availability of managers with relevant skills in running industrial projects, adequate demand, an economy which is growing and the availability of local funds and foreign exchange. Conversely, where these factors are lacking, industrial performance is likely to be poor. It seems to me, that the knowledge of the factors which had caused the success and failure of industrial development in the former East African Common Market is a useful tool in predicting industrial performance not only in the former three member countries, but also in other countries of the developing world.

Notes

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2. J. Viner (1950), The Customs Union Issue, (New York: Carnegie Endowment for Peace), Chapter 4.

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5. Part of the commercial benefit from the fall in unit costs of production would be expected to accrue to producers. The other part may be passed on to the consumers in terms of a reduction in the price of a good. This is likely to take place in a competitive environment, the producers lower a price in order to attract customers.

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11. P. Robson (1980), *The Economics of International Integration*, (London: George Allen and Unwin), p. 146.

12. F.S. Hall (1900), *Twelfth Census of United States*.

13. C.J. Friedrich (1929), *Alfred Weber's Theory of the Location of Industries*, Chicago.

14. F.A. Fetter (1924), "The Economic Law of Market Areas", *Quarterly Journal of Economics*, Volume 38.

15. A case in point is the East African Oil Refinery in Kenya. It supplied that country as well as Tanzania and Uganda. However, when Tanzania built her own oil refinery in 1966, some of the amount which used to be imported from Kenya stopped.

16. A. Lösch (1954), *The Economics of Location*, New Haven.

17. G. Myrdal (1957), *Economic Theory and Under-developed Regions*, (London: Duckworth).

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21. N. Kaldor (1970), "The Case for Regional Economic Disparities", *Scottish Journal of Political Economy*, Volume 17, p. 343.

22. Ibid.

23. A.P. Thirlwall (1974), "Regional Economic Disparities and Regional Policy in the Common Market", *Urban Studies*, Volume 11, pp. 1-12.

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26. A.O. Hirschman, *op. cit.*, pp. 35-38.

27. B. Higgins (1962), *United Nations and U.S. Economic Policy*, (Homewood, Illinois: Richard D. Irwin), pp. 22-25.

28. R.F. Mikesell (1962), *U.S. Private and Government Investment Abroad*, Policy Discussion Paper Number 7, (Eugene: University of Oregon), p. 365.

29. H.B. Chenery (1964), *Foreign Assistance and Economic Development*, Policy Discussion Paper Number 7, cited by W.J. Stephens (1971), *Capital Absorptive Capacity in Developing Countries*, (Leiden: Sitjthoff), p. 32.

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CHAPTER 4

INDUSTRIAL AND TRADE IMBALANCES IN EACM, 1962-1967

4.1 Introduction

It was noted in Chapter 1 that industrial and trade imbalances threatened to disrupt the forms of economic co-operation which had existed for a long time between Kenya, Tanzania and Uganda. It was also mentioned that where market forces operate freely, as had been the case in the East African Common Market, regional economic disparities tend to develop. Policy-makers in Uganda, and especially those in Tanzania, pressed for the regulation of market forces so that the operation of the Common Market would be rendered more equitable than it had been in the past.

The aim of this chapter is threefold. First, it examines closely and critically the attempts which were made to render the former East African Common Market equitable. Second, the intra-EACM branching out of industries is discussed.

The third aim is to analyse the intra-EACM trade for the six year period covered by this chapter.

4.2 The Distributable Pool

The Distributable Pool was an arrangement that was designed to make the East African Common Market more equitable than it had been before. The primary purpose of that arrangement, as the quotation below shows, was to reduce tension in the political relations between the three members of that Common Market. This was expected to be achieved through a mechanism of unequal contribution of funds to a common pool, which will be explained below.

> Our recommendation of a Distributable Pool of revenue is directed in <u>the first instance</u> at providing an <u>easement of tensions in relation</u> to the Common Market and to the establishment of some balance in the territorial advantages derived from it.[1]

The principle behind the Distributable Pool was that Kenya, which had benefitted from the operation of the Common Market more than the other two countries,[2] should bear a greater burden, in terms of the costs of running the common services, than her two partner states. Those who designed the Pool scheme held a view that under market forces a higher degree of efficiency was likely to be achieved than under a system where market forces were interfered with.[3] Moreover, because there was interest to attract foreign investors to the Common Market, it was considered by those who designed the scheme that interfering with market forces would be counterproductive. This consideration was responsible for the failure to tackle the root causes of industrial and trade imbalances.

How the Distributable Pool Operated

The Distributable Pool was an arrangement which required Kenya, Tanzania and Uganda to contribute funds to a common pool from which each would receive back an equal share after the cost of running the services provided on the Common Market basis had been met. The money came from two sources in each country. The first was the income tax on the profit of manufacturing and finance companies.[4] The second was the revenue of import duties collected by the East African Customs and Excise Department. Specific formulae applied were as follows. The formula applicable to the first source was that 40 per cent of the annual proceeds of profit would be paid into the Distributable Pool, and for the second source, it was expected that 6 per cent of each country's share of revenue from customs and excise duties would also be paid into the Pool.

The Distributable Pool revenue was expected to be shared by four parties, the High Commission which ran the common services, and Kenya, Tanzania and Uganda. The formula for distributing the revenue among the four parties was 3:1:1:1 for the High Commission and the three countries respectively.

Table 4.1 below shows the actual amount received by the four parties between 1961 and 1966.[5] Section A of the table indicates that Kenya contributed a bigger proportion of the revenue into the Pool than either Tanzania or Uganda did. Her contribution was between 46 and 53 per cent of the total revenue for the five years and average annual contribution was 51 per cent. Tanzania's contribution was between 24 and 26 per cent with the annual average contribution being 25 per cent. For Uganda, her contribution ranged from 21 to 29 per cent and the annual average was 24 per cent.

A credit which ought to be given to the Distributable Pool arrangement is that it made the contributions of the three countries to reflect the proportion of their gains from the common services. Kenya, for whom there was a general agreement that she had gained more than the other two countries, also paid more than either of them. Tanzania had also gained more than Uganda.[6]

There are three noteworthy points about the contents of Table 4.1. The first is that under the old system of contributing funds to run the common services, Tanganyika contributed more than Kenya and Uganda, and yet she had benefitted least from the operation of the Common Market. It seems that under that system the principle of equity

TABLE 4.1: Two Methods of Financing EACM Common Services and In-built Compensation

(in millions of East African shillings* and percentages)

Pre-Distributable Pool Contributions

Kenya	10.50	
Tanganyika	11.00	
Uganda	8.20	
Total	29.70	Revenue for High Commission

A. Contributions Under Distributable Pool

	1961-62 (1)	Share %	1962-63	Share %	1963-64	Share %	1964-65	Share %	1965-66	Share %
Kenya	34.62	53	41.84	53	51.02	52	49.98	46	58.70	51
Tanganyika	15.82	24	20.56	26	23.28	24	26.58	25	27.60	24
Uganda	15.18	23	16.62	21	23.18	24	31.80	29	28.90	25
Total	65.62	100	79.02	100	97.48	100	108.36	100	115.20	100

B. Distribution of Funds to:

	1961-62	1962-63	1963-64	1964-65	1965-66
High Commission (½)	32.80	39.50	48.76	54.18	57.60
Kenya	10.94	13.16	16.24	18.06	19.20
Tanganyika	10.94	13.16	16.24	18.06	19.20
Uganda	10.94	13.16	16.24	18.06	19.20
Total	65.62	78.98	97.48	108.36	115.20

C. Net Receipts for:

	1961-62	1962-63	1963-64	1964-65	1965-66
Kenya	-23.68	-28.68	-34.78	-39.92	-39.50
Tanganyika	- 4.88	- 7.40	- 7.04	- 8.52	- 8.40
Uganda	- 4.24	- 3.46	- 6.94	-13.74	- 9.70

* The shilling was a common currency in the three East African countries and it was at par.

Sources: Computed from: (1) P. Robson (1968), Economic Integration in Africa, (London: George Allen and Unwin), p. 113. (2) A. Hazlewood (1975), Economic Integration: The East African Experience, (London: Heinemann), p.42 .

was applied to the potential benefit likely to be derived by each country. The fact that Tanganyika was the largest of the three countries meant that she stood to gain more than the other two countries from the development of a communication network.

The second point is that while all the three countries' net receipts from the Distributable Pool were negative, Kenya's net negative receipts were greater than Tanganyika's or Uganda's. This suggests that there was some compensation by Kenya for her trade surplus with the other two countries. That was a right step in the direction towards easing political sensitivity about trade imbalance which was shown by policy-makers in Tanganyika and Uganda. The third point is that Tanganyika paid slightly more than Uganda into the Distributable Pool in spite of the fact that she was less industrialised than Uganda, and had had a persistent trade deficit with her (see Chapter 2). This could perhaps have been justified by the fact that the former had benefitted more from communication services than the latter.

Two major criticisms may be levelled against the Distributable Pool. First, it did not attempt to solve the root cause of trade imbalances which was industrial imbalances. Even distribution of industries among the three member countries of the East African Common Market was necessary not only to solve the problem of trade imbalances, but also to bring about even distribution of agents of economic growth.

The second criticism is that the amount which Tanganyika received back was too small, in relation to her balance of trade deficit in intra-EACM trade, to satisfy the policy-makers in that country. For instance, while she received Shs. 13.16 million back from the Distributable Pool in 1962-63, her trade deficit in 1962 was Shs. 179 million.[7] By 1966, the disparity between the "compensation" she received and her trade deficit was even greater, the amounts in question were Shs. 19.20 million and Shs. 225 million.[8]

The situation in Uganda was different in the 1962-63 period. The income compensation received from the Distributable Pool was Shs. 13.16 million. But that country's trade deficit with Kenya and Tanzania was only Shs. 33 million.[9] This means that about 40 per cent of Uganda's deficit was offset by that compensation. However, by 1966 the amount of compensation Uganda received, Shs. 19.2 million, was too small to substantially offset her trade deficit of Shs. 131 million.[10] Therefore, the greater were Uganda's and Tanzania's trade deficits with Kenya, the more unsatisfactory the Distributable Pool appeared to be an inadequate compensation scheme.

4.3 The Kampala Agreement

Policy-makers in Uganda and especially those in Tanganyika were dissatisfied with the Distributable Pool, largely because it did not tackle both industrial and trade imbalances. This led to a search, in 1964, for ways in which the two forms of imbalances could be corrected. The search culminated, in 1965, into an acceptance by Kenya, Tanganyika and Uganda to introduce a number of remedial measures. These were contained in a document called the Kampala Agreement.[11]

The remedial measures were of two types. The first involved the regulation of the intra-EACM trade. A country which had had a trade surplus with its partner state was to have her exports to that partner in trade deficit curtailed. The exports of the latter to the former were expected to be stepped up.

The second type of remedial measures dealt with the distribution of industries among the three countries. One of the two ways of achieving that objective was for some industries which had traditionally operated in Kenya and which had exported to Tanganyika, were requested to set up branches in the latter. It was expected that at a future date some Kenya-based industries would also branch out from there to Uganda. The other method of distributing industries was to allocate more "East African Industries" to Tanganyika than to the other two countries, thus contributing to

Tanganyika's catching up in industrial development with her partner states. An East African industry was one which was accorded a monopoly status in the East African Common Market by the Kampala Agreement. Because Uganda was less industrialised than Kenya, she was also allocated more East African industries than Kenya.

4.3.1 Balanced Distribution of Industries: A Critique

Since industrial imbalance was the cause of trade imbalance, it was considered appropriate that the former should be discussed first. The Kampala Agreement deserves credit for attempting to correct industrial imbalances. As has been explained above, the attempt was a right step towards promoting the economic growth of the less industrialised member as well as easing political sensitivity shown mainly by the Tanganyikan policy-makers.

However, the extent to which industrial imbalances could be reduced was limited. For instance, the Kampala Agreement proposed only four industries which would branch out from Kenya to Tanganyika. The latter was expected to have two more East African industries than the former.[12] Moreover, because Kenya was more industrialised than Tanganyika and had a more developed industrial infrastructure as well as being the centre of many East African Common Market Services (which meant a high purchasing capacity in Kenya), it would not have been realistic to expect a significant reduction in industrial imbalances. It would have been more realistic to expect that the process of cumulative causation would have worked towards industrial imbalances.

Actually, Kenya kept ahead[13] of her two partner states in moving into substituting for some goods which she formerly imported from both them and from the rest of the world.

The attempt to bring about a balanced distribution of industries may be further criticised on the ground that no economic criteria were used. For instance, there is no evidence to show that comparative advantage was considered. Equity seems to have taken precedence over efficient utilization of the East African Common Market resources. This was, however, essential in order for that Common Market to hold together. It seems that in the economic integration schemes of the less developed countries, there is often a trade-off of efficiency for equity.[14]

Another criticism which may be given about the attempt to distribute industries evenly is that there was no joint agreement on industrial development on the East African Common Market basis. In the absence of such an agreement, it seems reasonable to conclude that the Kampala Agreement was an *ad hoc* arrangement whose real purpose was to avert a political tension in the relations of the three East African partner states.[15]

It is noteworthy that despite the three states' co-operation in many areas, they never co-operated in industrial field. The experience of the Andean economic integration scheme suggests that even where an agreement on the rationalisation of industrial production exists, it is very difficult to rationalise production because of conflicting national self-interests.[16] This issue is discussed in more detail in Chapter 6, section 6.7.

4.3.2 An Attempt at Balancing Intra-EACM Trade: A Critique

As was mentioned earlier in this chapter, two methods for regulating the imbalances in the intra-EACM trade were proposed by the Kampala Agreement. The intention was to bring about some degree of balance in inter-country trade. The measure to restrict the volume of exports of the partner state which had had a trade surplus with another in the previous year, may be criticised on the ground that it threatened to curtail trade which would otherwise contribute to the economic growth of the three countries. What was overlooked is that the partner state whose volume of exports was restricted was likely to search for overt and covert ways of retaliating. Such a situation would have defeated one of the main purposes of economic integration, to expand production and exports.[17]

The measure to promote the exports of the country which had been in trade deficit with another partner state was a movement in the right direction. This is because seeking to expand exports would in turn have made it possible to expand production in the country in question. However, the Kampala Agreement did not specify how the expansion of exports could be achieved. It ought to have stated, for instance, how export-oriented industries in the countries in trade deficit would be assisted in expanding their exports to the countries in trade surplus.

There was a possibility that without assisting the former countries, they could not, on their own, have been able to substantially increase the volume of their exports.

The Kampala Agreement was not ratified by any of the three partner states. This was due to the disagreement between policy-makers in Kenya and Tanzania over maintaining a common currency which had traditionally been issued by the East African Currency Board.[18]
It would have been meaningless for Uganda which was outside that controversy to ratify the agreement since it had been arrived at with the EACM in mind.

4.3.3 Industrial and Trade Imbalances in EACM: A Result of Monetary Policies?

A question which this section seeks to answer is whether the monetary policies which had been pursued in the East African Common Market (EACM) were responsible for the industrial and trade imbalances. If the answer is an affirmative one, then Tanzania's demand that new monetary policies should be adopted would be understandable. But, if the answer is negative, then her demand would be construed to have been based on other considerations. This answer would mean that the Kampala Agreement did not make a serious omission by not suggesting the type of monetary policies which would contribute towards balanced industrial development and inter-country trade.

In order to be able to answer the above question, how the East African Currency Board (EACB) had operated, must be explained. The EACB came into existence in 1919 and it controlled money supply in the EACM and in other two territories.[19] Between that date and 1955, the EACB only issued local currency, the shilling, against the amount of foreign exchange (largely the pound sterling) held by each territory. This restrictive system was criticised on the ground that it retarded the economic growth of the territories in which it was practiced.[20]

With this criticism in mind, an attempt will now be made to examine the first part of the question posed above. That part is whether or not the restrictive monetary policy pursued in the EACM was responsible for the industrial backwardness of Tanzania and Uganda in relation to Kenya. There is no evidence to suggest that the lag of Tanzania and Uganda in industrial development was due to the rigid control of the money supply. In other words, the shortage of finance did not stunt industrial development in the two countries. On the contrary, both Newlyn (1952) and Hazlewood (1954) pointed out that for most times the East African banking system had excess supply of the pound sterling which, as explained above, was the basis for the quantity of money that could be supplied.[21]

Moreover, it was seen in chapter 2 that the under-development of industries in Tanzania and Uganda was partly a result of a colonial policy which discouraged the industrialisation of the colonial territories. It was also explained in that chapter that important factors which usually facilitate industrialisation were either absent or available in insufficient quantities in Tanzania and Uganda. In the light of these findings and the explanation by Newlyn and Hazlewood, it can be concluded that the restrictive monetary practice exercised by the EACB did not retard industrialisation in these two countries. In any case, Kenya was equally affected by that restrictive monetary practice.

An attempt will now be made to answer the second part of the question, namely the extent to which the restrictive monetary control affected trade imbalances in the EACM. The restriction of the quantity of money supplied should reduce imports. This is because the aggregate demand is suppressed under restrictive monetary practice.[22] The converse is, of course, true if expansionary monetary policy is adopted. In the view of this knowledge, it can be concluded that the monetary policy pursued before 1955 was not responsible for the trade imbalances in the intra-EACM trade. Instead, it may have helped in keeping imbalances lower than they would otherwise have been by depressing the aggregate demand.

Between 1955 and 1964 the East African Currency Board exercised modest expansionary money supply based on fiduciary issue of the currency. For instance, in 1964, Kenya, Tanzania and Uganda were each allowed a fiduciary issue of Shs. 197.2 million.[23] This expansionary monetary policy adopted should have led to an increase in investment in the industrial sectors of the three countries. Since these countries had received equal amounts, the industrial imbalances which would have followed, if any, could not be blamed on the EACB.

This conclusion does not apply to trade imbalances. As was explained above, the pursuit of expansionary monetary policy tends to raise the aggregate demand,

and that in turn will tend to raise the demand for imports. This is likely to be more so the case where there are few impediments to inter-country trade. It will be seen later in this chapter (section 4.6, Table 4.3) that the intra-EACM trade imbalances increased between 1962 and 1967, the period which this chapter covers. This is consistent with the expectation that expansionary monetary practices should be accompanied by a rise in aggregate demand and an increase in imports. The magnitude of trade imbalances would probably have been greater by the end of 1967 if obstacles introduced in 1964 had not been still present.

There was another force working in favour of the intra-EACM trade imbalances. This was the expansion of the national governments' expenditure. Such a practice also raises the aggregate demand and increases the demand for imports. The trade imbalances under such circumstances would reflect the three countries' ability in self-sufficiency in a number of products, particularly in industrial ones.

Tanzania and Uganda who, as Table 4.3 indicates, were in persistent trade deficit in the intra-EACM trade, were in a dilemma with regard to the expansionary monetary and liberal fiscal policies. The pursuit of these policies was essential in order to encourage economic growth. But such policies were bound to increase their trade deficit with Kenya since she was producing goods with a high income elasticity of demand and yet Tanzania and Uganda were not producing goods which would also be in high demand in Kenya.

Trade imbalances resulting from expansionary monetary policies were to be expected from 1966 onwards. This is because the three national central banks which replaced the East African Currency Board increased money supply substantially. The justification for this, as was explained above, was to facilitate economic growth. This subject of the effect of monetary policies pursued in the EACM on industrial and trade imbalances is examined again in chapter 5, for the period 1968-1977.

It was stated at the beginning of this section that judgement would be made as to whether or not the Kampala Agreement made a serious omission by not indicating which type of monetary policy would promote inter-country trade balance. Restrictive monetary practice, as was seen above, would have assisted to achieve that goal. It was also seen that that could have been achieved at the expense of retarding economic growth. Given that trade deficit, as was noted in chapter 1, does not retard economic growth, the Kampala Agreement's silence on which monetary policies to be pursued to curtail Tanzania's and Uganda's trade deficit was not a grave omission. Its silence on the type of monetary policy which would promote industrial development in those two countries may be explained by the fact that the question of monetary policy to be pursued had been dealt with by some other experts.[24]

4.4 Cross Border Flow of Investment in Industry in EACM

This section discusses the flow of some investments across the borders of the three partner states of the East African Common Market. The discussion is meant to illustrate the role market forces played in the distribution of industries among the three partner states. It will be recalled from the account given in chapter 1, that market forces played a part in the distribution of industries either because of a desire by investors to acquire a share of the new national market, or to retain the existing share.

4.4.1 Flow of Investments from Kenya and Uganda to Tanzania

The flow of investments from Kenya and Uganda into the Tanzanian industrial sector was carried out by two main agents. These were the industrialists of the Asian origin and some multinational companies. The former agent will be dealt with first.

The Chandalia family had a factory in Kenya which produced aluminium products.[25] In 1960, a similar factory was set up in Tanzania. At the time of the

Kampala Agreement that industry was allocated to Tanzania on the understanding that she would be the sole producer of the aluminium products in the East African Common Market. An examination of the intra-EACM trade shows that Kenya exported aluminium products before and after the Agreement. That means that Tanzania never became the sole producer of the aluminium products in the Common Market. This is no surprise since the Kampala Agreement was never ratified.

The Madhvani Group of companies was another agent of the flow of investment from Kenya to Tanzania. In the 1960s, the Group set up plants to produce biscuits, beer, glass bottles[26] and also was involved in a project to expand the output of sugar in Tanzania.[27] Sikh Saw Mills company was yet another enterprise owned by investors of Asian origin which was involved in the cross-border investments. This company which had traditionally been based in Uganda established plywood factories in Tanzania also in the 1960s.[28]

Four firms illustrate the role some multinationals played as agents of industrial distribution. The British American Tobacco Company had a history of being a "footloose" industry. Prior to 1956, the main plant of this company was in Uganda and it exported mainly cigarettes to both Kenya and Tanganyika.[29] After that date the main plant shifted to Kenya and its products were exported to Tanganyika and Uganda. In 1961, the company set up a plant in Tanganyika to meet the domestic demand. The fear of losing that country's market after her independence was one of the probable reasons why the company decided to branch out from Kenya.[30] There was, however, a valid economic reason for locating a plant in Tanganyika. There were savings to be made in transportation costs. Instead of transporting bulky tobacco from the country to Kenya to be manufactured into cigarettes which would then be exported to Tanganyika, as did actually happen, cigarettes were manufactured where the raw material was produced.

The East African Breweries Company which had operated in Kenya since the 1920s, expanded its plant in Tanganyika in 1961.[31] A brewery is the type of industry which is often located near the market. This is because water which forms a disproportionately large weight of beer is also bulky, and it is economically disadvantageous to transport the product over long distances. Supplying the Tanganyikan market from Kenya before 1961 may, however, have been a rational economic decision taken by the owners of the East African Breweries. This is because the demand for beer in Tanganyika was low. The decision to establish a brewery in the country may have been based, among other considerations, on the anticipation that in the post-independence period there would be high demand for beer. This actually did happen.[32]

Portland Cement Company, which had operated from Kenya for a long time, also decided to set up a plant in

Tanganyika. Although this industry was one of the four industries which were requested by the Kampala Agreement to shift from Kenya to Tanganyika, the decision to do so had been taken before the Agreement.[33] One of the factors which may have led to the decision to set up a plant in Tanganyika is the saving in transportation costs. Cement, like the brewery and cigarette industries, uses bulky inputs which are expensive to carry over long distances. Moreover, the main inputs were available near Dar-es-Salaam which was one of the main markets for cement in the country. The decision to locate a cement plant close to Dar-es-Salaam was, therefore, consistent with the reasoning that where an item to be produced is expensive to transport, a plant should be located near the market. Another factor which may have influenced the decision to locate a cement plant in Tanganyika was the anticipation that the demand for cement would increase sharply in the post-independence period. This is indeed what happened in the 1960s because of the Government's ambitious programme of construction.[34]

Bata, a Canadian-based shoe company, which had operated from Kenya since 1940, had established a small plant in Tanganyika in 1958.[35] In the 1960s policy-makers in the latter country brought pressure to bear on the company for it to expand production in the country.[36] The company was reluctant to duplicate plants in the East African Common Market because it was more economical for it to expand production at the plant in Kenya to meet the Tanganyikan and Ugandan demand.[36] Actually, in the early 1960s Kenya was the only country which had a tannery and that was probably one of the principal reasons why it was economical for the production of shoes to be expanded there. The company eventually increased the output of shoes in Tanganyika but only of the type which were not already being produced in Kenya.[37] In other words, duplication of plants was avoided through producing certain types of shoes in one country and not in another, a form of specialisation.

4.4.2 Flow of Investments to Uganda from Kenya and Vice Versa

This subsection seeks to provide a fuller picture of the flow of investments across the borders of the East African Common Market by discussing some industries which were involved in the shift from Kenya to Uganda and vice versa. What is of interest here, like in the previous subsection, is what was behind the investors' decision to shift their investments from one country to another. Later on it will be argued that given certain factors, the shift of industries among members of an economic integration scheme could be predicted.

Some Flow of Investments from Kenya to Uganda

Four industries which branched out from Kenya to Uganda described below represented a step towards reducing industrial imbalances between the two countries. One of the earliest of those industries was a tea processing plant. A factory owned by a company which grew and processed tea in Kenya branched out from there to Uganda in 1948. It has been suggested that the motive behind that shift was to establish a foothold in Uganda so that in case the Common Market broke up, the company would not lose the Ugandan market to a new arrival competitor.[38]

The Bata company was another industry which branched out from Kenya to Uganda. This took place in 1963 and the decision to branch out was also due to political pressure from policy-makers in Uganda which was brought to bear on the company.[39] The company was faced with a threat that if it failed to set up a branch in Uganda (as well as in Tanganyika) it could lose its market in that country.

The third industry which branched out from Kenya to Uganda was involved in paint manufacturing. This took place in the early 1960s. High demand for paint in the Ugandan market[40], coupled with the fact that the products of paints industry are bulky, may have been some of the main considerations for the decision to branch out.

Glass manufacturing industry is the fourth industry which branched out from Kenya to Uganda. In the early 1960s, there were two glass manufacturing plants in the East African Common Market and both of them were in Kenya. The two plants were owned by the Madhvani Group of companies whose headquarters of its main commercial activities was in Uganda. This group of companies set up a plant in Uganda in the late 1960s. The main advantages of setting up a plant in Uganda seem to have been two. The first was the economic benefit which would be derived from central management and financial arrangement on a large scale by the head office of the Madhvani Group in Uganda.[41] The second reason is the savings in transportation costs which could be made as a result of locating a glass plant in Uganda. The main input required by the industry, a certain type of sand, was available in abundance in the country.

The four industries discussed above were multinationals and were owned either by one company or a group of companies. It seems to be a safe generalisation to say that if the prospects of making a reasonable return on capital are good because of the presence of the appropriate economic and political climate, multinationals are likely to respond positively to a policy-maker's request for even distribution of industries among members of an economic integration scheme.

Flow of Investment from Uganda to Kenya

A flow of investment from Uganda to Kenya represented a step towards increasing the existing industrial imbalance between the two countries. Due to the difficulties of obtaining data, one industry is discussed here. The industry in question is the Iron and Steel. The first plant of that industry in the East African Common Market was established in Uganda in 1961 by the Madhvani Group of companies (major shareholder) and by two Italian companies.[42] Economic efficiency consideration suggests that the plant should have been located in Kenya. First, a large proportion of the scrap used was found in Kenya and was bulky and therefore expensive to transport. Second, Kenya consumed more iron and steel products than Uganda.[43] It has benn suggested that the decision to locate the plant in Uganda was based on the expectation of advantages from the centrality of management mentioned above.[44]

4.5 Comparative Industrial Growth in the Partner States of EACM, 1962-1967

The discussion of cross border investments in the East African Common Market (EACM) does not provide a full picture of the industrial performance of Kenya, Tanzania and Uganda, yet that picture is needed in order to indicate whether or not the industrial imbalances between the three countries were reduced. This section compares the industrial performance of the three countries from 1962 to 1967. During this period, instruments designed to correct industrial imbalances were not in operation and there was no cooperation in developing industry on the Common Market basis. In other words, the EACM was of a laissez faire type.

Table 4.2 shows both the contributions which the manufacturing sectors of Kenya, Tanzania and Uganda made to their respective gross domestic products. It may be seen that the size of the manufacturing sector in Kenya, in 1962, which was K Shs. 460 million, was approximately 2.4 times the size of the Ugandan manufacturing sector and approximately 3 times that of Tanzania.

TABLE 4.2: Contributions of Manufacturing Sectors in Kenya, Tanzania and Uganda, 1962-1967
(in millions of East African Shillings* and in percentages)

Year	Kenya Value added in Mfg.(1)	Kenya (1) as % of GDP	Uganda Value added in Mfg.(1)	Uganda (1) as % of GDP	Tanzania Value added in Mfg.(1)	Tanzania (1) as % of GDP
1962	460	7.6	195	6.2	154	3.7
1963	580	9.5	248	7.0	156	3.4
1964	676	10.3	273	7.0	194	4.0
1965	754	11.3	319	7.1	234	4.8
1966	842	11.1	352	7.5	282	5.8
1967	884	11.1	387	7.8	314	5.5

* East African shilling was still officially at par.
Source: Computed from United Nations Yearbook of National Accounts Statistics, 1968.

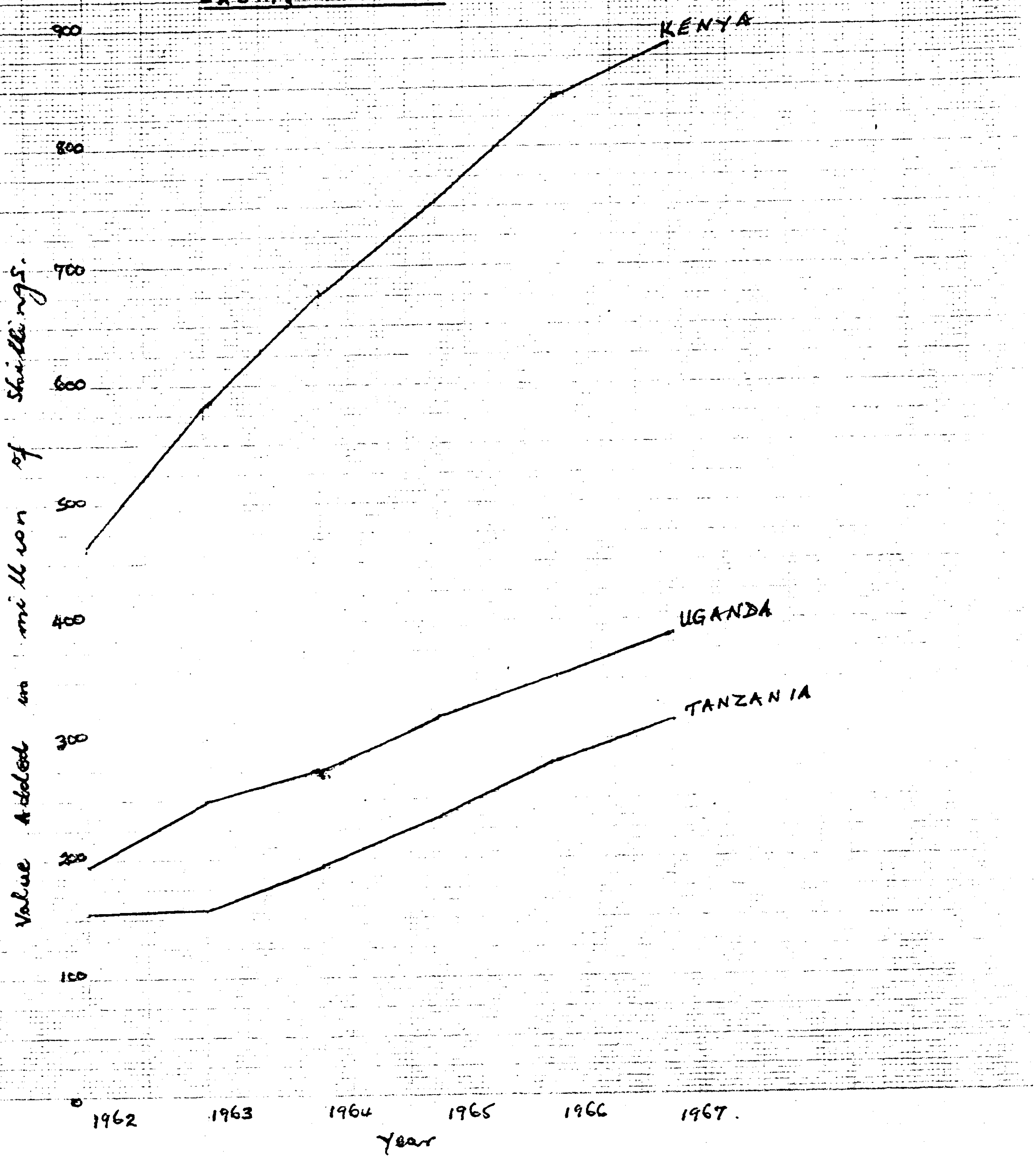
By 1967, value added in the Kenyan manufacturing sector had risen to K Shs. 884 million, in current prices. This represented an increase of K Shs. 424 million. Increases in Uganda and Tanzania on the other hand were T. Shs. 192 million and U. Shs. 160 million, respectively. Because the increase in Kenya was more than twice the size of increases in either of the other two countries, the industrial imbalances had increased. The movement towards the reduction of industrial imbalances shown above by the cross-border flow of investments was, therefore, counter-balanced by this general movement towards industrial disparity.

An important point which this study wishes to stress is that the difference in the results of national efforts to expand industrial production led to the widening of industrial imbalances. Given that there was no co-ordination of industrial development on the East African Common Market basis, it was to be expected that there would be differences in industrial output in the three partner states. It follows from this that it would have been unrealistic to expect that industrial imbalances between the three partner states could be corrected in the absence of relevant policy instruments.

The pattern of industrial imbalances discussed above is shown in Figure 4.1. It may be seen that the general movement was that one of the widening of industrial gap between Kenya and the other two countries. Since, as was seen in Chapter 2, there existed a causal relationship

Figure 4.1:

Pattern of Industrial Imbalances in EACM, 1962-67



between industrial imbalance and trade imbalance in the East African Common Market, the next section investigates whether or not that relationship also existed during the 1962-1967 period.

4.6 Intra-EACM Trade, 1962-1967

The magnitudes of inter-country trade in the former East African Common Market between 1962 and 1967 are shown in Table 4.3 below. Kenya exported more than Tanzania. As was seen earlier, Kenya was more industrially developed than the other two countries, and Uganda was also more industrialised than Tanzania. Therefore, a prima facie evidence of a partner state's level of industrial development and her capacity to export is provided by the table. It may also be seen that Kenya had a balance of trade surplus with Tanzania and Uganda for the six years. Notice that the size of Tanzania's trade deficit was greater than Uganda's for each of those six years. Bearing in mind the different levels of industrial development mentioned above, and the balance of trade just stated, a correlation between industrial imbalances and trade imbalances existed.

An attempt will now be made to show whether or not the relationship between industrial imbalances and trade imbalances was a causal one. This exercise will involve examining the extent to which manufactured products were responsible for trade imbalances.

TABLE 4.3:

Intra-EACM* Trade, 1962-1967

(in million of East African shillings)

Year	Kenya's Exports to:		Uganda's Exports to:		Tanzania's Exports to:		Balance of Trade for:		
	Tanzania	Uganda	Kenya	Tanzania	Kenya	Uganda	Kenya	Uganda	Tanza[illegible]
1962	200+	146	108	33	39	9	199	-14	-1[illegible]
1963	207	188	125	40	58	10	212	-33	-1[illegible]
1964	266	262	147	49	82	20	289	-76	-2[illegible]
1965	281	307	143	52	91	27	355	-129	-22[illegible]
1966	266	312	146	62	76	17	356	-121	-2[illegible]
1967	232	296	203	49	67	15	258	-59	-1[illegible]

* EACM is East African Common Market.

\+ Figures shown in the above Table were rounded to millions by the author.

Sources: Computed from East African Statistical Department, Economic and Statistical Reviews for 1962-1967.

As a prelude to examining the role manufactured products played in inter-country trade imbalances, manufactured products will be defined in a manner reflecting their international trade element. Beers and cigarettes under Section 1 of Standard International Trade Classification (SITC) and all goods falling under Sections 3 and Sections 5 to 8 are defined as manufactured traded products. This broader than usual definition is chosen in order to capture most of industrial goods traded in the East African Common Market. Because the definition has certain shortcomings, the results obtained by using it will have to be qualified. Two main shortcomings are that some of the manufactured products which are classified under Section 0 are left out and Section 3 in the case of Uganda include an item such as electric power which in strict terms ought not to be considered as a manufactured good. Despite the latter shortcoming, the magnitude of Kenya's exports is understated because a substantial size of her exports falling under Section 0 is left out.

Table 4.4 shows the magnitude of manufactured goods traded between Kenya, Tanzania and Uganda between 1962 and 1967. For Kenya, manufactured goods accounted for between 65 and 76 per cent of her total annual exports to the other two countries during the six year period. This meant that a disproportionately large part of her trade surplus with those two countries was attributable to the export of manufactures. This point deserves to

TABLE 4.4:

Intra-EACM Trade in Manufactured Goods, 1962-1967

(in millions of East African shillings)

Year	Kenya's Exports to:		(1) and (2) as % of total Exports	Uganda's Exports to:		(1) and (2) as % of total Exports	Tanzania's Exports:		(1) and (2) as % of total Exports
	Tanzania(1)	Uganda(2)		Kenya(1)	Tanzania(2)		Kenya(1)	Uganda(2)	
1962	135	90	65	40	25	46	11	1	25
1963	138	132	68	53	27	48	21	3	41
1964	204	176	73	51	36	44	40	10	49
1965	217	225	75	62	43	54	39	10	41
1966	205	233	76	88	49	66	36	10	49
1967	168	218	73	98	34	52	28	8	44

Source: Computed from annual reports of East African Statistical Department, Economic and Statistical Reviews for years 1962-1967.

be dealt with in some depth.

To demonstrate how industrial imbalance (which manifested itself in the unequal capacity of the member countries of the EACM to export manufactures) was the principal cause of the intra-EACM trade imbalances, the trade flows from 1962 to 1967 are used. Kenya and Tanzania are dealt with first. It was noted that the latter was in trade deficit with the former for the six years which this chapter covers (see Table 4.3). It may also be seen from Table 4.4 that Tanzania was persistently in trade deficit with Kenya, in manufactures, for all the six years shown in that table. Those products actually contributed a disproportionately large part to Tanzania's trade deficit. Their annual average contribution between 1962 and 1964 was 81.3 per cent[45] (calculated using statistics in Tables 4.3 and 4.4). In 1965 manufactures accounted for 93.7 per cent of Tanzania's deficit with Kenya and in the subsequent two years the annual average was 80 per cent. Bearing in mind that Tanzania was less industrialised than Kenya, these results support the hypothesis that the unequal levels of industrial development between the two countries was the principal cause of trade imbalance.

Uganda, as may be seen from Table 4.3, was also persistently in trade deficit with Kenya for each of the six years in the table. In examining the role the manufactures played in Uganda's trade deficit, a different approach from that one used in the case of Kenya and Tanzania is adopted. This approach is dictated by the nature of trade between Kenya and Uganda which is different from that of Kenya and Tanzania.

Uganda's trade deficit in manufactures with Kenya was Shs. 50, Shs. 79 and Shs. 125 million for 1962, 1963 and 1964 respectively (calculated from Table 4.4). But her trade position in all types of products, though still in deficit, was better than what has been shown. The figures were Shs. 14 million for 1962, Shs. 33 million for 1963 and Shs. 76 million for 1964. These reductions in deficit were due to the fact that Uganda was in trade surplus in non-manufactures for the three years.

Uganda's trade deficit in manufactures with Kenya reached the peak in 1965 when it stood at Shs. 163 million. In that year, she was also in trade deficit in the non-manufactured goods by Shs. 1 million. The overwhelming contribution of the manufactures should be noted. For the next two years, Uganda's deficit in manufactures fell to Shs. 145 million in 1966 and fell further to Shs. 120 million in 1967. In 1966 Kenya had increased her surplus with Uganda in non-manufactures to Shs. 21 million, but her surplus in manufactures was Shs. 18 million less than it had been in 1965. This fall was due to trade restrictions which both Uganda and Tanzania had imposed on Kenya's manufactures. In

1967, Kenya's exports of manufactures fell again due to the trade restrictions. During that year, Uganda was back in trade surplus with Kenya in non-manufactures. For four years, Uganda's trade surplus with Kenya in those products had helped to a small extent to offset her trade deficit in all products.

The findings above concerning the overwhelming contribution of manufactures to Tanzania's and Uganda's trade deficit show that industrial imbalance was the principal cause of trade imbalance for the period covered by this chapter. It must be reiterated that the uneven distribution of industries among the three members of the EACM manifested itself in unequal capacity of those members to export manufactures to each other.

Summary

Three main issues were discussed in this chapter. The first was the Distributable Pool. It was seen that while this scheme was intended to bring about a balanced distribution of "advantages" derivable from the Common Market, it did not attempt to correct the cause of the uneven distribution of "advantages". This was because those who devised the scheme feared to interfere with market forces lest the flow of investment to the Common Market from the external world be discouraged. The failure to tackle the twin problem of industrial and trade imbalances made the Distributable Pool arrangement unacceptable to policy-makers in Tanzania and Uganda.

The second issue concerned the corrective mechanisms of industrial and trade imbalances which were proposed in the Kampala Agreement. It was seen that though that Agreement was never ratified, there was movement towards correcting industrial imbalances. This movement was represented by the branching out of industries from Kenya and Uganda to Tanzania, as well as the branching out from Kenya to Uganda. It was also seen that there was a movement of industry from Uganda to Kenya which represented a step towards increasing the existing industrial disparity between the two countries. Furthermore, it was seen that the motive behind the relocation of industries was a commercial gain for private investors. The desire by national policy-makers in Tanzania and Uganda to expand industrial production provided the incentive for investors to move into the two countries. It seems that where there is a coincidence of interest between investors and a certain national policy, a flow of investment across the borders of members of an economic integration scheme may take place. However, it was also seen that industrial disparity between Kenya on the one hand, and Tanzania and Uganda, on the other, (viewed from the whole of national manufacturing sector) widened.

The third issue which was discussed concerned inter-country trade imbalances. It was found that a causal relationship between industrial and trade imbalances existed. Since industrial imbalance was the cause of trade imbalances, measures which sought to bring about a balanced distribution of industries among the three members of the EACM should have tried to correct industrial imbalance during the 1962-1967 period. It will be seen in the next chapter that a search for ways to correct industrial disparities got under way during the period covered by this chapter. The implementation of the corrective mechanisms was actually in December, 1967.

Notes

1. Colonial Office, East Africa, Report of the Economic and Fiscal Commission, Cmnd. 1279, (London: HMSO, 1961), paragraph 65.

2. Ibid., appendix.

3. F.I. Nixson (1973), Economic Integration and Industrial Location, (London: Longman), p. 34.

4. Colonial Office, East Africa, op. cit.

5. A search for the statistics for the year 1967 in several university libraries in Britain bore no fruits. This data may most probably be obtained in East Africa in the archives of the former East African Common Services. The absence of one year's data was not considered a serious drawback since the data for the other five years covered by the chapter were available.

6. World Bank (IBRD) (1962), The Economic Development of Uganda, (Baltimore: Johns Hopkins), p. 86.

7. Tanganyika's deficit is calculated from statistics in East African Statistical Department, Economic and Statistical Review, 1963. (The statistics for a given year usually appear in the report of the following year).

8. EASD, Economic and Statistical Review, 1967.

9. EASD, ______________________________, 1963.

10. ____ ______________________________, 1967.

11. The Document, The Kampala Agreement, April, 1965.

12. Ibid. Kenya was supposed to manufacture electric bulbs for the East African Common Market. Tanzania was expected to produce motor vehicle tyres and tubes, to assemble radios, and to manufacture aluminium products also for the EACM. Uganda was expected to produce for that market bicycle parts and nitrogenous fertilizers.

13. See R.C. Porter, "Kenya's Future as an Exporter of Manufactures", Eastern Africa Economic Review, Volume 6, Number 1, June, 1974, pp. 44-69.

14. See P. Robson (1980), The Economics of International Integration, (London: George Allen and Unwin), p.149.

15. Policy-makers in Tanzania claimed that they had accepted a less than optimal solution (the Kampala Agreement) in order to maintain the East African economic integration scheme. See J.S. Nye (1966), Pan-Africanism and East African Integration, (London: Harvard University Press), p. 177.

16. See D.E. Hojman (1981), "The Andean Pact: Failure of a Model of Economic Integration?", Journal of Common Market Studies, Volume 20, p. 158.

17. See R.F. Mikesell (1963), "The Theory of Common Markets and Developing Countries", in P. Robson (1972), International Integration, (London: Penguin), p. 166.

18. For the operation of the East African Currency Board, see W.T. Newlyn and D.C. Rowan (1954), Money and Banking in British Colonial Africa, (Oxford: Clarendon Press).

19. Ibid.

20. See "Analyst", (1954), "Colonial Monetary Theory", Social and Economic Studies, Volume 3, p. 105. See also A. Hazlewood (1954) "Colonial Monetary Arrangements", Social and Economic Studies, Volume 3, p. 301. He simply reports the allegation that a deflationary monetary policy retards economic development.

21. W.T. Newlyn (1952), "The Colonial Empire", in R.S. Sayers' Banking in the British Commonwealth, (Oxford: Clarendon Press).

22. This is well explained by Galbraith. See J.K. Galbraith and N. Salinger (1979), Almost Everyone's Guide to Economics, (London: Andre Deutsch), Chapter VI.

23. See H.H. Binhammer (1975), The Development of Financial Infrastructure in Tanzania, (Dar-es-Salaam: East African Literature Bureau), p. 7.

24. Ibid. pp. 1-2. The experts in question were E. Blumenthal and W.T. Newlyn.

25. See East African Development Bank, Aluminium Africa, file PS/16B/17/I.

26. P. Zajadacz (ed.) (1970), Studies in Production and Trade in East Africa, (New York: Humanities Press), pp. 127.

27. The Madhvani Group bought Mtibwa Sugar Estate in 1966. See East African Development Bank, Mtibwa Sugar Estate, Basic Data, file PS/16B/25.

28. Republic of Tanganyika, Annual Report of the Commerce and Industry Division, 1963, (Dar-es-Salaam: Government Printer), p. 8.

29. The plant in Eastern Uganda, at Jinja, was set up with a view to satisfying most of the cigarette demand in the East African Common Market. In 1956, that plant was relocated to Kenya.

30. It was a common practice for policy-makers in Kenya, Tanzania and Uganda to issue threats that unless industries were to set up their branches in national boundaries, they would lose their share of the market to new competitors. See Nye, op. cit., Chapter 5.

31. See A. Hazlewood (ed.) (1967), African Integration and Disintegration, (London: Oxford University Press), p. 96.

32. For instance, between 1971 and 1977, the consumption of beer (bottled "European beer") increased from 53,916 to 88,307 litres per annum. This represented an annual growth rate of 7.3 per cent. See United Republic of Tanzania, Economic Survey, 1977-78, (Dar-es-Salaam: Government Printer), 1979.

33. See A. Hazlewood (ed.) (1967), op cit., p. 96.

34. See United Republic of Tanzania, Tanzania Second Five Year Plan, Volume 1, (Dar-es-Salaam: Government Printer), p. 71.

35. Tanzania continued to import substantial quantities of shoes from Kenya which means that the domestic plant did not satisfy the domestic demand. This is not surprising given that the company in Tanzania produced only a given type of shoes.

36. See Nixson, op. cit., p. 86.

37. The plant in Tanzania specialized in plastic footwear. See Hazlewood, op. cit., p. 97.

38. See Nixson, op. cit., p. 76.

39. Ibid., p. 86.

40. The demand for paint in Uganda grew fast in the early 1960s. On the other hand, in Kenya there was a decline in demand between 1961 and 1964, and this was one of the motives for the paint industry to branch out from there to Uganda. See Zajadacz, op. cit., p. 167.

41. See Nixson, op. cit., p. 98.

42. Ibid.

43. For the quantities of iron and steel products consumed by the two countries as well as Kenya. See East African Development Bank, Iron and Steel Industry in East Africa, p. 41.

44. Nixson, _op_. _cit_., p. 98.

45. Calculated from EASD, _Economic and Statistical Reviews_, 1963 and 1965.

CHAPTER 5

INDUSTRIAL DEVELOPMENT AND INTER-COUNTRY TRADE, 1968-1977

5.1 Introduction

The object of this chapter is four-fold. First, it examines closely and critically on an *a priori* basis how realistic it was to attempt to bring about a balanced distribution of industries between Kenya, Tanzania and Uganda. Balanced industrial development between the three countries was the stated objective of the Treaty for East African Co-operation (TEAC), as will be seen below. Second, the measure of success which could be expected from one of the two mechanisms that were supposed to contribute to the reduction in industrial imbalances between the three countries is evaluated. The mechanism, to be discussed in this chapter, is a system of import duties on some manufactured products imported from Kenya and Uganda, which was called the Transfer Tax. Third, the changes in industrial production in the three countries between 1968 and 1977 are analysed with a view to showing whether or not industrial imbalances were reduced at the end of this period. Finally, the pattern of inter-country trade is examined with the aim of showing whether or not trade imbalances between the three countries were corrected during the 1968-1977 period.

This chapter attempts to highlight the causes and the dynamics of industrial and trade imbalances during the ten year period when the Transfer Taxes were in operation. It is argued that there was a strong movement towards industrial imbalances in the East African Common Market which could not be significantly offset by the proposed corrective mechanism.

5.2 The Balanced Economic Development Objective: A Critique

The balanced industrial development objective was an integral part of a broader goal, the balanced economic development[1] between Kenya, Tanzania and Uganda. It seems logical that the broader goal should be discussed before critically examining the expected effectiveness of its component. As was seen in chapters 2 and 4, Kenya had persistently been ahead of Tanzania and Uganda in economic development in the 1950s and the 1960s. It was also seen in chapter 3 that there is a tendency for a region which has acquired an economic development lead over other regions to maintain that lead.

The question is whether it was realistic to suppose that that tendency of cumulative causation would be checked. As a prelude to answering this question, it is important to recall how the cumulative causation process tends to operate in favour of persistence of regional disparities. Economic advantages which a more economically advanced region has over the less developed regions tend to encourage more economic activities to be undertaken in the former than in the latter. This is likely to be more so where market forces operate freely. In order to check the perpetuation of regional economic disparities, strong measures which curtail the freedom of market forces and which give more encouragement to the expansion of economic activities in the less developed regions than in the advanced regions need to be in place.

There were no broad measures designed to equalize economic development in the East African Common Market (EACM). All the three member countries of the EACM intended to accelerate the pace of their economic development, and their strategies were very similar. They all intended to play an active role in facilitating the realisation of fast economic growth rates.

In the absence of instruments to suppress the tendency towards the persistence of regional economic disparities, it should have been more realistic to expect that balanced economic development in the EAC would not be achieved. It will be remembered that for a number of reasons (see Chapter 2) Kenya was a more attractive site of economic activities in the EACM than Tanzania and Uganda. It could have been foreseen that because of the circular and cumulative causation phenomenon unless drastic adverse conditions were to develop in Kenya, she would grow faster than the other two countries. This would, therefore, have meant that the level of economic development in the EAC would continue to be unequal.

5.2.1 The Balanced Industrial Development Objective: A Critique

The balanced industrial development between the three members of the East African Community may be criticised on several grounds. The first is that no consideration seems to have been given to the possibility of cumulative and circular causation working in favour of the persistence of industrial disparities between Kenya and the other two countries. As was seen in Chapter 2, Hanson observed that because industry in Kenya was more developed than in Tanzania and Uganda, less encouragement was required for further industrial development in Kenya than in the other two countries. But there is evidence that after the three countries had become independent, the Kenyan government was as active, and in some cases more active[2], in promoting industrial development than the governments of Tanzania and Uganda. This was before the Treaty for East African Co-operation (TEAC) (signed in 1967) which contains the balanced industrial development goal was signed.

The second ground which suggests that the balanced industrial development objective was unrealistic, is the absence of extensive incentives to encourage more industries to be set up in the less industrially developed countries. The TEAC mentioned that efforts should be made by policy makers in Kenya, Tanzania and Uganda to reach an agreement on such a scheme of incentives. The fact that incentives which would have made Tanzania and Uganda more attractive as industrial sites than Kenya were not included in the Treaty suggests there were problems in agreeing to have such an arrangement. As will be seen in Chapter 6, policy makers in Kenya found it unacceptable to retard the economic development of their country in order to enable Tanzania and Uganda to catch up with her.

Finally, the balanced industrial development may be criticised on the ground that there was no system of equalizing investments in the three countries' industrial sectors. In the late 1950s, as was seen in Chapter 2, a large investment had been undertaken in Kenya when the first oil refinery in the EACM was set. It contributed to the divergence in industrial disparities between Kenya and the other two countries. This ought to have been a lesson to those who wanted to bring about an even distribution of industries that that objective could be achieved if projects of greater investment magnitude were set up in Tanzania and Uganda.

If strict equal level of industrialisation was to be achieved, there needed to be one East African investment allocation authority. It had to discriminate in favour of the less industrialised countries, Tanzania and Uganda. The East African Development Bank (EADB) was such an authority. Its effectiveness is evaluated in Chapters 6 and 7. It will be seen that the EADB was an ineffective instrument because it had limited funds to offset the disparity tendency arising from the fact that Kenya's capacity to generate investment was greater than either Tanzania's or Uganda's. Furthermore, it will be seen that conditions conducive to the success of investments undertaken were relatively more abundant in Kenya than in the other two countries. It is noteworthy that there were two forces working in favour of the persistence of industrial disparities in the EACM. One was Kenya's greater capacity to generate investment than the other two countries, and the other was that conditions conducive to the success of projects were better there than in either Tanzania or Uganda.

5.2.2 An Evaluation of the Effectiveness of Transfer Taxes: A Critique

It was mentioned at the beginning of this chapter that a critical examination, on an *a priori* basis, of the measure of success which could be expected from the Transfer Taxes will be carried out. This is the aim in this subsection. To begin with, the necessary information which can make that examination possible is provided.

It was explained in Chapter 1 that the Transfer Taxes were a system of protective tariffs in the East African economic integration scheme. The primary aim of those tariffs was to protect and promote manufacturing industries in the less industrialised member so that after a given period she would be as industrially developed as her partner state or states who had been ahead of her in the past.

Industries in the less industrialised member of the East African Common Market were actually protected against competition from the more advanced member country's industries, as well as against rival industries from the external world. Protection from the latter was provided by the presence of a common external tariff on imports from the industries outside the EACM.

Several conditions had, however, to be fulfilled before the Transfer Taxes could be legitimately imposed. First, a country had either to be already producing goods similar to those it intended to protect or it had to have the industrial capacity to do so in about three months after the Transfer Taxes had been introduced. The rationale for this restrictive condition seems to have been to avoid unnecessary curtailment of intra-EACM trade. Given that one of the raison d'être of a common market is to encourage trade between member countries, that rationale was a reasonable one.

One of the important assumptions underlying the Transfer Taxes is that the presence of tariff protection would induce investors to set up new industries or expand output from the existing capacity. This presupposed the capacity of those investors to generate or mobilize the financial and human resources required to carry out new investments or to expand output from the existing plants. That capacity may be limited in a less economically developed country. This limitation may be particularly so in a country which adopts a policy of nationalising the "major means of production", as was the case in Tanzania in 1967 and Uganda in 1970. It seems reasonable to expect that for a country which is still economically backward, it can hardly stand on its own and make fast economic development advances. Either that country will take a long time on its own to develop or it will have to accept foreign capital and technical expertise as well as foreign managerial know-how in order to make fast economic advances. If the more economically advanced member country is more willing to accept foreign investors to contribute to the development of her industrial sector than the industrially backward countries are, then the expectation should be that the former is very likely to remain industrially ahead of the latter.

The second condition, which had to be met before the Transfer Taxes could be validly imposed, is that the firm seeking to be protected by those tariffs had either to be able to satisfy at least 15 per cent of the total national demand for the product to be protected or the value of the product in question had to be over Shs. 2 million. This restrictive condition seems to have been based on the assumption that there were industries which would become commercially profitable in the national market. The above two values were perhaps the minimum requirement for the commercial success of such firms. It would have been more important to require a firm to indicate how the Transfer tariff protection would enable it to increase employment and output, thus contributing to the reduction of industrial imbalances.

The third condition was that the rate of the Transfer Tax would not exceed 50 per cent of an external common tariff imposed on a product similar to that which was to be protected by the Transfer Tax. This meant that though a substantial tariff protection was given to some industries in the less industrialised partner state, exports of competing products from the more industrialised partner could still reach the market of the former. The extent to which those exports would be consumed would depend on their price elasticity.

If the quality of rival products[3] from the more industrialised member was higher than that of the goods protected by the Transfer Taxes, then it would be expected that the degree of protection would be small. That, in turn, would mean that the extent to which those Taxes would encourage industrial development would be small.

There is reason to suppose that the tariff wall provided by the Transfer Taxes was too low to induce new investors. The average tariff which Tanzania imposed on 35 items of manufactures from Kenya was 17 per cent.[4] And the average tariff Uganda imposed on 14 items of manufactures from Kenya was 15 per cent.[5] These rates were much lower than many tariff protection rates given to other industrial products.[6]

It seems that those who devised the Transfer Taxes were in a dilemma. On the one hand, they intended to encourage industrial production in Tanzania and Uganda to enable the two countries to catch up in industrial development with Kenya. Ideally, this required, among other measures, a total ban of imports of competing products. On the other hand, they did not intend to discourage totally Kenya's exports to her two partner states by introducing prohibitive tariff rates.

However, it may be argued that the introduction of the Transfer Taxes would have reduced Kenya's exports to her two partner states due to a switch in demand for her products to those from the external world. This is because the imposition of a duty on a Kenyan product would have diminished its price attractiveness <u>vis a vis</u>

a similar product from the external world. Although its price would still have been lower than that of its competitor from outside the East African Community, it would nevertheless have been higher than it had been before the imposition of a Transfer Tax.

The fourth restrictive condition which had to be abided by was that if a firm was able to export more than 30 per cent of its output to one or both of its partners, it had no right to be protected by a Transfer Tax. This suggests that if a firm was able to export about a third of its products to her partner states, she was competitive enough not to need tariff protection. This seems to have been a reasonable condition considering that care had to be taken to avoid unnecessary curtailing of intra-EACM trade.

Because of the above restrictive conditions, the Transfer Taxes' effectiveness as an instrument for reducing industrial imbalances in the East African Community was limited. At any rate, it may be argued that tariff protection on its own may not be a potent instrument for encouraging industrial development in economies where co-operant factors for economic growth are limited. Protection may need to be complemented by the availability of skilled workers, experienced managers and various forms of government assistance. As was seen in Chapter 2, it was Kenya, the most industrialised member of the EACM, who seemed to fulfil those conditions more than Tanzania and Uganda. This suggests that any advances which the latter two countries would make towards catching up industrially with Kenya would be more than offset by her further advancement in industrialisation. This would be assisted by the relative abundance of conditions conducive to success in industrialisation in Kenya. This dynamic explanation may be presented in a nutshell this way. It was more realistic to expect Kenya to forge ahead in industrialisation at a faster rate than the other two countries, in spite of the Transfer Taxes.

The maximum lifetime of the Transfer Taxes was fifteen years. This implies that after that period those protective tariffs were supposed to have contributed to a balanced distribution of industries between Kenya, Tanzania and Uganda, all other things remaining the same. As was argued earlier, the cumulative causation process was likely to work in favour of Kenya retaining her industrial lead. And what seems to have been ignored by those who designed the Transfer Taxes is that some investors in industry in Kenya would respond to the presence of those tariffs by moving into the substitution of new products which were not yet subjected to the Transfer Taxes. In such a case, their exports to Tanzania and Uganda would not at all be adversely affected. As a result, this response would have enabled Kenya to retain her industrial lead over her two partner states in the EAC. Actually, Porter (1975) points out that Kenya kept a step ahead of Tanzania and Uganda in introducing new industrial activities in the EACM.[7]

The effectiveness of the Transfer Taxes could also have been doubted from the outset because they were not designed to promote large scale - East African - oriented industries. If, for instance, those protective tariffs had been used to protect a vertically integrated iron and steel project in Uganda[8], there would probably have been a substantial reduction in industrial imbalance between that country and Kenya. Those tariffs could also have been used to encourage the development in Tanzania of a vertically integrated project to produce coconut oil for human consumption and as an input for the soap industry in East Africa.[9] Since such a project would have been a large scale one, it would have contributed substantially to the reduction in industrial imbalance between Tanzania and Kenya. The above two examples would have served two purposes. One was to reduce industrial imbalances and the other was for each country to specialise in those products in which its natural endowment was the best in the Community.

5.2.3 Industrial and Trade Imbalances in EACM from 1967 to 1977: A Result of Monetary Policies Adopted?

This subsection seeks to examine whether it made sense to aspire to bring about a balanced distribution of industries in the East African Community and to have intra-EAC trade balance in the absence of a strategy on common monetary policies to be pursued in the EAC. The period to be discussed is from 1967 to 1977. During this period, the East African Currency Board (EACB) had been replaced by three national central banks as regulators of money supply in each country.

Before examining the role monetary policies adopted may have played in industrial and trade imbalances between 1967 and 1977, a brief explanation concerning how the regulation of money supply affects economic activities needs to be provided. If a government intends to expand economic activities, it can direct the central bank to effect measures such as lowering the reserve requirement and interest rates. Selling government securities will serve the same purpose. This should create the basis for money creation by commercial banks. And aggregate demand is expected to expand.[10] Aggregate demand can also be expanded through fiscal measures such as increasing government expenditure or cutting taxes. In response to the expansion of demand, investments and output are expected to increase. The converse is supposed to happen if, say, in the interest of fighting inflation, the government adopts monetary and fiscal policies which reduce the aggregate demand.

Expansionary monetary policies were pursued by the three East African countries after the creation of national central banks in 1966. From 1967 to 1977 the money supply expansion in Kenya was 6.3 fold[11], while in Tanzania it increased by a factor of 5.8.[12] In Uganda the increase was 8.8 fold.[13]

The question of interest is how these expansions were likely to affect industrial and trade imbalances in the East African Community. According to the theory seen above that expansionary monetary policies are likely to result in increases in investments and output, it would be expected that the greatest industrial expansion would have occurred in Uganda. As will be seen later in this chapter, industrial production in that country contracted between 1968 and 1977. The fact that the expansion of money supply was not accompanied by an increase in industrial output, illustrates an important point that the availability of finance does not necessarily result in an increase in investment.

This did not, however, apply to Kenya. The expansion of money supply there was accompanied by an increase in industrial output, as will be seen later in this chapter. And, as Table 5.1 below indicates, there was a big credit expansion in the manufacturing sector in Kenya. Between 1967 and 1977, the amount of credit rose from Shs. 244 million to Shs. 1286 million, an increase by the factor of 5.3. It is noteworthy that the credit to the manufacturing sector exceeded credit extended to the agricultural sector which was the backbone of the economy. This is not surprising given the high priority which was attached to the development of the manufacturing sector.

TABLE 5.1: Credit Expansion in Kenya and Tanzania, 1967-1977
(in million of shillings)

Year	KENYA				TANZANIA			
	Agric.	Mfr.	Others	Total	Agric.	Mfr.	Others	Total
1967	133	244	983	1360	293	115	410	818
1968	155	254	927	1336	292	142	463	897
1969	172	302	926	1400	381	196	516	1093
1970	186	311	1242	1739	452	214	681	1347
1971	251	495	1656	2402	479	223	802	1504
1972	240	486	1701	2427	627	255	666	1548
1973	356	558	2314	3228	656	360	805	1821
1974	481	796	2886	4163	1093	628	1178	2899
1975	737	838	3107	4682	1150	897	1304	3351
1976	813	924	3577	5314	1296	1039	1338	3673
1977	1088	1256	4881	7225	1376	1418	1609	4403

Sources: Calculated from:

1. Central Bank of Kenya, Economic and Financial Review, Volume 12, July - September, 1979, p. 29.

2. Bank of Tanzania, Economic Bulletin, Volume 13, December, 1981, p. 45.

In Tanzania, credit expansion in the manufacturing sector was even greater than the increase which occurred in Kenya. Credit rose from Shs. 115 million in 1967 to Shs. 1418 million in 1977, a 12.3 fold increase. But, as will be seen later in this chapter, industrial expansion in Tanzania was less than that which took place in Kenya in that eleven year period. This may be explained in two ways. First, Tanzania was starting from a lower industrial base than Kenya. Second, it is possible that credit availability may not have been translated into successful investments because of the inadequate presence of conditions conducive to successful investments. It will be seen in Chapter 7 that those conditions were relatively more abundant in Kenya than in the other two countries.

The fact that money supply in Uganda exceeded that in Kenya and yet industrial production in the latter was greater than that in the former, suggests that the manipulation of money supply would not have reduced industrial imbalances between the two countries. This argument is also valid in the case of Kenya *vis a vis* Tanzania.

The foregoing argument implies that monetary integration of the East African Community would not have been a solution to industrial imbalances in that Community. On the contrary, it is probable that monetary integration would have exacerbated industrial disparities by making it easier for capital to gravitate to Kenya where the prospects of the return to capital were more promising than in the other two countries.

5.2.4 Trade Imbalances in Intra-EAC Trade: A Result of Expansionary Monetary Policies?

It was explained earlier that expansionary monetary policies raise aggregate demand. As a result, the consumption of domestic goods is expected to go up. In an economic integration scheme where there are not many obstacles to inter-country trade, the rise in aggregate demand should lead to an increase in the consumption of imports from the partner states.

If some partner states are unable to provide the goods which other partners want and if they are not able to satisfy the domestic demand for many products and instead they depend on the partner states to satisfy that demand, then trade imbalances may be expected. The expansionary monetary policies in such an economic integration scheme will benefit most the member country capable of producing most goods which consumers in the integration scheme want. And such a country will tend to be in trade surplus with her partner states who have less capacity to satisfy the demand for a number of products in that economic scheme.

It will be seen later that Uganda's industrial production declined between 1968 and 1977. At the same time, her imports from Kenya, who was her more important trading partner than Tanzania, increased enormously between the two years. Due to the decline in industrial production in Uganda, her capacity to maintain her share of Kenya's market fell. These two factors resulted in an enormous trade deficit between her and Kenya (Table 5.4). It seems reasonable to assume that the great expansion of money supply seen above also contributed to that trade deficit.

The same may be said for Tanzania's increase in trade deficit with Kenya. However, because industrial production in Tanzania did not fall during the ten year period, her trade deficit with Kenya may be partly attributed to the pressure of demand for Kenyan products in Tanzania, partly to her lower capacity to export, and partly to the increase in aggregate demand following the expansion in money supply.

Trade imbalances could also be expected if as a result of monetary expansionary policies inflation in one partner state was greater than in another or others. This is particularly likely to be the case if one of the partner states has lost the capacity to satisfy both domestic and the partner states' demand in many products due to the collapse of domestic industries. That scenario actually obtained between Kenya and Uganda for the period covered by this chapter. Production in Uganda, as was explained earlier, had collapsed and inflation in that country was higher than in Kenya.[14] Due to the high inflation in Uganda, the demand for her products in Kenya was likely to be low. On the other hand, the demand for Kenyan goods in Uganda was likely to be high because low inflation in Kenya would mean that the cost of production of goods would also be low. This would, of course, lead to trade deficit for Uganda. That, as was seen above, is what actually happened.

Since monetary expansion in Kenya was greater than that in Tanzania, that should have led to an upsurge in demand for Tanzania's products. Table 5.4 shows that between 1968 and 1976 Tanzania's exports to Kenya increased by a factor of 3.4. Greater expansion could probably have occurred if inflation between the two years had not almost doubled.[15] And such an increase in exports would have contributed to a reduction in Tanzania's trade deficit with Kenya.

Despite the fact that the expansion in money supply in Kenya was greater than that in Tanzania, inflation was on the whole lower in the former.[16] This means that consumers in Tanzania would have been more inclined to buy Kenyan low cost products. Conversely, the Kenyan consumers would have been less inclined to purchase high-cost Tanzanian goods. As a result of this, one would expect that Tanzania would have been in trade deficit with Kenya. It will be seen later in this chapter that Tanzania was persistently in trade deficit with Kenya between 1968 and 1976.

5.2.5 Industrial and Trade Imbalances in EACM: A Result of Unharmonised Fiscal Policies?

Active fiscal policies were adopted in the three partner states of the East African Common Market soon after their independence in the early 1960s. The term active fiscal policy refers to the introduction of expansionary public spending programmes. The object of that policy was to stimulate the economic growth of those partner states. The expansion in spending was expected to raise aggregate demand, thus providing a stimulus for economic growth. In order to achieve this goal, the level of taxes must either be reduced or held constant.

In the light of the above explanations, an examination of what would be expected to happen in an economic integration scheme where fiscal policies are not harmonised, will be carried out. If the most economically advanced member's public expenditure is greater than that of a less developed partner, and if the level of taxation in the former is lower than that in the latter, then economic disparities between the two countries are very likely to be aggravated. This is because the expansion in aggregate demand will be greater in the more economically advanced partner state. Part of that expansion will stimulate industrial development by inducing entrepreneurs to increase investment in the industrial sector. If in addition to a greater rise in aggregate demand in the more economically advanced country, conditions conducive to industrialisation are more favourable there than in the less economically developed partner, then the existing disparities in industrial development would also become wider.

The expansion in expenditure in Kenya for the period 1968-1977 exceeded that in Tanzania for all but one year during this period. The cumulative amount of Kenya's excess expenditure was Shs. 5152 million.[17] And Kenya's expansion in public expenditure for the 1968-1973 period exceeded that of Uganda by Shs. 5059 million.[18] In theory, therefore, it would be expected that aggregate demand, investment and output, would be greater in Kenya. As will be seen later in this chapter, the expansion in industrial production was greater in Kenya than in either Tanzania or Uganda between 1968 and 1977. This establishes a correlation between uneven public expenditure and different levels of industrial development among members of an economic integration scheme.

A question of interest in this subsection is whether harmonised fiscal policy in the EACM would have reduced the unequal industrial development among the members of that economic integration scheme. A harmonised fiscal policy on its own would not have made a contribution towards the correction of industrial imbalances. To illustrate this point, let it be assumed that an agreement had been reached between the three member countries of the EACM that expenditure in each country would bear a relation to each country's level of economic development. This would have meant that expenditure in Kenya would have been greater than in either Tanzania or Uganda. Under such an arrangement, fiscal policy in the EACM would have been in harmony. Yet that would have been a recipe for the perpetuation of economic disparities between Kenya and the other two countries.

In order to reduce economic disparities in the EACM, there needed to be fiscal measures discriminating in favour of the less economically developed members. Such measures could have included greater expansion of public expenditure in those members than in the more economically advanced members. Also taxation should have been lower in the former than in the latter. Furthermore, a scheme of incentives discriminating in favour of the less economically advanced countries would have been necessary. As will be seen in Chapter 6, Kenya was not willing to accept arrangements which would retard her economic growth. This was understandable given that even though she was more economically and industrially developed than either Tanzania or Uganda, she was still by international standards backward economically and industrially.

Expansionary fiscal policies adopted in the East African Common Market could be expected to lead to intra-EACM trade imbalances. This is because those policies would result in an increase in aggregate demand. And as was explained earlier, part of that increase would lead to a rise in the consumption of imports. The country with greater capacity to export to its partner states was likely to be in trade surplus, while those members with a relatively limited capacity to export could be expected to be in trade deficit. This would particularly be the case in an economic integration scheme where goods entering inter-country trade are predominantly manufactures, and where member countries' ability to export those products differ according to their level of industrial development.

5.3 Industrial Performance of Kenya, Tanzania and Uganda, 1968-1977

The aim in this section is to compare the changes in the industrial sectors of Kenya, Tanzania and Uganda between 1968 and 1977 so as to establish whether or not industrial imbalances between the three countries were reduced. It will be recalled that it is during this period that economic disparities between the three countries were expected to be corrected. A hypothesis to be tested is that there was a general trend towards the divergence of economic disparities between Kenya and the other two countries.

Table 5.2 shows that Kenya's gross domestic product was greater than that of either Tanzania or Uganda for the ten year period covered by this chapter. It also shows that the increase in the GDP of Kenya between 1968 and

1977 was greater than that achieved by either Tanzania or Uganda. As a result, there were divergencies in economic disparities. For Kenya and Tanzania, the divergence had been rather small. The ratio of the two countries' GDP was 1.2 to 1 in 1968 and by 1977 the ratio was 1.3 to 1, both times in favour of Kenya. In the case of Kenya versus Uganda, the ratio was 1.3:1 in 1968 and 1.8:1 in 1977, also in favour of Kenya. These findings support the hypothesis that the general trend was one of the divergence of economic disparities between Kenya and the other two countries.

Table 5.2 also indicates that the manufacturing sector in Kenya made a greater contribution to the GDP than those of Tanzania or Uganda did in each of the ten years in the table. At the end of that period the cumulative contribution of the Kenyan manufacturing sector was Shs. 754 million compared to Shs. 402 million in Tanzania. In Uganda the contribution of that sector in 1977 was Shs. 18 million less than it had been in 1968. This means that there had been a strong movement towards the divergence of industrial disparities between Kenya and Uganda. The ratio of value added of the two countries' manufacturing sector moved from 2.2 to 1 in 1968 to 4.1 to 1 in 1977 in both cases in favour of Kenya.

There had also been a divergence in industrial imbalance between Kenya and Tanzania during the ten year period. It had, however, been smaller than that just

TABLE 5.2: A Comparison of Economic Performance of Kenya, Tanzania and Uganda, 1968-1977 (in millions of shillings (in real terms) and in percentages)

Year	KENYA			TANZANIA			UGANDA		
	GDP (1)	MFR (2)	(2)as % of (1)	GDP (1)	MFR (2)	(2)as % of (1)	GDP (1)	MFR (2)	(2)as % of (1)
1968	8,858	1,001	11	7,182	648	9	6,626	449	7
1969	9,340	1,115	12	7,313	727	10	7,332	489	7
1970	9,980	1,195	12	7,750	781	10	7,423	517	7
1971	10,556	1,328	13	8,142	777	9	7,669	539	7
1972	11,146	1,320	12	8,574	978	11	7,720	545	7
1973	11,748	1,501	13	8,838	969	11	7,644	507	7
1974	12,017	1,597	13	9,097	962	11	7,668	513	7
1975	12,095	1,496	12	9,598	1002	10	7,500	446	6
1976	12,821	1,699	13	10,228	1029	10	7,481	441	6
1977	13,848	1,755	13	10,890	1050	10	7,547	431	6
Changes (1968-77)	4,990	754	2	3,708	402	1	921	-18	-1

Sources: Calculated from:

1. Central Bank of Kenya, Economic and Financial Review, Volume 10, 1977, p.54.
2. World Bank Tables 1980, World Bank, pp. 118-119 for Kenya; pp. 192-193; pp. 204-5.
3. Economic Survey, 1977-78, United Republic of Tanzania, p. 9.
4. Uganda Ministry of Planning and Economic Development, Statistical Department.

seen above. The disparity ratio in 1968 had been 1.5 to 1 and by 1977 it had risen to 1.7 to 1 in favour of Kenya in both cases.

Table 5.2 furthermore shows that the importance of the manufacturing sector had risen by two percentage points in Kenya between 1968 and 1977. The increase in Tanzania between those two years was one percentage and in Uganda the importance of the manufacturing sector had declined by one percentage point. A noteworthy point is that that sector was still underdeveloped in the three countries. Its' share in the gross domestic product was by 1977 13, 10 and 6 per cent for Kenya, Tanzania and Uganda, respectively. Given the high priority attached by the three countries to industrial development, these percentages show that there was still a long way to go before those sectors could make major contributions to the national economies.

5.3.1 Employment Provided by Manufacturing Sectors of Kenya, Tanzania and Uganda, 1968-1977

Employment provided by the manufacturing sectors of Kenya, Tanzania and Uganda between 1968 and 1977 is used in this subsection to assess the direction of industrial imbalances once again. Table 5.3 below indicates that the Kenyan manufacturing sector provided more employment than the Tanzanian or the Ugandan counterpart sectors did. In 1968, the Kenyan manufacturing sector employed

8.6 thousand more people than the Tanzanian sector did and 12 thousand more than was employed in the Ugandan manufacturing sector. In the subsequent years, as the table indicates, the disparity in employment in the case of Kenya and Tanzania, reached the climax in 1972 when it stood at 39.3 thousand people in favour of Kenya. From then onwards the general trend in employment disparity was downwards. By 1977, employment in Kenya was 26.7 thousand more than in Tanzania. And the total increase in disparity between the two countries since 1968 was 18.1 thousand people. This lends support to the hypothesis seen earlier that the general trend was one of industrial development divergence between Kenya and her partner states in the East African Community.

A comparison of employment provided by the Kenyan and the Ugandan manufacturing sectors provides even more convincing evidence to support the hypothesis. Table 5.3 indicates that the employment disparity between the two countries increased from 12 thousand in 1968 to 66.4 thousand in 1977. The increase in employment in Kenya was 59.8 thousand while in Uganda it was only 5.4 thousand. This meant that on average the additional annual employment creation was 6 thousand in Kenya and only 0.54 in Uganda. In Tanzania, it was about 4.2 thousand. Assuming that these rates of job creation had not changed, say in the next five years from 1977, the disparity between Kenya and the other two countries would have been greater at the end of that

TABLE 5.3: A Comparison of Employment in Manufacturing Sectors of Kenya, Tanzania and Uganda, 1968-1977

(in thousands and in percentages)

Year	KENYA (1)	TANZANIA (2)	UGANDA (3)	K-T* Disparity (4)	K-U* Disparity (5)	Kenya's Share of EA Employment (6)	Tanzania's Share of EA Employment (7)	Uganda's Share of EA Total Employment (8)
1968	51.4	42.8	39.4	8.6	12.0	38.5%	32.0%	39.5%
1969	55.9	43.8	42.9	12.1	13.0	39.2	30.7	30.1
1970	61.6	48.7	42.5	12.9	19.1	40.3	31.9	27.8
1971	75.1	50.9	42.0	24.2	33.1	44.7	30.3	25.0
1972	94.4	55.1	40.6	39.3	53.8	49.7	29.0	21.3
1973	99.7	63.7	41.5	36.0	58.2	48.7	31.1	20.2
1974	93.8	70.3	43.5	23.5	50.3	45.2	33.9	20.9
1975	108.6	74.3	44.0	34.3	64.6	47.9	32.7	19.4
1976	110.0	79.0	46.8	31.0	63.2	46.7	33.5	19.8
1977	111.2	84.5	44.8	26.7	66.4	46.2	35.1	18.6
Changes 1968-1977	59.8	41.7	5.4	18.1	54.4	7.7	3.1	-10.9

Sources: Calculated from:

1. Uganda Government, Ministry of Economic Development and Planning, Statistical Department.
2. United Nations, Statistical Yearbooks, 1972-77.
3. Bank of Tanzania, Economic Survey, various years.

* K-T stands for Kenya-Tanzania.
* K-U stands for Kenya-Uganda.

period than it had been at the beginning (1977).[19]

The last three columns of Table 5.3 show employment in the manufacturing sector of each country as a proportion of total employment in the East African Community manufacturing sectors. The Kenyan manufacturing sector's share was, as may be expected, greater than that of either of the two countries. This is true for each of the ten years shown in the table. Although the Kenyan share fluctuated, the general trend was in the upward direction. The same is true for Tanzania, although between 1969 and 1973 the trend was downwards; after the latter year, the movement was generally in the upward direction.

Table 5.3 shows that Uganda's share declined throughout the ten year period. Her share fell by 10.9 percentage points between 1968 and 1977. Kenya's share, on the other hand, increased by 7.7 percentage points. The increase in Tanzania was only 3.1 percentage points. If there had been an agreement on how to promote balanced employment creation in the EAC, it would have been reasonable to consider a strategy of promoting more investments in labour intensive industries in Tanzania and especially in Uganda.

5.4 Intra-East African Community Trade, 1968-1977

This section seeks to analyse the changes in trade between Kenya, Tanzania and Uganda from 1968 to 1977. As had already been mentioned, the relationship which existed between industrial imbalance and trade imbalance was of a causal nature. It is expected, therefore, to find that trade imbalances widened between the two years because industrial imbalances also widened.

It may be seen from Table 5.4 that trade imbalances widened between 1968 and 1976. The reason why the focus of attention should be on this period and not the 1968-1977 one, is that in 1977 the border between Kenya and Tanzania was closed, and that drastically reduced the volume of trade with each other.

During the 1968-1976 period, Kenya not only had a persistent balance of trade surplus, but the size of that surplus increased 3.7 fold. On the other hand, both Tanzania and Uganda had persistent trade deficit. For Uganda, her trade deficit increased 13.6 times between 1968 and 1977. For Tanzania, the deficit increased 1.9 fold between 1968 and 1976.

The fact that trade imbalances increased at the time when industrial imbalances were also increasing, is consistent with the expectation that the two forms of imbalances should move in the same direction, but that does not establish a causal relationship. This is because some of the goods entering inter-country

TABLE 5.4:

Intra-East African Community Trade, 1968-1977

(in million of East African shillings*)

Year	Kenya's Exports to:		Tanzania's Exports to:		Uganda's Exports to:		Balance of Trade of		
	Tanzania	Uganda	Kenya	Uganda	Kenya	Tanzania	Kenya	Tanzania	Uganda
1968	261	265	74	17	173	34	279	-204	-75
1969	257	319	80	23	156	40	340	-194	-146
1970	295	334	119	29	201	16	309	-163	-146
1971	295	385	159	38	160	6	361	-104	-257
1972	332	335	116	15	156	2	395	-203	-192
1973	340	446	154	18	96	-	536	-168	-368
1974	384	552	193	26	76	-	667	-165	-502
1975	407	514	192	6	29	-	720	-229	-491
1976	651	654	253	7	15	-	1037	-391	-646
1977	195	1025	33	-	8	-	1179	-162	-1017

Sources: Computed from:
1. Central Bank of Kenya, Report for June, 1978, pp. 57-58.
2. Bank of Tanzania, Economic Bulletin, Report for 1978, p.52.
3. East African Statistical Department, Statistical Reviews, 1968-1976.

* The shilling, although it was since 1966 issued by three national central banks, it was still officially at par until 1980.

trade were not manufactured products. In order to give an idea of the correlation between industrial imbalance and trade imbalance, manufactured goods are defined. That is a prelude to showing the causal relationship between the two variables.

Manufactured products are defined as some items falling under Standard International Trade Classification (SITC) Section 1, beverages and tobacco, and all items falling under Sections 3, 5 to 8. This definition is broader than the one usually used which includes only items in SITC 5 to 8. The choice of a broad definition is based on a consideration that at an early stage of industrial development, most industrial activities tend to concentrate in basic manufacturing activities such as food processing and beverages which fall below SITC 5.

Table 5.5 shows the size of manufactured and non-manufactured products traded between 1968 and 1975. The other two years, 1976 and 1977, are left out because disaggregated data on them are not available. Notice that manufactured products accounted for between 70 and 85 per cent of Kenya's total exports to Tanzania and Uganda.

On the other hand, in Tanzania manufactures accounted for between 41 and 59 per cent of her exports to Kenya and Uganda. In Uganda, although the exports declined sharply between 1968 and 1975, manufactures still

TABLE 5.5:

Intra-East African Community Trade in Manufactured and Non-Manufactured Products, 1968-1975

(in million of East African shillings and in percentages)

	Kenya			Tanzania			Uganda		
Year	Mfg.	Non-Mfg.	Mfg.as % of total exports	Mfg.	Non-Mfg.	Mfg. as % of total exports	Mfg.	Non-Mfg.	Mfg.as % of total exports
1968	400	127	76	43	48	47	112	101	52
1969	409	167	71	49	55	47	118	72	62
1970	452	177	72	61	86	41	141	100	58
1971	508	170	75	98	98	50	108	69	61
1972	458	198	70	71	62	53	103	54	66
1973	562	213	72	100	70	59	70	26	73
1974	768	199	79	111	106	51	38	37	51
1975	782	141	85	80	94	46	18	11	62

Mfg. stands for manufactured products.

Non-Mfg. " " non-manufactured products.

Sources: Computed from data in East African Stastical Department, Economic and Stastical Reviews, 1968-1976.

accounted for between 51 and 73 per cent of the total exports.

The Ugandan situation where, due to industrial decline, the value of exports of manufactures which used to form over 50 per cent of her exports to Kenya and Tanzania also declined sharply, provides further proof that industrial imbalance and trade imbalance were causally related. It is also relevant to note that as industrial production in Tanzania expanded and manufactured products increased their share in her total exports to Kenya and Uganda (see Tables 5.3 and 5.5), her trade deficit generally declined between 1969 and 1974.

Summary

The main findings and arguments of this chapter are the following. The balanced economic development of the three member countries of the East African Community was found to be an unrealistic objective. This was because there were no plans to bring about that objective. Instead, there seemed to be competition to accelerate the pace of development of national economies. It was argued that under such competition the circular and cumulative causation was likely to work in favour of Kenya. That would lead to the persistence of economic disparities. It was also argued that the expansionary monetary and fiscal policies pursued in the EAC were not the type which would correct industrial and trade imbalances.

It was further argued that the Transfer Taxes could not realistically be expected to make a significant contribution towards even distribution of industries in the EAC. This argument was based on two principal considerations. The first was that conditions conducive to industrial development were more favourable in Kenya than in the other two countries. Secondly, Kenya's capacity to generate investment, as will be seen in Chapter 6, was greater than either Tanzania's or Uganda's.

Empirical investigations concerning the changes in industrial production in the three countries showed that industrial imbalances diverged between 1968 and 1977. The divergence between Kenya and Uganda had been greater than that between Kenya and Tanzania. It was also found that intra-EAC trade imbalances had widened. This was to be expected since industrial imbalances, the main cause of trade imbalances, had widened.

The divergence in industrial disparities between Kenya and the other two countries is borne in mind in the next chapter. In that chapter, the measure of effectiveness of the East African Development Bank met with as an instrument for correcting industrial imbalances between Kenya and the other two countries is evaluated. The question to be answered there will be whether or not the EADB contributed towards the reversal of the industrial disparities seen in this chapter.

Notes

1. *See* Document: Treaty for East African Co-operation, *Journal of Common Market Studies*, Volume 7, Article 2.

2. The Kenyan Government was more active than those of Tanzania and Uganda in so far as the encouragement and support of private investors were concerned. *See* A. Siedman (1972), *Comparative Development Strategies*, (Nairobi: East African Publishing House), Chapter VI.

3. The author knows from his experience of East Africa that a number of consumer goods produced in Kenya were considered by the consumers to be of higher quality than those manufactured in either Tanzania or Uganda. In many cases this judgement was right. But one should not completely rule out an irrational preference of imported products over the locally produced goods.

4. Calculated from Republic of Kenya, *Economic Survey*, 1965, p. 46.

5. Ibid.

6. For instance, in Uganda tariff protection for 22 industrial products used in a certain study was between 125 and 12 per cent. The average was 41 per cent. Calculated from V. Jamal (1976), "Effective Protection in Uganda", *Eastern Africa* Economic Review, volume 8, p. 64.

7. *See* R.C. Porter (1974), "Kenya's Future as an Exporter of Manufactures", *Eastern Africa Economic Review*, volume 6, pp. 44-69.

8. Uganda has deposits of iron ore close to its Eastern border with Kenya. From that region, it is also easy to reach northern Tanzania through Lake Victoria. Therefore, if an iron and steel plant had been set up there, it would have been able to serve both Kenya and Tanzania as well as Uganda.

9. Tanzania has the largest area suitable for growing coconut trees in East Africa. See East African Development Bank, Mafia Coconut, file PS/16B/8/I.

10. See J.K. Galbraith (1969), The Affluent Society, (London: Hamish Hamilton), Chapter XV.

11. Changes in Bank deposits are used to calculate the increase in money supply. See for Kenya, Central Bank of Kenya, Economic and Financial Review, Volume XII, July-September, 1979, p. 28.

12. For Tanzania, see Bank of Tanzania, Economic Bulletin, Volume XII, March, 1980, p. 42.

13. For Uganda, see Ministry of Planning and Economic Development, Statistical Department Reports.

14. The annual rate of inflation in the 1970s was about 29 per cent in Uganda and 11 per cent in Kenya. See World Bank (1981), Accelerated Development in Sub-Saharan Africa, (Washington, D.C.: World Bank), p. 143.

15. See World Bank, World Tables (1980), pp. 118-9 for Kenya, and pp. 192-3 for Tanzania.

16. The annual rate of inflation in Tanzania was approximately 13 per cent, while in Kenya, as was noted above, it was 11 per cent. See World Bank (1981), Accelerated Development in Sub-Saharan Africa, op. cit., p. 143.

17. Calculated from United Nations, Statistical Yearbook, 1970, 1974 and 1978.

18. Ibid.

19. At the end of a five year period beginning in 1977 - in other words by 1982 - the disparity in employment would have been 95 thousand between Kenya and Uganda. It was seen that by 1977 the disparity between the two countries stood at 66.4 thousand. There would also have been a divergence in employment disparity in the manufacturing sectors of Kenya and Tanzania. The disparity in 1982 would have been 36 thousand. But, as was noted earlier, the disparity between the two countries in 1977 had been about 27 thousand.

CHAPTER 6

EFFECTIVENESS OF EAST AFRICAN DEVELOPMENT BANK IN ITS TWO PRINCIPAL OBJECTIVES

6.1 Introduction

A balanced distribution of industries among the three member countries of the former East African Community (EAC) was one of the major objectives of the Treaty for East African Co-operation, and the East African Development Bank (EADB), as was mentioned in Chapters 1 and 5, was one of the two mechanisms which were created to bring about that objective. The Bank (as EADB will be called from now onwards) was actually designed primarily to reduce industrial imbalances between Kenya on the one hand, and Tanzania and Uganda, on the other. Another objective of the Bank was to promote and finance industrial projects which would make the economies of its three member countries, Kenya, Tanzania and Uganda, complementary. The Bank came into existence in December, 1967, but started lending in 1969. It survived the break-up of the East African Community in 1977 mainly because of the World Bank's intervention.[1] The Bank still operates today.

The aim of this chapter is to evaluate how effective the Bank was as an instrument for reducing industrial gaps and for bringing about industrial complementarity in the East African Community. The period to be covered is from 1969 to 1977. After 1977, the activities of the Bank ground virtually to a halt following the end of the Community. This is the reason why investigations of this chapter end at 1977.

The evaluation of how effective the Bank was as an instrument for reducing industrial imbalances takes a very large part of this chapter. This is not because the author attaches more importance to that objective than to the industrial complementarity one.[2] It is rather because the activities of the Bank were such that more work was done on lending in order to achieve a balanced distribution of industries than in promoting industrial complementarity. This does not mean that the Bank neglected work on industrial complementarity. On the contrary, the Bank took important initiatives to fulfil that objective, but nothing came out of these initiatives.

6.2 Data Collection and Methods of Analysis

Data used in this chapter came from three sources. The first is the published annual reports of the Bank from 1969 to 1977. The second is the files of projects which are kept by the offices of the Bank in Kenya, Tanzania and Uganda. These confidential files were studied by the author during his fieldwork. The third source is the interviews which were conducted with some officials of the Bank in the three countries. The author also had a discussion with the former Director-General of the Bank, who led it from 1967 to 1977.

Three types of analyses are carried out. First, the degree of success the Bank achieved in allocating the funds at its disposal to the three partner states, according to the prescribed lending formula, is established. The formula was that at the end of a five year period of lending, funds should have been distributed in such a way that Kenya would have been allocated 22.50 per cent of the total amount lent,[3] and Tanzania and Uganda were supposed to have been each allocated 38.75 per cent of the total amount lent over five years. It is this unequal distribution of funds that was expected to reduce industrial imbalances.

The second type of analysis is to use fund disbursement as a criterion on which the effectiveness of the Bank as an instrument for reducing industrial imbalances is evaluated. The author is aware that the Charter of the Bank did not expect fund disbursement to be used as a criterion for evaluating the effectiveness of the Bank. It should, however, be realised that because funds may be allocated but may not be drawn in a reasonable time, fund allocation criterion can give results which are different from those given by the fund disbursement criterion. Bearing in mind the steps taken towards implementing a project, the latter criterion is a step ahead of the former. Therefore, fund disbursement is a better indicator of the effectiveness of the Bank, or lack of it, than the fund allocation criterion.

The third type of analysis is a comparison of the importance of the Bank as a source of finance with other sources. For the purpose of simplifying analysis, the sources of finance for the projects in whose financing the Bank participated, are divided into two, namely, the Bank and the Non-Bank. The aim of this exercise is to indicate the extent to which the Non-Bank source in Kenya contributed to the widening of industrial imbalances between her and the other two countries. The exercise involves comparing the amounts of finance contributed to the total cost of projects by the Non-Bank source in Kenya on the one hand, and the Non-Bank sources in either Tanzania or Uganda on the other. In order to give a fuller picture, an attempt is made to compare what this study calls "balancing effect" of the Bank with the "disparity effect" arising from Kenya's greater capacity to invest. The two terms are defined below.

6.3 Main Arguments

The main arguments of this chapter are the following. The first is that the Bank was not an effective instrument for reducing industrial imbalances, partly because it had limited funds. The second is that because fund absorption was higher in Kenya than in the other two countries, the expected reduction in industrial imbalances could not be achieved. In other words, making available funds to Tanzania and Uganda *per se* was no guarantee that industrial imbalances between the two countries with Kenya would be reduced. What was required was not only the unequal distribution of funds seen above, but also that fund absorption in Tanzania and Uganda should be at least equal to fund absorption in Kenya. The latter was something completely beyond the control of the Bank, as will be explained later.

The third argument is that the expectation concerning the effectiveness of the Bank was exaggerated. This argument derives mainly, but not exclusively, from the benefit of hindsight after comparing the finance contributed by the Non-Bank sources in Kenya and in the other two countries. It is, however, borne in mind that if there had been no uncertainty about the future of the East African Community, probably the Bank would have achieved more than it did. The fourth argument is that because no agreement existed on the rationalisation of industrial production in the Community, the industrial complementarity objective was an unrealistic goal. Finally, it is argued that the political will to co-operate which was first eroded by the economic hardships faced by the three member countries of the Bank in the early 1970s, and exacerbated by the Amin regime in Uganda which was constantly at loggerheads with the Tanzanian government, created an environment in which it was very difficult for the Bank's initiatives at rationalising production to succeed. Rationalising production on the Community basis as suggested by the Bank (to be seen later) would have had adverse effect on some producers. Yet, no arrangement was proposed on how to compensate those who would be adversely affected.

6.4 Sources of Funds for the Bank and Methods of Operation

The Charter of the Bank proposed two sources of finance for projects.[4] The first was the paid-in capital, reserves of the Bank, its undistributed surplus and the Special Funds. The second was funds raised from capital markets within or without the East African Community. The authorised capital stock of the Bank was Shs. 400 million.[5]

The Bank, like most other regional banks, was only concerned with whether or not a project submitted to it for a loan was economically viable and technically feasible. The Bank was not involved in the decisions concerning political considerations of the location of projects in its member countries.[6] This meant that it was seen to be impartial in distributing the funds at its disposal. This is perhaps the main reason why despite some misunderstandings which existed between its member countries, the Bank was never accused of partiality. That in turn seems to be one of the major reasons for its survival when other Community institutions collapsed in 1977.

6.5 Allocations, Disbursements and Sources of Finance for EADB-Financed Projects, 1969-1973

It was explained earlier that the Bank was expected to reduce industrial imbalances by allocating more funds to Tanzania and Uganda than to Kenya. It will also be recalled that the Bank was expected to comply with the lending formula at the end of a five year period of lending.

6.5.1 Allocations to Kenya, Tanzania and Uganda, 1969-1973

The allocations to Kenya, Tanzania and Uganda between 1969 and 1973 are shown in Table 6.1. It may be seen that by 1973 Kenya had been allocated a

TABLE 6.1: Allocation of Funds to Kenya, Tanzania and Uganda, 1969-1973

(in million East African shillings and in percentages)

Year	Kenya	Tanzania	Uganda	Total
1969	11.20	13.65	12.00	36.85
1970	19.43	18.60	1.50	39.53
1971	4.80	8.60	33.47	46.87
1972	10.46	44.60	38.25	93.31
1973	22.60	12.76	10.00	45.36
Total	68.49	98.21	95.22	261.92
Actual Percentage	26.10	37.50	36.40	
Expected Percentage	22.50	38.75	38.75	
Deviations in Amount	+ 9.56	- 3.28	- 6.27	

Source: Computed from East African Development Bank and *Industrial Development of East Africa*, Ten Year Report (1967-1977), pp. 34-35.

cumulative sum of Shs. 68.49 million, while Tanzania and Uganda had been allocated Shs. 98.21 million and Shs. 95.22 million respectively. These amounts correspond, as row 8 indicates, to 26.1, 37.5 and 36.4 per cent of the total amount that the Bank had lent to the three countries. It may be seen by comparing rows 8 and 9 that the deviations from the expected were small. For Kenya, the Bank deviated from the expected by 3.60 per cent in an upward direction. This meant that Kenya was allocated Shs. 9.56 million more than was expected (see last row). On the other hand, the deviation from the expected in Tanzania was 1.25 per cent below the 38.75 mark as rows 8 and 9 indicate. This meant that she was allocated Shs. 3.28 million less than was required by the lending formula. For Uganda, the deviation from the expected was 2.35 per cent and that meant that she was allocated Shs. 6.27 million less than was required by the lending formula (see the bottom row).

While in principle the fact that the Bank did not fully comply with the prescribed lending formula meant that industrial imbalances could not be reduced according to expectation, the deviations were almost insignificant. The Bank did, therefore, achieve a very high measure of success. This judgement considers the fact that the deviations seen above were for a five year period.

The fluctuations in year to year allocations shown in Table 6.1 deserve comment. The amount the Bank allocated to each country was not the same in each year. For instance, in 1971 Kenya was allocated Shs. 4.80 million, while in 1973 she received Shs. 22.60 million. There were similar fluctuations in both Tanzania and Uganda as the table shows. The explanation for those fluctuations is that the number of projects the Bank financed varied from year to year. In some years the Bank had more projects which passed its criteria of economic viability and technical feasibility than in other years. The Bank, like other lending institutions, appraised projects and committed its funds to those with very high prospects of becoming commercially profitable. However, in some cases it financed projects with no outstanding chances of succeeding provided those projects' potential for contributing to economic growth were high. Such projects were often guaranteed by national governments. This meant that in the event of the commercial failure of those projects, the government would repay the Bank's loan to such projects.

6.5.2 Disbursements to Kenya, Tanzania and Uganda

This subsection investigates whether or not the Bank also achieved much success from the standpoint of disbursements. It may be recalled that it was argued that disbursement is a better indicator of whether or not the Bank was an effective instrument. As a prelude to analysing the distribution of disbursements, a term which will be used in the discussion must be defined. The term is fund absorptive achievement. It is defined as the amount of funds disbursed to each country divided by the amount allocated. In other words, fund absorptive achievement is that fraction of the amount allocated which was disbursed. This term will be applied to what had happened at the end of a five year period, 1969-1973, since it is after this period that the Bank was expected to have reduced industrial imbalance. It should be pointed out that the Bank had a policy of disbursing the amounts allocated only if satisfactory progress in project implementation was taking place.

It may be seen from Table 6.2 that by 1973 more funds had been disbursed to Tanzania than Kenya. This was consistent with the principle that the former should receive more funds than the latter. Notice, however, that Kenya's fund absorptive achievement was slightly greater than Tanzania's. This meant that industrial imbalance between the two countries could not be reduced exactly as the lending formula required. In order for imbalance to be reduced according to the ratios given by the lending formula, fund absorptive achievements in Kenya and Tanzania needed to be at least equal. But the Bank, as will be explained in the

TABLE 6.2: Disbursements to Kenya, Tanzania and Uganda, 1969-1973

(in million of East African shillings and in percentages)

Year	Kenya		Tanzania		Uganda	
	Cumulative Disbursements	Fund Absorptive Achievement	Cumulative Disbursements	Fund Absorptive Achievement	Cumulative Disbursements	Fund Absorpt[illegible] Achieve[illegible]
1969	1.93		Nil*		2.00	
1970	11.25		Nil		7.48	
1971	23.80		20.10		14.17	
1972	28.84		37.36		17.32	
1973	45.82	67	62.90	66	19.86	21
Disbursement Ratios		35.64		48.92		15.44
Deviations in percentage	+13.14		+10.17		-23.31	

* There were no disbursements to Tanzania in 1969 and 1970 because projects had not yet been implemented.

Source: Computed from East African Development Bank and Industrial Development of East Africa, Ten Year Report (1967-1977), pp. 36-38.

next two paragraphs, had hardly any control over fund absorptive achievement.

Uganda had the lowest fund absorptive achievement in the Community. It may be seen from Table 6.2 that Uganda's absorptive achievement was 21 per cent, less than one third of Kenya's. This low absorptive achievement was largely due to the mismanagement of the Ugandan economy by the Amin Government which came into office in 1971. The term mismanagement of the economy refers to the failure on the part of the Government to provide a coherent policy on what was expected to be achieved and the failure to create the environment conducive to economic growth. As will be seen ahead in this chapter, the necessary co-operant factors which would have facilitated high fund absorption were lacking in Uganda mainly because of the poor performance of the economy. This reminds us of the important role of the co-operant factors in capital absorptive capacity seen in Chapter 3.

A question which must now be answered is what the different fund absorptive achievements seen above tell us about the effectiveness of the Bank as an instrument for reducing industrial imbalances. In the case of Kenya and Tanzania, because absorptive achievements of the two countries were almost the same (67 and 66 per cent, respectively) industrial imbalance between the two countries was also reduced almost as the lending formula required. It must be stressed, however, that since the Bank had hardly any influence over absorptive achievements in the two countries, the compliance with what the Bank was expected to achieve was coincidental.

For Kenya and Uganda, the industrial imbalance between the two countries widened because of a very low fund absorptive achievement in Uganda. By 1973, Kenya had absorbed Shs. 25.96 million more than Uganda. It is of interest to note that while the fund allocation criterion in the subsection 6.5.1 showed that industrial imbalance between the two countries was reduced, the fund absorptive achievement criterion shows the opposite. In other words, while the former criterion showed that the Bank had been effective, the latter shows that it had been ineffective. Because it was argued that disbursement (which is closely related to fund absorptive achievement) is a better indicator of the effectiveness of the Bank, or lack of it, than the fund allocation criterion, it is concluded that the Bank did not reduce industrial imbalance between Kenya and Uganda. The Bank may hardly be blamed for that failure since its influence over the determinants of fund absorption was minimal.[7]

It seems that those who designed the Bank assumed that funds made available to the member states of the Bank would be utilized (disbursed) in a reasonable time. They could not envisage that conditions in Uganda could change in such a way that fund absorption there would be v

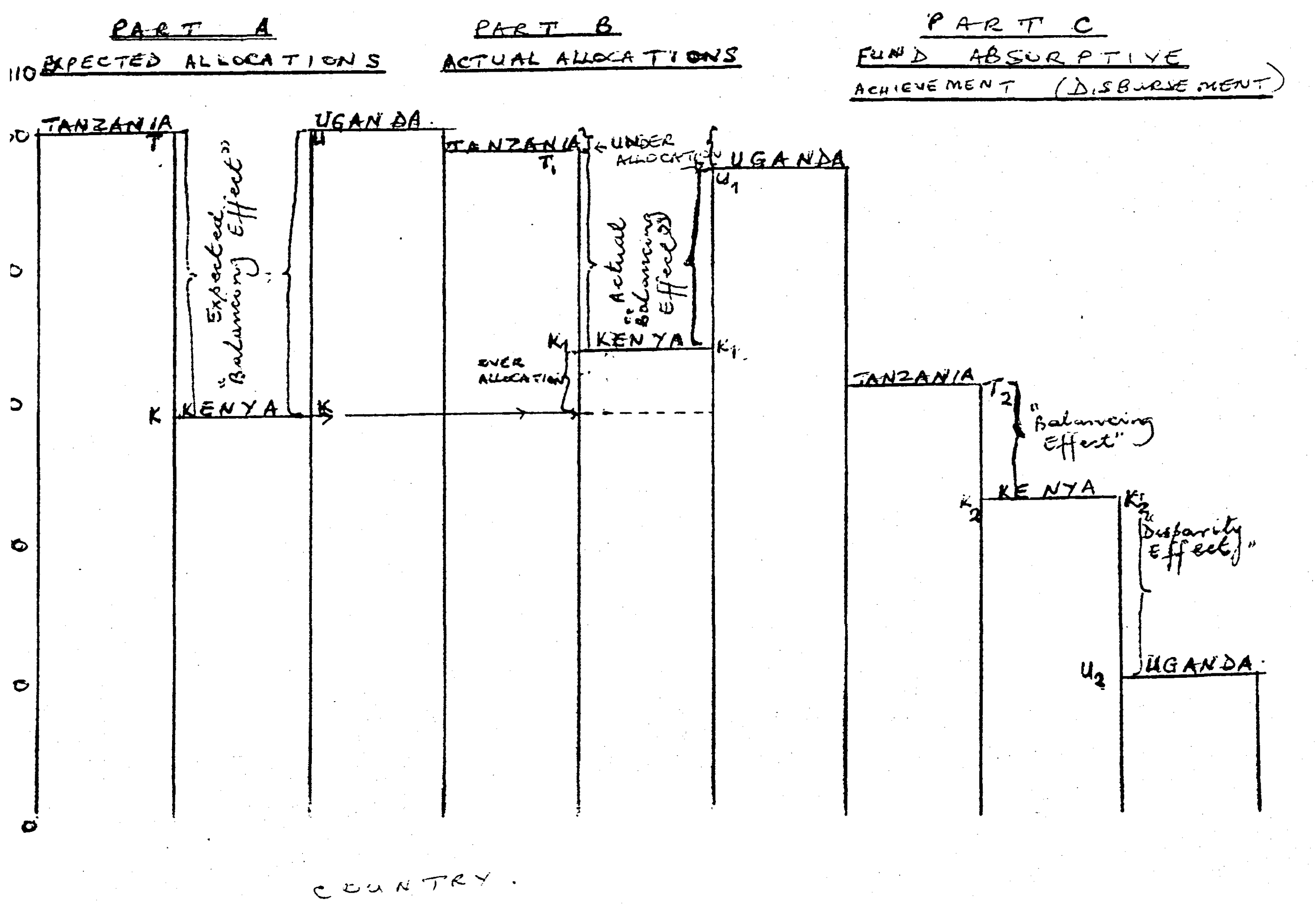
very low. While it may be unfair to expect that the designers of the Bank could predict conditions in Uganda, a lesson arising from the Ugandan situation is that in future consideration should be given to the likelihood of the rates of disbursement varying between member countries of an economic integration scheme. The variation could mean that the reduction of regional economic disparities might not be achieved.

Before moving on to evaluate the effectiveness of the Bank from a broader criterion than the two used above, the results of analyses carried out in this subsection and in the last one are summarised in Figure 6.1. Part A shows what should have been allocated to Kenya, Tanzania and Uganda at the end of five years. The amounts in Part A are arrived at by applying the prescribed lending formula (22.50 : 38.75 : 38.75) to the total amount that was lent between 1969 and 1973. Part B shows the actual allocations and Part C shows the amount which had been disbursed to the three countries after the five year period. Deviations from expectation in so far as allocations were concerned are referred to either as over- or under-allocations. Terms "balancing effect" and "disparity effect" which are explained in subsection 6.5.2 are shown in the figure. Notice that while fund allocation criterion (actual) showed that there had been "balancing effects" K_1T_1 for

Figure 6.1

Expected, Actual Allocations and Fund Absorption (Disbursements)

(in million of shillings)



Kenya and Tanzania, and K_1 U_1 for Kenya and Uganda, the disbursement criterion showed that the "balancing effect" for Kenya and Tanzania was only K_2 T_2 and for Kenya and Uganda there was "disparity effect" in favour of Kenya, represented by U_2 K_2.

6.5.3 Sources of Finance and the Balanced Industrial Development Objective, 1969-1973

An attempt will now be made to evaluate how effective the Bank was using a broader criterion than the fund allocation and fund disbursement criteria. The broader criterion is what the study classifies as the two types of sources of finance for the projects in whose financing the Bank participated. One source was the Bank itself and the other is what the study calls the Non-Bank which comprises all other parties that provided finance to a given project. Although this classification may appear arbitrary, it serves a useful purpose of distinguishing the Bank from other sources of finance. That makes it possible to examine its effectiveness as an instrument for reducing industrial imbalances.

Table 6.3 shows the two sources of finance mentioned above. It may be seen that, on the whole, the Bank's contribution to the total cost of projects was least in Kenya. For instance, by 1973 the Bank's contribution

TABLE 6.3: Sources of Finance from the Bank and Non-Bank, 1969-1973
(in million of East African shillings* and in percentages)

Year	KENYA				TANZANIA				UGANDA			
	Non-Bank (1)	Bank (2)	Expected Allocations (3)	(2) as % of Total Cost of Projects (4)	Non-Bank (1)	Bank (2)	Expected Allocations (3)	(2) as % of Total Cost of Projects (4)	Non-Bank (1)	Bank (2)	Expected Allocations (3)	(2) as % of Total Cost of Projects (4)
1969	69.80	11.20	8.29	14	66.35	13.65	14.28	17	40.40	12.00	14.28	21
1970	305.67	19.43	8.89	6	38.90	18.60	15.32	44	13.50	1.50	15.32	10
1971	4.00	4.80	10.54	54	16.40	8.60	18.16	34	114.53	33.47	18.16	22
1972	30.54	10.46	20.99	N.A.	189.60	44.60	36.16	19	159.27	38.25	36.16	21
1973	229.11	22.60	10.21	4	82.13	12.76	17.58	13	16.00	10.0	17.58	38
Total	639.12	68.49	58.92	10	393.38	98.21	101.50	20	343.70	95.22	101.50	22

Source: Computed from East African Development Bank, Annual Reports, 1969-1973.

* The Shilling which was a common currency in the East African Community was officially at par until 1980.

N.A. stands for not available. The total cost of projects could not be ascertained due to the lack of the relevant data.

to the cumulative cost of projects in that country was 10 per cent. In Tanzania and Uganda, the Bank's contributions, also at the end of 1973, were 20 and 22 per cent respectively.

A question which should be answered is that given that the Bank was not as important a source of finance for projects as the Non-Bank, could it make a significant impact in reducing industrial imbalances? As a prelude to answering that question, two terms which will be used are defined. The first is what the study calls the Bank's "balancing effect". This is defined as that amount by which the Bank's allocations to either Tanzania or Uganda at the end of five years of lending exceeded the amount allocated to Kenya. The other term is the "disparity effect". This is defined as that amount by which investment finance provided by the Non-Bank in Kenya exceeded the amount supplied by the Non-Bank sources in either Tanzania or Uganda. Once again, the focus of interest is on what had happened by 1973.

The "balancing effect" (of the Bank) in the case of Kenya and Tanzania was Shs. 29.72 million by 1973. The "disparity effect" was Shs. 245.74 million. The net effect was, therefore, that of disparity, equal to Shs. 216.02 million. For Kenya and Uganda, the "balancing effect" was Shs. 26.73 million and the "disparity effect" was Shs. 295.42 million. Therefore, the net effect was that of disparity, represented by shs. 268.69 million. Clearly, the "balancing effect" of the Bank was greatly offset by the "disparity effect". This was more so in the case of Kenya and Uganda. In view of these findings, it follows that the Bank was not an effective instrument for reducing industrial imbalances.

The reason why the Bank was ineffective is that it had limited funds in relation to the task of counter-balancing the difference in capacity to invest between Kenya and the other two countries. However, even if the Bank had had more money to lend than it did, that may not have necessarily made it a more effective instrument for reducing industrial imbalances. This is because, as was noted in subsection 6.4.2, Kenya's fund absorptive achievement was greater than either Tanzania's or Uganda's. If the Bank had had more funds and increased the amounts allocated to the three countries, it is probable that Kenya would have absorbed more funds than either Tanzania or Uganda. That would have led to an increase in industrial imbalance, which was the opposite of what was wanted.

The "disparity effects" would have slightly narrowed if the Bank had fully complied with the prescribed lending formula. Table 6.3, column 3 under each country, shows the expected allocations, while column 2 shows the amounts which were actually allocated. There was a small over-allocation for Kenya. And there were even smaller under-allocations for both Tanzania and Uganda.

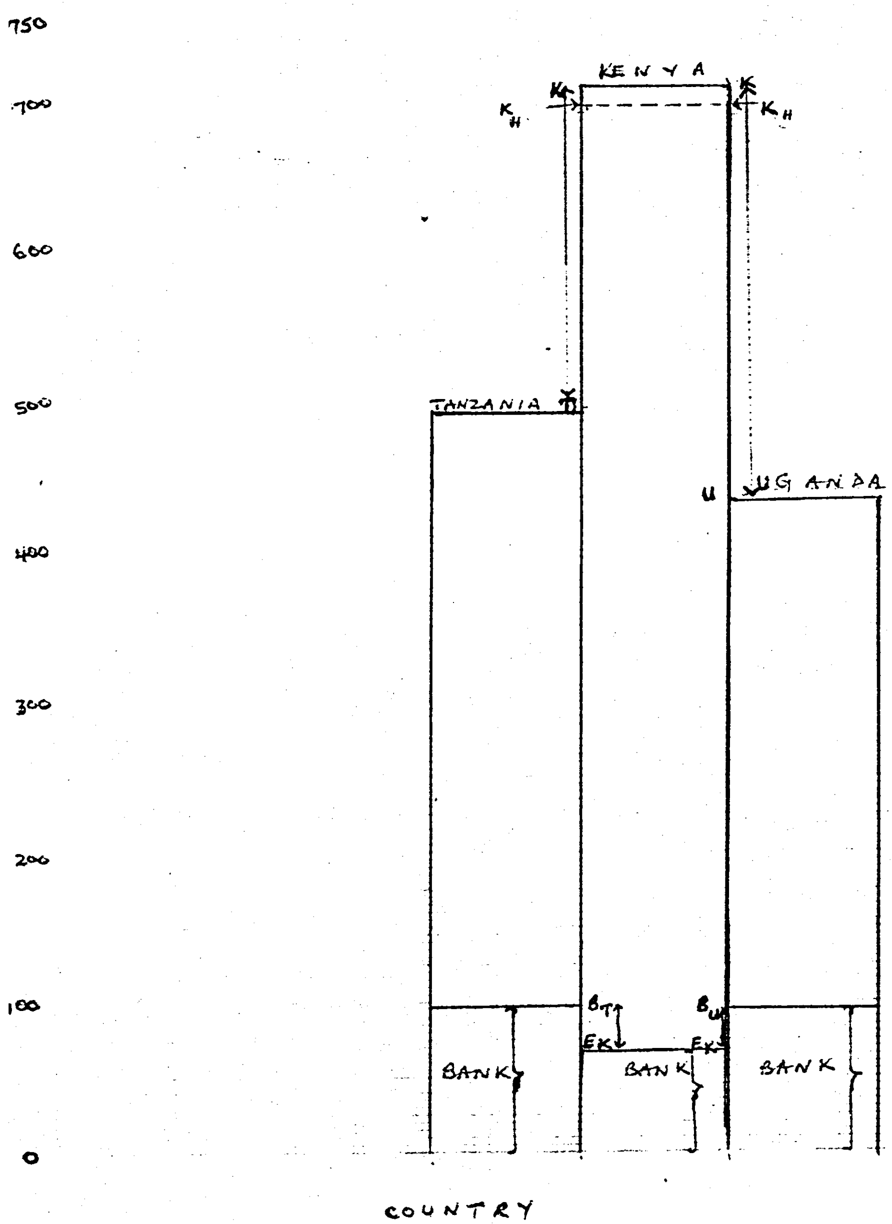
If the lending formula had been strictly adhered to, the "balancing effect" in the case of Kenya and Tanzania would have been Shs. 42.58 million instead of being Shs. 29.72 million as seen above. The net "disparity effect" would, therefore, have been reduced from shs. 216.02 million to Shs. 203.16 million.

The "balancing effect" in the case of Kenya and Uganda would also have risen by the same amount as in the case of Kenya and Tanzania. This is because Tanzania and Uganda were supposed to be allocated equal amounts. The net "disparity effect" between Kenya and Uganda would have fallen from Shs. 268.69 million to Shs. 255.83 million. These reductions in investment disparities which would have resulted from strict adherence to the lending formula, are very small in relation to the "disparity effect" of the Non-Bank. Therefore, complete compliance with the lending formula, *per se*, would not have made the Bank an effective instrument for correcting industrial imbalances.

The "balancing" and "disparity effects" discussed above are shown in Figure 6.2 below. The distance KT represents the net disparity effect between Kenya and Tanzania. The balancing effect is $E_K B_T$. In the absence of the balancing effect, the investment differential between the two countries would have been longer than KT. For Kenya and Uganda, the net disparity effect is shown by KU and the "balancing effect" is

Figure 6.2

Bank and Non-Bank Sources of Finance, 1969-1973
(in millions of shillings)



represented by $E_K B_U$.

The net disparity effect in the hypothetical case where the Bank had complied with the lending formula is $K_H T$ for Kenya and Tanzania. This distance is shorter than the actual one seen earlier, KT. The reduction in investment differentials due to complete compliance with the lending formula is $K K_H$ in both the cases of Kenya - Tanzania and Kenya - Uganda. The net disparity effect for the latter is $K_H U$.

Now that the importance of the two sources of finance for projects in the three countries has been shown, it may be instructive to give an idea of capital formation that took place in the industrial sectors of Kenya and Tanzania between 1969 and 1973. Uganda is excluded because of lack of data. In Kenya, capital formation was K Shs. 1986 million.[8] The Bank's allocations to that country over the five year period (see Table 6.1) were equal to 3.4 per cent of that capital formation. In Tanzania, capital formation was T Shs. 1524 million,[9] and the Bank's allocations to that country for five years (see again Table 6.1) was equal to 6.4 per cent of cumulative capital formation. These figures show two things which are relevant to the industrial imbalance issue. The first is that Kenya's capital formation was greater than Tanzania's. This may be an explanation of why, as was seen in Chapter 5, industrial imbalance between the two countries widened between 1968 and 1977. The second thing is that while the Bank was more important in Tanzania than in Kenya, its contribution to capital formation in the former was too small to make a substantial impact in reducing the gap in capital formation between the two countries. The amount considered here are those represented by the "balancing" effect and the difference in capital formation between the two countries.

It is important to point out that in Tanzania, an institution called the Tanzania Investment Bank (TIB) which was expected to finance and promote industrial development, was set up in 1970.[10] Its effectiveness will be briefly examined later. The relevance of this exercise is that it is expected to shed light on that institution's contribution to a balanced industrial development between Kenya and Tanzania. Kenya also set up an institution, called the Industrial Development Bank (IDB), in 1973, and its objective was similar to that of the TIB.[11] More will be said later about the IDB.

6.6 Allocations, Disbursements and Sources of Finance for EADB-Financed Projects, 1974-1977

This section carries out analyses similar to those carried out in the previous section. It may be recalled that the Bank was expected to comply with the lending formula at the end of a five year period. Therefore, in principle, every five year period stands on its own for the purpose of evaluating the effectiveness of the Bank as a mechanism for reducing industrial imbalances. However, because when the Community broke up in 1977 the activities of the Bank virtually came to a standstill, four years instead of five are covered. Caution will, therefore, be exercised in drawing conclusions on whether or not the Bank was effective, since its evaluation will be based on a period of less than five years.

6.6.1 Allocation of Funds to Kenya, Tanzania and Uganda, 1974-1977

The distribution of funds by the Bank to Kenya, Tanzania and Uganda between 1974 and 1977 is shown in Table 6.4. The focus of interest is on the cumulative amount which had been allocated at the end of the 1974-1977 period. At the end of this period, the Bank had allocated shs. 99.87 million to Kenya, shs. 104.50 million to Tanzania and shs. 82.45 million to Uganda.

TABLE 6.4:

Allocation of Funds to Kenya, Tanzania and Uganda, 1974-1977

(in millions of East African shillings and in percentages)

Year	Kenya	Tanzania	Uganda	Total
1974	15.22	27.00	17.45	59.67
1975	41.50	8.00	23.00	72.50
1976	8.45	43.50	20.00	71.95
1977	35.70	26.00	22.00	82.70
Total	99.87	104.50	82.45	286.82
Actual Ratios %	34.82	36.43	28.75	
Prescribed Ratios %	22.50	38.75	38.75	
Deviations in Amounts	+35.34	-6.64	-28.69	

Sources: Computed from East African Development Bank, Annual Reports, 1974-1977.

Considering that the Bank was expected to allocate more funds to Tanzania and Uganda than Kenya, the first striking thing is that Kenya was allocated more funds than Uganda. Notice also that Tanzania was allocated slightly more funds than Kenya, only shs. 4.63 million. Although there was one more year to go before the end of a second five year period of the Bank's lending, it seems that the Bank was off the course to complying with the prescribed lending formula. The actual ratios in row 7 and the prescribed ratios in row 8 indicate that there were big deviations from expectations for Kenya and Uganda. For Kenya, the deviation was 12.32 per cent above expectation. On the other hand, the deviation for Uganda was 10.0 per cent below expectation. This meant that industrial imbalance between the two countries increased. The amount representing that increase is shs. 17.42 million, this being the difference between Kenya's and Uganda's cumulative allocations between 1974 and 1977. The amount by which Tanzania's allocation exceeded Kenya's, as seen above, was so small that the Bank seemed to be incapable of complying with the lending formula even if the East African Community's break-up had not disrupted the activities of the Bank.

The amounts representing deviations from expectations are shown in the last row of Table 6.4. It may be seen that while Kenya had been allocated shs. 35.34 million more than stipulated by the lending formula, Tanzania and Uganda had been underallocated by shs. 6.64 million and shs. 28.69 million respectively. The author learned that these deviations were mainly due to the "pressure" of demand for investment funds arising from Kenya[12]. The demand for the Bank's funds in Tanzania was lower than that of Kenya. The low "pressure" of demand in Tanzania may be explained by the tendency there to rely more on the national financial institutions[13]. As for Uganda, the facts that the economy was in depression and that there were very few competent entrepreneurs are the two main explanations for the low "pressure" of demand for investment funds.

The point made above that the Bank seemed not to be capable of complying with the lending formula was based on the fact that it had been experiencing a shortage of funds to lend since 1975[14]. Yet its chance of complying with the lending formula lay in it having substantial sums of funds. This argument will be elaborated using a hypothetical case. Suppose that the Community had not broken up and therefore that the Bank had been able to complete its second five year period of lending. Suppose also that the management of the Bank had decided in 1977 that since the Bank was off the course to complying with the lending formula, no more funds would be allocated to Kenya in 1978. Suppose further that the Bank had decided to allocate the funds it had in 1978 (the fifth year of the second five year period) to Tanzania and Uganda in such a way that the lending formula would be complied with. Under these assumptions Tanzania and Uganda would have been allocated shs. 67.50 million and shs. 89.55 million respectively. These figures are arrived at first, by equating the cumulative amount which had been allocated to Kenya to 22.50 per cent. Second, the amount corresponding to the expected share of Tanzania and Uganda, 38.75 per cent, is worked out. Finally, the cumulative amounts which had been allocated to the two countries by 1977 is subtracted from their expected shares.

It should be realised that the amount which should have been allocated to Uganda in 1978, shs. 89.55 million, in order to comply with the lending formula, was greater than the amount the country had been allocated in the previous four years. In view of the difficulties the Bank had been experiencing in obtaining funds to lend, it would be unrealistic to expect that the Bank would have been able to lend such an amount. Even in the case of Tanzania, it would also have been unrealistic to expect that in one year she would have been allocated about 65 per cent of the total amount she had been lent in the previous four years.

6.6.2 Disbursements to Kenya, Tanzania and Uganda, 1974-1977

This subsection evaluates the effectiveness of the Bank as a mechanism for reducing industrial imbalances for the 1974-1977 period using the disbursement criterion. The term fund absorptive achievement, which is related to disbursement, will also be used as was done in subsection 6.5.2. The focus of interest is once again on the cumulative amounts in the final year of lending.

Table 6.5 shows the cumulative amounts which were disbursed to Kenya, Tanzania and Uganda between 1974 and 1977. It also shows fund absorptive achievements in the three countries and the extent to which the amounts disbursed to the three countries deviated from what could have reduced industrial imbalances as required by the lending formula principle. It may be seen that by 1977 Kenya had received Shs. 73.08 million, while Tanzania and Uganda had received Shs. 72.63 million and Shs. 71.11 million respectively. The fact that Kenya absorbed more funds than either of the two countries was inconsistent with the idea behind the lending formula, which was that more funds should go to Tanzania and Uganda.

The last row shows that the deviation in Kenya was 11.20 per cent above the 22.50 per cent mark which was supposed to be her share according to the lending formula. Tanzania and Uganda were 5.25 and 5.85 per cent below their expected shares. This meant that according to the disbursement criterion the industrial imbalances between Kenya and the other two countries widened between 1974 and 1977. It may be recalled that in Chapter 5 it was seen that value added indicator showed that industrial imbalances between Kenya and the other two countries did indeed widen between 1968 and 1977.

It is of interest to note that while fund absorptive achievement in Kenya and Tanzania had gone up by 6 and 3

TABLE 6.5:

Disbursements to Kenya, Tanzania and Uganda, 1974-1977
(in millions of East African shillings and in percentages)

Year	Kenya		Tanzania		Uganda	
	Cumulative Disbursements	Fund Absorptive Achievement	Cumulative Disbursements	Fund Absorptive Achievement	Cumulative Disbursements	Fund Absorptive Achievement
1974	9.56		15.73		19.76	
1975	39.08		45.21		26.88	
1976	66.08		66.96		47.66	
1977	73.08	73	72.63	69	71.11	86
Disbursement Ratios		33.70		33.50		32.80
Deviations in percentages	+11.20		-5.25		-5.85	

Source: Computed from East African Development Bank and Industrial Development of East Africa, op. cit., p. 38.

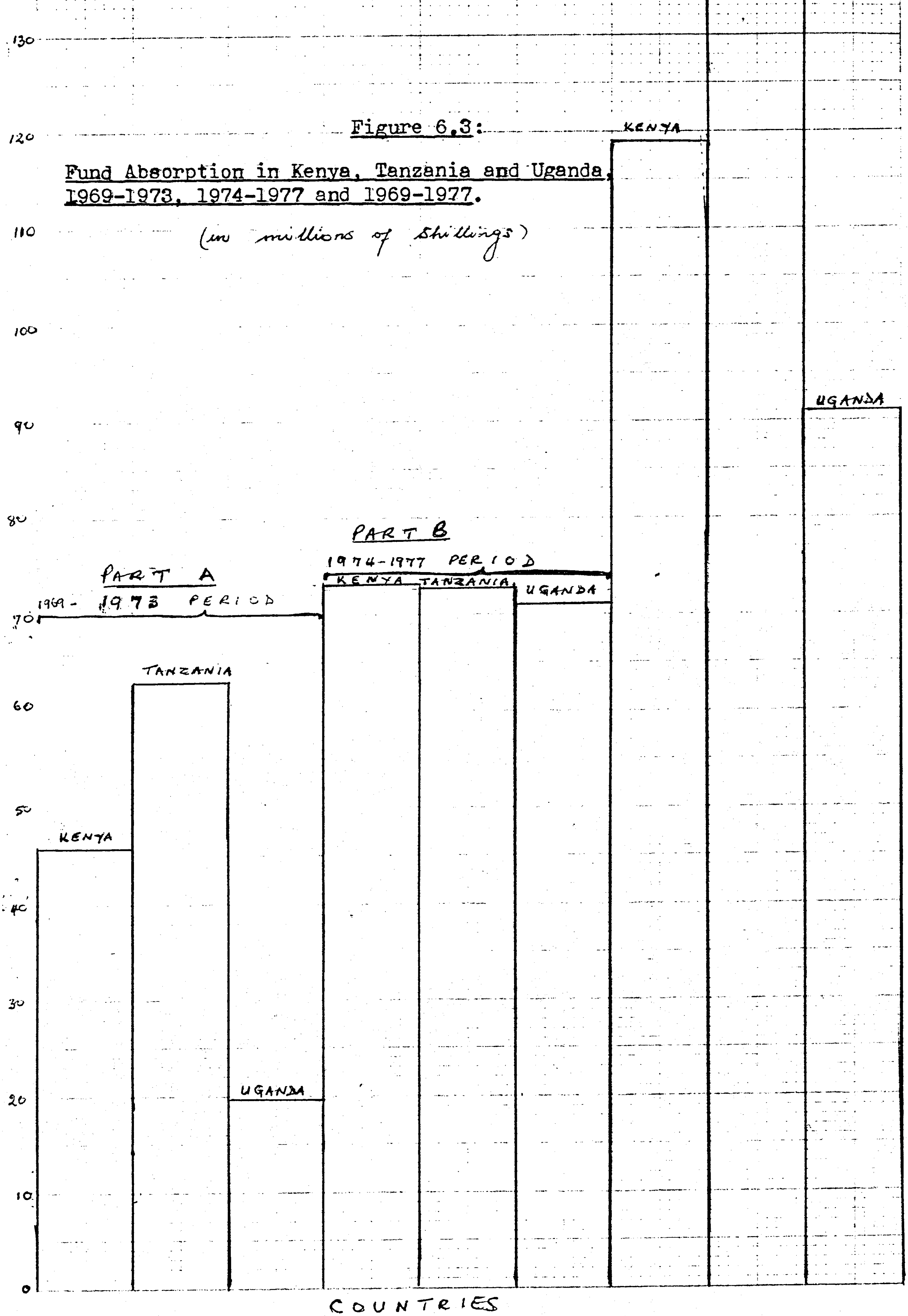
percentage points between 1973 and 1977, in Uganda there had been a very large increase of 65 percentage points. This increase calls for explanation. The broad explanation is that most of the amount allocated in 1969-1973 was disbursed in the 1974-1977 period[15]. Also the amount allocated to Uganda in the latter period was disbursed without much delay. There are three more specific explanations. The first is that the government rather belatedly started to promote industrial development, something which had been neglected since the Amin regime came into power. The government urged those responsible for project implementation to see to it that production started as soon as possible. The second explanation is that the country now had more foreign exchange than in the past because of the high price of coffee on the world market. This meant that projects which could not in the past be implemented because of the scarcity of foreign exchange now no longer faced that problem. Finally, some projects which could not be implemented because their Asian owners had been expelled in 1972 could be implemented during the 1974-1977 period because they had been reallocated to new owners.

The explanations given above also serve a useful purpose of showing some of the major determinants of fund absorptive achievement. It may be added that an economy which functions well, as the Kenyan one was doing, tends to have a high fund (finance) absorptive

Figure 6.3:

Fund Absorption in Kenya, Tanzania and Uganda, 1969-1973, 1974-1977 and 1969-1977.

(in millions of Shillings)



achievement. As was seen above, Tanzania's absorptive achievement was not far behind Kenya's. In fact, the absorptive achievements in the three countries was very high even by the international standards[16].

A visual picture which fund absorptive achievement paints concerning the effectiveness of the Bank as an instrument for reducing industrial imbalances for the 1974-1977 period is shown in Figure 6.3. The results of the 1969-1973 period have also been included in order to compare the effectiveness of the Bank in the two periods. It may be seen that the Bank was more effective in the 1974-1977 period than it had been in the 1969-1973 period (see Part A and B of the figure). Part C of the figure shows that for the 1969-1977 period Tanzania received more funds than Kenya. However, Uganda received less than Kenya. It will be recalled that both Tanzania and Uganda were expected to receive more funds than Kenya if there was to be a reduction in industrial imbalances. At the end of the 1969-1977 period, funds had been disbursed in the following ratios: 34.42:39.24:26.34, for Kenya, Tanzania and Uganda respectively. This meant that while Kenya and Tanzania were 11.92 and 0.49 percentage points above the marks required for the reduction of industrial imbalances in accordance with the lending formula, Uganda was 12.41 percentage points below what should have been her share.

These findings mean that the Bank was not an effective mechanism for reducing industrial imbalances.

In winding up the discussion on the effectiveness of the Bank from the standpoint of disbursement, it should be pointed out that that indicator is a second best one. The best indicator is whether or not the projects financed by the Bank became operational and whether or not they were commercially successful.[17] This will be investigated in chapter 7.

The assumption underlying the idea of allocating more funds to Tanzania and Uganda seems to have been that the co-operant factors (seen in chapter 3) would be available. It seems also that there was another assumption, namely, that the main constraint to industrial development in the two countries was the scarcity of finance. This assumption, as Newlyn (1977) points out, has been seriously questioned.[18] As for the first assumption, the Ugandan situation has shown how it stood on its head. However, because those who devised the Bank could not foresee the political and economic changes which were to take place in Uganda, the assumption that co-operant factors would be present was a reasonable one. It must, however, be reiterated that the benefit of hindsight suggests that it is more reasonable to assume that fund absorptive achievement will differ between member countries of an economic integration scheme. Having made this assumption, then a proviso concerning how low fund absorptive achievement could be improved in a country which deviates from expectation needs to be present.

6.6.3 Sources of Finance and the Balanced Industrial Development Objective, 1974-1977

In this subsection the effectiveness of the Bank as an instrument for reducing industrial imbalances will be evaluated using the Bank and Non-Bank sources of finance. The period covered is from 1974 to 1977 and the focus of interest is again on what had taken place at the end of that period.

The amounts supplied by the two sources of finance are shown in Table 6.6 below. The importance of the Bank as a source of finance is shown in the last row of the table. It may be seen that while the Bank's contributions towards the total cost of projects in Kenya between 1974 and 1977 was 5.2 per cent, its contributions in Tanzania and Uganda were 15.2 and 19.1 per cent respectively. This means that Kenya would have been least affected by the break up of the Bank. Uganda would have been most affected and the effect on Tanzania though would have been between the two extremes; it would have been closer to Uganda's than Kenya's. It is of interest to note that the Bank was most appreciated in Uganda, and that Tanzania also appreciated its existence more than Kenya.[19]

It is also noteworthy that in both Kenya and Tanzania the importance of the Bank fell between 1973 and 1977. In Kenya, it fell from 10 per cent to 5.2 per cent (for these comparisons see Tables 6.3 and 6.6). However, in terms of the amounts allocated by the Bank in the 1969-1973 and 1974-1977 periods, Kenya's allocation at the end of the first period was Shs. 68.49 million and in the second period she was allocated Shs. 99.87 million. For Tanzania, her allocations were Shs. 98.21 million and Shs. 95.22 million for the two periods. Uganda's allocations were Shs. 95.22 million and Shs. 82.45 million for the 1969-1973 and 1974-1977 periods respectively (see again Tables 6.3 and 6.6 for the absolute amounts distributed). Uganda was, therefore, the only country whose allocations did not rise. The rise in the importance of the Bank in relative terms was, therefore, an indication that the Non-Bank source had hardly improved in Uganda. In contrast, the Non-Bank's contribution to the cost of projects in Tanzania was by 1977 about 1.5 times what it had been by the end of the 1969-1973 period. In Kenya, the Non-Bank's contribution by 1977 was about three times what it had been by the end of the 1969-1973 period.

A question which must be answered is what the difference in importance of the two sources of finance for the projects tells us about the effectiveness of the Bank as a mechanism for reducing imbalances in the

1974-1977 period. The terms "balancing" and "disparity" effects will once again be used. It may be recalled that the "balancing effect" was represented by the amount by which the Bank's allocations to either Tanzania or Uganda exceeded the amount allocated to Kenya, and the "disparity effect" was the amount by which the finance supplied by the Non-Bank in Kenya exceeded the finance supplied by the Non-Bank sources in either Tanzania or Uganda.

The "balancing effect" in the case of Kenya and Tanzania was Shs. 4.83 million by the end of the 1974-1977 period (computed from Table 6.6). The "disparity effect" between the two countries was Shs. 1237.22 million (see again the statistics in Table 6.6). The net effect was, therefore, overwhelmingly that of disparity represented by Shs. 1232.39 million. The conclusion drawn from this is that the Bank was not an effective mechanism for reducing industrial imbalances between Kenya and Tanzania.

The same conclusion applies even more to the case of Kenya and Uganda. The "balancing effect" did not exist because the Bank at the end of the 1974-1977 period had allocated Kenya Shs. 17.42 million more than it had allocated Uganda (see Table 6.6). The "disparity effect" was represented by Shs. 1470.37 million. The net effect was, therefore, Shs. 1487.79 million which is the sum of the two amounts. Notice that this

TABLE 6.6: Sources of Finance from the Bank and Non-Bank, 1974-1977
(in millions of East African shillings and in percentages)

Year	KENYA				TANZANIA				UGANDA			
	Non-Bank (1)	Bank (2)	Expected Allocat-ions (3)	(2) as % of Total Cost of Projects (4)	Non-Bank (1)	Bank (2)	Expected Allocat-ions (3)	(2) as % of Total Cost of Projects (4)	Non-Bank (1)	Bank (2)	Expected Allocat-ions (3)	(2) as % of Total Cost of Projects (4)
1974	83.50	15.22	13.42	15.4	31.04	27.00	23.12	46.5	11.30	17.45*	23.12	N.A.
1975	340.36	41.50	16.31	10.8	28.47	8.00	28.09	25.4	189.19	23.00	28.09	12.1
1976	33.91	8.45	16.19	19.9	73.96	43.50	27.88	37.0	74.43	20.00	27.88	26.9
1977	1362.62	34.70	18.65	2.5	449.70	26.20	32.12	5.5	75.10	22.00	32.12	29.3
Total	1820.39	99.87	64.57	5.2	583.17	104.70	111.21	15.2	350.02	82.45	111.21	19.1

Source: Computed from East African Development Bank, *Annual Reports*, 1974-1977.

* N.A. stands for not applicable because the amount supplied by the Bank exceeded the amount supplied by the Non-Bank, which was unusual. The explanation for that is that supplementary loans were given.

"disparity effect" is greater than that between Kenya and Tanzania (Shs. 1232.39 million).

It is instructive to compare the "disparity effects" between Kenya and the other two countries at the end of the 1969-1973 and 1974-1977 periods. This is done in order to illustrate the author's argument that the circular and cumulative causation phenomenon was reflected in the different capacities to invest between Kenya and the other two countries. Only the Non-Bank supplied amounts will be used since that source represents what may be called "purely" national efforts to finance industrial projects. The inclusion of the Bank would introduce the "balancing" element which the author wishes to isolate.

For Kenya and Tanzania, the "disparity effect" by the end of the 1969-1973 period was Shs. 216.02 million and Shs. 1232.39 million at the end of the 1974-1977 period. For Kenya and Uganda, the "disparity effects" were represented by Shs. 268.69 million and Shs. 1487.79 million for the two periods respectively. The circular and cumulative causation process is indicated by the fact that Kenya's capacity to invest which was greater than the other two countries' at the end of the 1969-1973 period, was even greater at the end of the 1974-1977 period, hence the increase in the "disparity effects".

It may be asked whether at the time of designing the Bank it could not have been foreseen that the cumulative causation process would make the impact of the Bank small. It seems that this possibility was overlooked since that was not mentioned in the Bank's Charter. Instead, policy-makers in Tanzania predicted greater scale of activities of the Bank than were actually to take place.[20] As Hazlewood (1979) has argued, it is possible that if the future of the East African Community had been certain, the Bank could have attracted more funds and expanded its scale of lending.[21] This was also the view of the former Director-General of the Bank (from 1967 to 1977) whom the author talked to.[22]

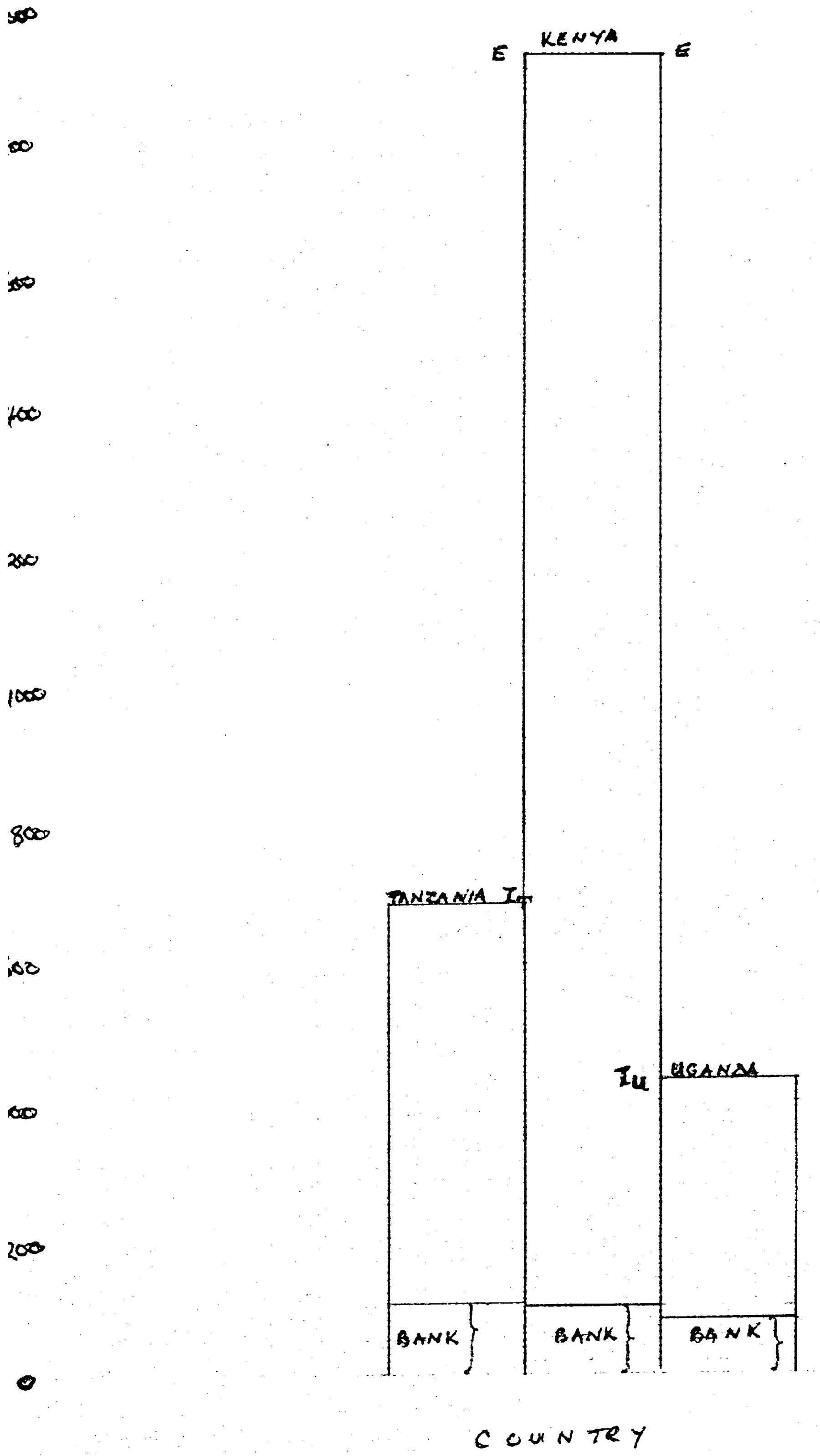
As was noted above, the Bank had not complied with the lending formula by the end of the 1974-77 period. It may be asked whether it would have made much difference if the Bank had fully adhered to the prescribed lending formula. To answer this question, a comparison will be made between the actual and the expected allocations. To be able to work out the expected allocations at the end of the 1974-77 period, it is assumed that for each year of the Bank's lending activities it had complied completely with the prescribed lending formula. Under this assumption, the amount allocated to Kenya at the end of the four year period should have been Shs. 64.6 million. According to this scenario and the actual situation, Kenya had been over allocated by Shs. 35.3 million. On the other hand, Tanzania and Uganda had been under allocated by Shs. 6.5 and Shs. 28.7 million respectively (obtained by subtracting the expected allocations from the actual in Table 6.6).

These deviations did not contribute much to the Bank's ineffectiveness as an instrument for correcting industrial disparities in the 1974-77 period. To illustrate this point the "balancing effect" as a result of compliance, will be compared with the "disparity effect". In the case of Kenya and Tanzania, the "balancing effect" would have been Shs. 46.6 million. But the "disparity effect" would have been Shs. 1232.39 million. In other words, by completely complying with the lending formula, investment differentials between the two countries would have been reduced by 3.8 per cent.

In the case of Kenya and Uganda, the "balancing effect" would also have been Shs. 46.6 million because both Uganda and Tanzania were supposed to receive equal amounts. But the "disparity effect" between Kenya and Uganda would have been Shs. 1470.4 million. This means that total compliance with the prescribed lending formula would have reduced the investment differential between the two countries by 3.2 per cent. A noteworthy point is that in both the Kenya - Tanzania and Kenya - Uganda cases the "disparity effect" greatly outweighed the "balancing effect" in the hypothetical scenario of complete compliance with the lending formula.

Figure 6.4 gives a visual picture of the importance of the Bank and Non-Bank as sources of finance for the projects in whose financing the Bank participated during the 1974-1977 period. The ineffectiveness of

Figure 6.4
Bank and Non-Bank sources of Finance, 1974-1977.
(in million of shillings)



the Bank in the case of Kenya and Tanzania is represented by distance $I_T E$, and in the case of Kenya and Uganda, by the distance $I_U E$.

A question may be asked about how much fund the Bank needed in order to bring about balance in industrial development between its member countries. That balance, even if the Bank were able to bring it about, would have been partial, since it would have been only for the projects in whose financing the Bank would have participated, not the whole industrial sectors in the three countries. In attempting to answer the above question, a hypothetical situation is created by making a number of assumptions. Suppose that the Bank could easily obtain funds to lend. Suppose also that before deciding on the allocations, the Bank knew the total cost of projects (in whose financing it would be involved) which were to be undertaken in its three member countries. Suppose further, that the Bank was to adhere strictly to the prescribed lending formula (22.50 per cent for Kenya, 38.75 for Tanzania and 38.75 for Uganda).

Under these assumptions the Bank should have allocated at the end of the 1974-1977 period Shs. 9184 million, which is 32 times the actual amount it had allocated.[23] If this amount had been allocated as the prescribed lending formula required, the "disparity effect" would have been completely offset. Tanzania and Uganda would each have been allocated 3559 million and Kenya would have been allocated Shs. 2066 million.

In view of the fact that the Bank had been experiencing difficulties in obtaining small amounts of funds to lend, it was almost impossible that it could obtain the Shs. 9184 million. A point which should be stressed is that for the Bank to be completely effective, to counter-balance the "disparity effect", then it required an enormous amount of funds.

6.6.4 National Development Banks as Covert Rivals of EADB

It was mentioned earlier that two financial institutions whose objectives were similar to the Bank's (EADB) were set up in Tanzania and Kenya in 1970 and 1973, respectively. Uganda also set up a similar institution in 1973. While there is no firm evidence that the Bank and these national financial institutions were rivals, there are reasons to suppose that that was the case. This argument is based on the importance of the national financial institutions vis a vis the Bank.

The importance of the Tanzanian Investment Bank (TIB) as a source of finance for projects in the country, is shown by the scale of its lending. Between November, 1970 and July, 1978, it lent Shs. 677.52 million.[24] On the other hand, the Bank lent to projects in Tanzania Shs. 202.71 million between 1969 and 1977 (this is the sum of the amount allocated to Tanzania as shown in Tables 6.1 and 6.4). Notice that the TIB lent about

3.3 times more money than the Bank did. Moreover, the TIB achieved that in a shorter time than the Bank, six years and nine months, compared to nine years for the Bank. Clearly, the TIB was a more important source of finance than the Bank. Given the tendency mentioned earlier for Tanzania to rely more on national institutions and also given the importance it attached to industrial development, it was to be expected that the TIB would play an important role since it was the main instrument for financing industrial projects. This meant that the Bank was a gap-filler.

In Kenya, the Industrial Development Bank (IDB) lent Shs. 310.85 million between 1973 and 1977.[25] The Bank lent to the projects in the country Shs. 168.36 million between 1969 and 1977 (see Tables 6.1 and 6.4). In other words, the IDB lent approximately 1.8 times in only five years the sum the Bank lent in nine years. Therefore, the national financial institution in Kenya, like the one in Tanzania, was more important than the Bank. Kenya had actually several other financial institutions from which finance for industrial development could be obtained.[26] This reduced further the importance of the Bank.

The importance of a financial institution in Uganda, the Uganda Development Bank (UDB), is also shown by the magnitude of its lending. It lent Shs. 156.78 million between 1973 and 1976 (data from 1977 to 1982 were not available when the author visited the UDB in September, 1982).[27] The Bank lent to projects in Uganda Shs. 177.67 million between 1969 and 1977 (see again Tables 6.1 and 6.4). This meant that the Bank was a more important source of finance than the UDB. Notice, however, that the amount the UDB lent over only four years was about 88 per cent of what the Bank had lent over nine years. It is probable that if the UDB had operated for as long as the Bank did, it would have lent more than the Bank.

A point which the author wishes to underline about the above findings, is that the emergence of national financial institutions after the creation of the Bank tended to reduce the importance of the Bank as a mechanism for reducing industrial imbalances. It will be recalled that the national financial institutions had similar objectives as the Bank in so far as the promotion of industrial development was concerned. It may also be added that given the facts that there was no co-operation in industrial development on the Common Market basis, the emergence of similar national financial institutions was no surprise.

6.7 The Industrial Complementarity Objective

This section evaluates the performance of the Bank in so far as the industrial complementarity objective was concerned. As will be seen later, the Bank took that objective to mean rationalising industrial production in the East African Community. As a prelude to evaluating the performance of the Bank, some background literature from both the political and economic standpoints is discussed.

6.7.1 The Absence of Close Political Co-operation as an Obstacle to Rationalising Industrial Production in EAC

At the beginning of the 1960s, there was an opportunity for Kenya, Tanzania (then Tanganyika) and Uganda to federate. At that time, Nyerere held the view that meaningful economic co-operation could only be achieved in a framework of close political co-operation.[28] Policy-makers in Kenya[29] also seemed to be keen on close political co-operation, but those in Uganda were sceptical about the issue.[30] Uganda's scepticism was largely based on the different political structures in the three countries and on the fact that while in Kenya the large scale farmer was more important than the small scale one, in Uganda, the reverse was the case. The Ugandan Prime Minister claimed to be a firm supporter of the small farmer in Uganda.[31]

By the time Kenya became independent in 1963 (she was the last of the three territories to gain independence) the prospects of federation were remote. This was partly due to the Ugandan scepticism and more importantly due to the failure to agree on power sharing.[32] Moreover, it was alleged that Kenyan politicians had never been serious about political federation, that the issue had been used to facilitate rapid attainment of independence. Politicians on the Kenyan Government side denied that that had ever been their strategy.[33]

It was probably the above facts and allegations that led to Robson's (1968) observation:[34]

> .... integration will be a perennial concern of African States for a long time to come, it is unrealistic to suppose that its progress will be either smooth or rapid

Robson was also aware of the political difficulties faced by other economic integration schemes on the African Continent. Hazlewood (1967) remarked that effective economic union could be achieved only within the framework of political association.[35] Green and Krishna (1965) explained why political association is difficult to achieve.[36] They argued that unless there were strong reasons to believe that national economic interests will be served and that no serious blows will be dealt to national key economic sectors, no state will accept to surrender the controls of certain economic policies to a supranational institution. They also argued that political divergence either in substance or in style which lead to acrimony will destroy the atmosphere of mutual goodwill and belief in real common interest.

Policy-makers in Tanzania and Uganda had since the 1920s expressed concern that their territorial interests were being harmed. This view was still held in the 1960s, hence the restriction of imports of some products from Kenya. As was argued earlier, policy-makers in Tanzania and Uganda seemed to misunderstand what was the raison d'être of a Common Market. Since the existence of an economic integration scheme depends on the perception by national policy-makers that national interests will be served by being members, it is important that those policy-makers should have a realistic perception of what may come from economic co-operation.

With regard to the point about political divergence in style or substance, there is reason to think that Tanzania's socialist policies and Kenya's pursuit of capitalist policies contributed to a political environment which was not conducive to effective co-operation. The author knows, from his personal experience as an employee of the East African Community at its headquarters, that the difference in ideology between the two countries created an atmosphere of mutual suspicion.

In such an atmosphere, it would have been unrealistic to expect that rationalising industrial production between Kenya and Tanzania could be achieved. In this connection, a question posed by Robson (1968) about whether economic co-operation without political unity can maximise the gains from economic integration, is relevant.[37] The experience of the East African Community suggests that the answer is negative. Thirlwall (1974), uses the European Economic Community to argue that the absence of political solidarity makes it difficult to have an effective economic integration.[38] Nyerere's remark (seen in Chapter 4) to the effect that in the absence of political federation between Kenya, Tanzania and Uganda, nationalism would, as time passed, make regional co-operation difficult, is noteworthy. Equally noteworthy is the fact that Tanzanian policy-makers were impatient about the unequal distribution of the benefits from the Common Market. This impatience may be interpreted as stemming from the ambitious targets which the policy-makers in Tanzania had set in the period soon after independence.[39]

6.7.2 The Economic Consideration in Economic Integration in LDCs

The main economic argument for regional economic integration in the developing world is, as Robson (1980) correctly points out, to rationalise the emergent structures of production.[40] Efficient utilization of resources, as was seen in Chapter 3, is the main benefit expected from rationalising production in an economic integration scheme. More specifically, three grounds in support of regional co-operation in the less developed world may be offered. The first is that the smallness of national market (in terms of purchasing power) which is a hindrance to the exploitation of economies of scale, may be overcome by pooling national markets.[41] The second argument, which is related to the first, is that market enlargement may improve the prospects of inflow of foreign investments in an economic integration scheme.[42] The third argument is that market enlargement may make it possible for diversification to take place. The diversification may arise from high demand for certain goods produced by one partner and exported to another where their demand may be higher.[43]

The diversification point may be appreciated if it is remembered that developing countries which depend mainly on primary products are often vulnerable either because of changes in weather (for agricultural produce) or because of the fall in prices on the world market.[44] The implication of this is that diversification in industrial products is likely to be more beneficial than diversification in agricultural produce.

6.7.3 Rationalisation of Industrial Production in Some Other Economic Integration Schemes of LDCs

This short subsection examines the importance policy-makers, mainly on the African continent, have attached to rationalising production in regional economic groupings. A question to be answered is why there has been a gap between the stated objective and the actual results.

The potential benefits from co-ordinating and harmonising national development plans in Africa were appreciated in the early 1960s. The United Nations Economic Commission for Africa (UNECA), in recognition of those benefits, undertook a feasibility study of how rationalisation of industrial production in several regions of Africa could be brought about. By 1965, it had produced a report on how that objective could be achieved.[45] This report was presented to the African national policy-makers who had assembled in Lusaka in that year. In spite of the Pan-Africanism spirit which was strong at that time, no action was taken to translate the recommendations of the UNECA into action. However, national policy-makers continued to voice interest in the benefits of regional economic co-operation. For instance, a paper published by the United Nations Industrial Development Organisation (UNIDO) in 1975, mentions that national policy-makers appreciated the potential benefits of regional economic co-operation.[46]

Interest shown in regional economic co-operation in Africa was translated into agreements in several regions. There was the Treaty for East African Co-operation in December, 1967, but this Treaty did not give prominence to the rationalisation of production. The issue is only mentioned in the Charter of the Bank and even there, it is overshadowed by the industrial imbalances reduction objective. Ndegwa (1968) suggested that the Bank was created because policy-makers in Kenya, Tanzania and Uganda had failed to agree on the list of industries in which rationalisation could be carried out.[47] On this issue, the Treaty was a retrogressive step compared to the Kampala Agreement because the latter (see Chapter 4) had a list of industries whose production was to be rationalised.

West Africa has several examples which show attempts to translate interest in regional economic co-operation into action. The Community of West African States (CEAO) created by the Treaty of Abidjan in 1973, has as one of its objectives to rationalise industrial production among the six members of that Community.[48] Since the signing of that Treaty no progress has been made towards rationalising production. This can be explained by the fact that the region does not yet have a regional industrial policy. One of the causes of the delay in coming to an agreement on the regional policy could be a conflict of national economic interest between the more economically advanced members and the backward ones.

The former members may insist on high degree of free operation of market forces. This is because in an economic grouping of countries that are at different levels of economic development, free operation of market forces tends to work more in favour of the more economically advanced countries.[49] On the other hand, the economically backward members are likely to strive to regulate the operation of market forces and may seek to guide those forces to distribute evenly the benefits from an economic integration scheme. The failure in the East African Community to have a regional policy was, as explained above, due to a conflict in what national policy-makers perceived to be national economic interest.

The Lagos Treaty of 1975, which created the Economic Community of West African States, has as one of its objectives the harmonisation of industrial development among the sixteen members of that Community.[50] However, up to now (early 1985) there is no agreement on the strategy for the development of industries in a harmonised manner in that Community.

The Mano River Union, which came into existence in 1973, has also as one of its objectives to rationalise industrial production between the three member countries, Guinea, Sierra Leone and Liberia.[51] A commission was set up to decide the location of "Union Industries". Robson (1983) reports that ten years after the creation of the Mano River Union, little progress had been made in rationalising industrial production in that union.[52]

The Senegambia Economic and Monetary Union is yet another example which shows the appreciation of efficient utilization of regional resources. The principal stated reason for co-operation was to optimize the exploitation of the resources of Senegal and the Gambia.[53] In 1976, a convention for establishing a committee to co-ordinate the development of the Gambia River basin was signed. According to Robson (1983) ..... "the results of co-operation..... have been modest and no greater than those achieved by many countries lacking formal treaties or machinery of co-operation".[54]

The Andean Pact of five South American countries also shows the appreciation of rationalising industrial production among member countries. The members agreed, among other things, on sectoral programmes for industrial development.[55] These programmes were about the allocation of some industries to the members in a manner that matched supply with demand.

It may be of interest to note that the benefits of rationalising production in the fertilizer industry in the Andean grouping was estimated to be a 40 per cent fall in the price that would be paid by the consumer.[56] This point should have been of interest to policy-makers in the East African Community where there was over-capacity in a similar industry. But the Andean experience also shows that the conflict in what policy-makers consider to be of national interest has made it difficult to rationalise industrial production.[57]

6.7.4 Attempts by the Bank to Bring about Industrial Complementarity and Results Achieved

The Bank correctly interpreted industrial complementarity to mean rationalising industrial production in the East African Community. The first practical step the Bank took in trying to make the industrial sectors of Kenya, Tanzania and Uganda complementary was to conduct a feasibility study of industries in which complementarity seemed possible. Forty seven industries were selected for a preliminary feasibility study.[58] This study led to the selection of eight industries for a more detailed examination.[59] It was reported that rationalisation was possible in all eight industries. The Bank was only focusing on the economic aspects and ignored whether other requisites for rationalisation, such as the co-operation of private vested interests as well as the guardians (national policy-makers) of national economic interest. More is said below about this point later.

The author learned from his interview with the former Director-General of the Bank that it tried in the mid-1970s to sell the idea of rationalising production in the eight industries to its three member countries through the East African Community Secretariat. The

Bank failed. This was no surprise, for two main reasons. First, ever since the Amin Government had come into power (starting from 1971) political relations between Tanzania and Uganda had been acrimonious. Therefore, it was to be expected that negotiation concerning rationalisation of production could not take place in such a political environment.[60] The second reason is that the political will to co-operate between Kenya and Tanzania had become weak in the 1970s because of the economic hardships faced by the three countries in the early and the mid-1970s and because of ideological divergence between the two countries. Because of that ideological difference, insults between the two countries were traded in national newspapers and other news media which usually expressed national governments' views. The fact that national governments did not discourage the trade of insults was indicative of the lack of concern regarding the likely adverse effect those insults could have on the East African Community (EAC).

Before that stage of hostile political relations had been reached, the Bank had taken the second practical step towards bringing about industrial complementarity. It convened a meeting in 1972 of the producers of iron and steel in Kenya, Tanzania and Uganda with a view to persuading the producers to find a way of rationalising production.[61] This industry was one of the eight in which a feasibility study had been carried out. The Bank's study of the iron and steel industry had identified three major problems, namely, uneconomic competition, lack of diversification and limits on expansion.[62] The author considers lack of diversification to have been the real problem because the demand for various iron and steel products in the EAC exceeded, in 1972, the total installed capacity.[63]

At the meeting, it was made clear that the uneconomic competition was a problem for Kenya alone, where three hot rolling mills had been set up in a short period of two years. Tanzania had one plant which by 1972 was not able to satisfy the domestic demand. Uganda also had one plant, but it was meeting all the domestic demand. The meeting failed to produce a formula for rationalising iron and steel production in the Community.

This failure was to be expected. The East African Community, unlike the Andean Community, did not have a regional industrial development policy. In this connection, an observation by Hazlewood (1979) is relevant.[64]

> It would have been difficult for the Bank alone to pursue this aim (bringing about industrial complementarity). It could have done so if agreements had existed between the partner states on a pattern of industrial specialisation into which investments would fit.

This, in turn, required the presence of an effective regional planning machinery which, from the author's knowledge, existed only on paper.

A serious obstacle to rationalisation of production in an economic integration scheme is how to compensate those producers who may be adversely affected by the rationalisation. This issue is very often ignored. The Bank did not address it at all. For instance, those producers in Kenya who were competing against each other in a limited number of iron and steel products (only three types were produced) might have accepted to branch out into other types of iron and steel products if they were assured of assistance to modify the existing plants. They may also have needed to be assured that there would be adequate demand for the new goods to be produced. In view of the fact that demand exceeded supply in the Community, the question of the assurance about adequate demand did not arise.

The author holds a view that the rationalisation of production in an economic integration scheme of the less developed countries would be easier to achieve in new industries. This is because no vested interest groups would be present to fight against the rationalisation which would adversely affect their commercial interests. Effective rationalisation of production would exist if national governments first agreed on industries in which rationalisation would take place, and secondly, if national governments honoured the agreements signed.

This point can be illustrated by the motor car tyre and tube industry in the East African Community. The first large scale plant which was to produce tyres and tubes for the Community's market and was established in Tanzania with the help of an American company, General Tire.[65] Some years later, another American company, Firestone, set up a similar plant in Kenya, probably due to the fact that the demand for tyres and tubes was greater in that country than in the other two.[66] Kenya cannot be accused of having violated rationalisation in the tyre and tube industry because agreement on it had not been ratified. It should be realised that an offer by a multinational to set up an important plant in the country would have been very tempting. To refuse the offer would have been interpreted by some Kenyan politicians as retarding the economic growth of the nation, while the economic growth of another nation, Tanzania, was being promoted by a similar industry. Actually, some politicians in Kenya had said that it was unacceptable that the economic growth of that country should be retarded in order to help Tanzania and Uganda catch up with Kenya.[67]

Summary

It was seen in the first part of this chapter that the Bank was an ineffective instrument for reducing imbalances. This was to a very small extent the case because it had not fully complied with the prescribed lending formula. The principal reasons for its ineffectiveness were that it did not have adequate funds to offset the "disparity effects" of the Non-Bank and the fact that it had no control over the fund absorptive achievement of its member countries. It was concluded that in the light of those obstacles the Bank had been asked to carry out a very difficult task indeed.

The Bank, as was noted in the second part of this chapter, completely failed to make its member countries industrially complementary. However, the Bank cannot be blamed for that failure. This is because it tried to sell the idea of rationalising production in certain industries on the East African Community basis. In addition, it brought together the producers of iron and steel so that a formula for rationalising production could be worked out. Nothing came from these efforts.

The Bank, as the observation by the Director of its Operations shows, had no legal power to do what was beneficial to its member countries:[68]

> The East African Development Bank has no legal power to do what it may think is good for the East African Community. For instance, it cannot select and allocate industries or projects so as to avoid a wasteful duplication of resources.....

This was due to the absence of agreement on the harmonisation of industrial development on the EAC basis.

If the Bank's member countries intend to attract finance from the rich countries, they will have to agree on a regional development policy. It was learned during fieldwork that both the World Bank and the European Investment Bank were willing to give loans to the Bank (EADB) to finance the East-African oriented projects.[69] The East African region could benefit if the production of regional projects were rationalised. The next chapter, which deals with the determinants of success and failure of projects co-financed by the Bank, provides guidance about which types of project might be successful in the future.

Notes

1. I learnt from interviews with some members of the East African Development Bank that a Mediator for East African Community matters who was appointed by the World Bank, tried hard to convince those policy-makers in East Africa who wanted to see the end of the EADB that that institution could be in the future of significant economic interest in the region.

2. I share the view expressed by Hazlewood that the complementarity objective was more important than that of reducing industrial imbalances. See A. Hazlewood (1979), "The End of the East African Community: What are the Lessons for Regional Integration Schemes?", Journal of Common Market Studies, Volume 18, p. 45.

3. Charter, East African Development Bank, p. 10.

4. Ibid., pp. 2-3 and p. 15.

5. One half of the authorized capital was expected to be paid-in. That is the amount which was supposed to be credited to the account of the Bank in a period of about one year and one half from Dec., 1967. By the end of 1977, only one third of the authorized capital had been paid in. See East African Development Bank, East African Development Bank and Industrial Development of East Africa, Ten Year Report (1967-1977).

6. The Director of the Operations of the Bank pointed out that the Bank had no legal power to allocate projects among its member countries so that wasteful duplication could be avoided. See Address by M.B. Ngatunga to the East African Staff College Special Seminar, No. 2 on 10th November, 1976, East African Development Bank's Mimeograph.

7. The Bank used to advise on how to improve the rate of project implementation. It had, however, no influence on macroeconomic factors which determined fund absorption.

8. Computed from, World Bank (IBRD), World Tables, Second Edition (1980), (London: Johns Hopkins University Press), pp. 118-119.

9. Ibid., pp. 192-193.

10. See Tanzania Investment Bank, Annual Report, July, 1980 - June, 1981, p. 2.

11. Industrial Development Bank Limited, Annual Report and Accounts, 1977, p. 7.

12. The high demand for investment funds by projects in Kenya was a step towards full exploitation of the existence of the Bank. If the funds the Bank had not been limited each member country ought to have tried to get as much as it was entitled to.

13. Following the Arusha Declaration, Tanzania created a number of financial institutions to provide credit to various sectors of the economy. A study of one of those institutions, the Tanzania Investment Bank, by Kanimba (1978), revealed that the TIB had surplus funds to lend. Since that institution was lending to industrial sector as the Bank was doing, it would not have been surprising if loan-seekers in Tanzania approached first before going to the Bank. In any case, as will be soon mentioned, the Bank was experiencing a shortage of funds to lend, while the TIB had surplus funds.

14. East African Development Bank, Annual Report, 1975, p. 10.

15. This was learnt from the Director of Operations of the EADB.

16. Fund absorption for the projects financed by the African Development Bank from 1969 to 1977 was on the average about 42 per cent. This is computed from African Development Bank, Annual Report, 1980-1.

17. Projects which came into production added to output and employment which was the essence of industrialisation.

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Uganda, which was greater than
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39. For instance, soon after Independence, the manufacturing sector had been planned to grow at 14.8 per cent per annum. This was a very high rate of growth and the sector did very well to grow by 10 per cent per annum. See The United Republic of Tanzania, Tanzania Second Five-Year Plan, op. cit., p. (xiii).

40. P. Robson (1980), The Economics of International Integration, (London: George Allen and Unwin), p. 146.

41. See R.F. Mikesell (1963), "The Theory of Common Markets and Developing Countries", in R.F. Harrod and D.C. Hague (eds.) International Trade Theory in a Developing World, (London: Macmillan), pp. 205.

42. Ibid.

43. A member country of an economic integration scheme may be able to increase the range of goods it produces if there is a substantial demand for such goods among its partner states. This is likely to be the case where investors require more than one partner state's market for the investment to be worthwhile. The Dawa Pharmaceutical project in Chapter 7 is a case in point about diversification.

44. For a discussion of the constraints to diversification, see S. Dell (1963), Trade Blocks and Common Markets, (London: Constable), Chapter 5.

45. The report is called Conference on the Harmonisation of Industrial Development Programmes in East Africa. Policy implications of the findings of that conference were said by the United Nations Economic Commission for Africa to be relevant to other African countries. See United Nations, Economic Bulletin for Africa, Volume VII, pp. 11-34.

46. UNIDO (1975), Declaration and Plan Action on Industrial Development and Co-operation, Second Ministerial Meeting of the Group of Seventy-seven, Algiers 15-18 February, 1975.

47. P. Ndegwa (1968), The Common Market and Development in East Africa, (Nairobi: East African Publishing House), p. 202.

48. P. Robson (1983), *Integration, Development and Equity: Economic Integration in West Africa*, (London: George Allen and Unwin), Chapter 4.

49. In the Economic Community of West African States (ECOWAS), Senegal has expressed fear that that economic integration scheme could lead to a divergence in regional economic disparities because market processes are likely to work in favour of the members which are already more economically advanced than others. *See* U. Ezenwe (1983), *ECOWAS and the Economic Integration of West Africa*, (London: C. Hurst and Company), p. 151.

50. *See* S. Olefin (1977), "ECOWAS and the Lome Convention: An Experiment in Complementary or Conflicting Customs Union Arrangements", *Journal of Common Market Studies*, Volume 16, p. 62.

51. Robson (1983), op. cit., Chapter 5.

52. Ibid., p. 83.

53. Ibid., Chapter 7.

54. Ibid., pp. 126-7.

55. *See* D.E. Hojman (1981), "The Andean Pact: Failure of a Model of Economic Integration?", *Journal of Common Market Studies*, Volume 20, pp. 139-160.

56. Ibid., p. 157.

57. Ibid., p. 158-9.

58. East African Development Bank: Industry Study Unit, *A Study of the East African Community's Manufacturing Sector*, Mimeograph.

59. Ibid.

60. The supreme source of legal power in the East African Community which was called the Authority had not met since 1971 when Amin came to power. The authority comprised the Heads of States of Kenya, Tanzania and Uganda. The fact that the Authority had not met deprived the Community of a political environment conducive to the rationalisation of production.

61. Iron and Steel Industry in East Africa, A Study by East African Development Bank, Mimeograph.

62. Ibid., pp. (i) - (ii).

63. The installed capacity in Kenya, Tanzania and Uganda was 134,000 tons and the consumption of iron and steel products was 254,000 tons. See Iron and Steel Industry in East Africa, op. cit., p. 41.

64. Hazlewood (1979), op. cit., pp. 45-6.

65. East African Development Bank, Report and Recommendations of the D.G.B.P. 23/73 of 10.10.1973, Mimeograph.

66. Ibid., the estimated demand for tyre in Kenya was between 17,000 and 34,000 units higher than that of Tanzania.

67. Rothchild, op. cit., p. 126.

68. Address by Ngatunga, op. cit., p. 8.

69. The current Director-General of the Bank informed the author that the Bank's efforts to secure funds to lend was supported by influential members of its Advisory Panel. They included Robert McNamara, Rudolph Peterson (former UNDP Administrator), Chairman and Chief Executive of Bank of America, and Lars Kalderen, the Director General of the Swedish National Debt Office.

CHAPTER 7

EFFECTIVENESS OF EADB EVALUATED USING PERFORMANCE OF PROJECTS

7.1 Introduction

This chapter intends again to evaluate the effectiveness of the East African Development Bank (EADB) in its primary objective of reducing industrial imbalances between Kenya and her two partner states in the East African Community. This time its effectiveness is assessed on the basis of the performance of the projects it cofinanced in its three member countries.

It was seen in Chapters 2 to 6 that the reduction of industrial imbalances between Kenya on the one hand and Tanzania and Uganda on the other, was a requisite for the political cohesiveness of the East African economic integration scheme. But it was also noted that balanced development among the members of that economic block was an unrealistic goal. This was chiefly because conditions conducive to economic growth were not evenly spread in the three countries. For example, it was revealed in Chapter 6, that finance absorptive achievements of the three countries were, for a variety of reasons, different. In this chapter, it will be seen that the performance of projects in Kenya, Tanzania and Uganda was different because the co-operant factors responsible for the success or failure of projects were not evenly distributed among those countries.

The aim of this chapter is twofold. First, how the different performance of projects the EADB cofinanced influenced its effectiveness as an instrument for correcting industrial imbalances, is analysed. Second, the factors which determined the performance of those projects are examined.

Two main arguments are advanced in this chapter. The first is that the effectiveness of the EADB depended on it having influence over the determinants of performance of projects. The second is that even if the EADB had had the power to ensure that the projects it cofinanced would succeed, but was not in a position to determine the size of projects undertaken in the three countries, then it could not be an effective instrument for reducing industrial imbalances. Underlying this argument is an important point touched on in Chapter 6 concerning the unequal capacity of the three member countries of the EADB to generate investment.

7.2 The Performance of Projects

The word "performance" is used in this chapter to refer to whether or not a project had come into production and had been able to repay the Bank's (EADB) loan from the proceeds of its sales. A project which came into production and was able to repay the Bank's loan will be said to have succeeded. A project will be described as unsuccessful if the converse had happened.

The projects the EADB cofinanced are classified by this study into three; large, medium and small scale, according to the magnitude of investment in each project. A large scale project is defined as an investment proposal of at least shs. 50 million. A medium scale project had between shs. 20 and shs. 49 million invested in it. And a small scale project was one in which between shs. 1 and shs. 19 million was invested.

It is important to explain, albeit briefly, how the Bank selected projects to finance. It, like other development-oriented financial institutions, waited to be approached by sponsors of projects for loans. But in the initial period of the Bank's activities, it tried to identify projects which were East African Community-oriented. None of those projects were financed by the Bank.[1]

Applications for loans which the Bank received were appraised from four angles. The first was the technical feasibility of a project. The second was whether or not the project would be so commercially viable that it would repay the Bank's loan and remain a sound business. The third was whether or not the project would make significant economic contributions to the economy in which it was located. These contributions included employment creation, saving or earning foreign exchange, the creation of forward or backward linkages or both, and imparting of technical skills to some of the labour force. The fourth angle was whether or not the project had a satisfactory managerial set up. As will be seen later in this chapter, the managerial factor was of crucial importance in determining whether or not a project succeeded. A project which satisfied the four criteria, qualified for a loan. The maximum amount the Bank was permitted to lend was shs. 20 million.

7.2.1 The Performance of Large Scale Projects

The Bank cofinanced seventeen large scale projects in its three member countries. They are shown in Table 7.1 below. Eight of those projects were in Kenya, six were in Tanzania and three were located in Uganda. The number of successful projects were five in Kenya, three in Tanzania and none in Uganda. Since Kenya, the most industrialised of the three countries, had more successful projects than either of the two countries did, the conclusion one may draw at first thought is that there was a movement towards the divergence of industrial imbalances. It is

TABLE 7.1: Large Scale Projects Cofinanced by EADB in Kenya, Tanzania and Uganda
(in millions of shillings and in percentages)

Name of Project (1)	Cost (2)	EADB Loan (3)	$\frac{(3)}{(2)}$ as % of (4)	Loan to Project as ££ of EADB Loans (5)	Commercial Performance (6)
KENYA					
1. Panafrican Paper Mills	355.0	13.9	3.9	16	Success
2. ICDC I	67.0	5.2	7.8	6	Success
3. Mumias Sugar Co.	575.6	15.0	2.6	17.3	Success
4. South Nyanza Sugar Co.	632.4	20.0	3.2	23.0	Success
5. Thika Cloth Mills	60.4	6.7	11.1	7.7	Success
6. Kisumu Cotton Mills	73.5	3.0	4.1	3.5	Failure
7. Nanyuki Textiles	102.7	20.0	19.5	23.0	Failure
8. Rift Valley Textiles	235.0	3.0	1.3	3.5	Failure
Total	2101.6	86.8	4.1	100.0	
TANZANIA					
1. General Tyre (EA) I	67.0	10.0	14.9	14.1	Success
2. General Tyre (EA) II	80.0	8.0	10.0	11.3	Success
3. Aluminium Africa	69.2	7.0	10.1	9.8	Success
4. Mtibwa Estate	69.0	10.0	14.5	14.1	Failure
5. Arusha Pharmaceuticals	63.7	16.0	25.1	22.5	Failure
6. Mbeya Cement Co.	469.0	20.0	4.3	28.2	Delay in Implementation
Total	817.9	71.0	8.7	100.0	

TABLE 7.1 (Contd.)

Name of Project (1)	Cost (2)	EADB Loan (3)	(3)/(2) as % of (4)	Loan to Project as % of EADB Loans (5)	Commercial Performance (6)
UGANDA					
1. Steel Corp. (EA)	122.0	20.0	16.4	33.3	Failure
2. Uganda Cement Ind.	147.0	20.0	13.6	33.3	Failure
3. Lake Katwe Salt	184.1	20.0	10.9	33.3	Failure
Total	453.1	60.0	13.2		
Grand Total	3372.6	217.8	6.4		

Sources: Compiled and computed from:

1. East African Development Bank's Annual Reports, 1969-77.
2. Commercial performance of projects obtained from EADB projects files and EADB's "Reports on Approved Projects".

wiser to examine the amount of investment involved in the successful projects in both Kenya and Tanzania before drawing any conclusion. This is done because a country may have a bigger number of successful projects than another and yet the amount of investment in those projects may be less than that in a country with fewer projects.

The total amount invested in the three successful projects, as Table 7.1 indicates, in Tanzania was shs. 216.2 million. The amount in the Kenyan five successful projects was shs. 1690.2 million (see Table 7.1 again). Therefore the conclusion reached above that there was a movement towards the divergence of industrial disparity between Kenya and Tanzania is now confirmed. The disparity, which the study prefers to call a gap in "effective investment", is shs. 1474 million. The term effective investment refers to the amount of investment in the successful projects.

In Uganda, as was stated above, all the three projects the Bank financed there failed. Therefore, the effective investment gap between her and Kenya was shs. 1690.2 million, the total amount in the successful projects in the latter.

It should be realised that it is not only the difference in the number of successful projects in the three countries which can explain the ineffectiveness of the Bank as an instrument for reducing industrial imbalances. The size of projects in the three countries has to be taken into account. Table 7.1 shows that, on the whole, projects in Kenya were bigger than those in Tanzania and Uganda. To illustrate how this situation undermined the achievement of the reduction of industrial imbalances, it is assumed that all the projects in the table had succeeded. There would still have been a huge investment gap of shs. 1283.7 million between Kenya and Tanzania in favour of the former. And the amount of investment in Kenya would have exceeded the amount in Uganda by shs. 1648.5 million. As long as the Bank was not the determinant of the amount of investment in the projects in the three countries, then it could not be realistically expected to correct industrial imbalances between Kenya and the other two countries.

It is noteworthy that if the money from the Bank is excluded, the distribution of total investment in the large scale projects was as follows: Kenya had generated 63.9 per cent while Tanzania and Uganda produced 23.7 and 12.4 per cent respectively. The Bank's funds are excluded because they have a "balancing element", which was explained in Chapter 6. That element, as was seen, was too small to offset the "disparity effect" from the Non-Bank sources of finance. In the present case, the Non-Bank sources in Kenya generated 40.2 per cent more than the Non-Bank did in

Tanzania, and 51.5 per cent more than the Non-Bank achieved in Uganda.

It is also noteworthy that due to the larger size of projects in Kenya, the Bank's contribution to their cost was, in percentage terms, the lowest in the three countries. Table 7.1, column 4, shows that the average contributions of the Bank were 4.1, 8.7 and 13.2 per cent in Kenya, Tanzania and Uganda, respectively. Yet, in absolute terms, the large scale projects in Kenya received a bigger sum than similar projects did in either Tanzania or Uganda.

Since this chapter is mainly concerned with the evaluation of the effectiveness of the Bank from the standpoint of the performance of projects, the distribution of its loans to both the successful and the unsuccessful projects must be examined. The Bank's funds lent to the successful projects in Kenya, (calculated from Table 7.1, column 3) was shs. 60.8 million. In Tanzania, the corresponding amount was shs. 25 million. This means that the difference between these two sums, shs. 35.8 million, represents a gap in effective investment in favour of Kenya. Because there were no successful projects in Uganda, the effective investment difference between her and Kenya was shs. 60.8 million. Therefore, due to the fact that projects performed best in Kenya, a fact over which the Bank had hardly any control, the Bank turned out to be an instrument for reinforcing industrial disparities. This is, of course, contrary to what was supposed to happen.

The amount of the Bank's funds in the unsuccessful projects in Kenya was shs. 26 million, and the corresponding sum for Tanzania was shs. 31 million (see again Table 7.1, column 3). In Uganda, since all the projects failed, shs. 60 million of the Bank's money was in the unsuccessful projects. However, because the Ugandan Government had guaranteed the three large scale projects, the Bank's loans were repaid by the Government.[2] Therefore, the total amount of the Bank's funds in the large scale unsuccessful projects was shs. 57 million, or 26 per cent of the amount lent to the large scale projects. This was too high a proportion to write off and still hope to become an effective instrument for contributing to investment equalization between Kenya and her two partner states. As was noted in Chapter 6, the Bank had since 1975 been experiencing a shortage of funds to lend.

EADB's Claim to Investment Generation

The Bank (EADB), as may be seen from the quotation below, claimed to have played a part in generating investment :

> It is important to appreciate that the role of an institution like the EADB should not be judged in the light of the size of resources that itself commits to projects but on the total investment which, along with other financial institutions, it has helped to generate.[3]

The claim to "the total investment...... it (EADB) has helped to generate" is not a valid one. This is because the EADB did not play the role of a merchant bank by organising the entire financing package of projects. Also, there is no evidence of it having helped the projects it cofinanced to obtain loans from other financial institutions. And, as was seen in Table 7.1, the EADB's contribution to the projects averaged 4.1 per cent in Kenya, 8.7 and 13.2 per cent in Tanzania and Uganda respectively.

The Bank's perception of its role as a catalyst in the generation of investments can in future be matched by practice in two ways. First, it would have to act, to some extent, as a merchant bank. Its success in this direction may very much depend on its reputation in the eyes of other lending institutions. Second, and related to the reputation of the EADB, it would have to ensure that it selected projects which have high chances of succeeding. Its contribution as a catalyst would be more significant among the larger scale projects than the smaller ones.

7.2.2 The Performance of Medium Scale Projects

The Bank (EADB) co-financed also seventeen medium scale projects in its member countries. Five of those projects were in Kenya, seven were in Tanzania and five were located in Uganda. These projects are shown in Table 7.2 below. This table indicates that there were two successful projects in Kenya, three projects succeed in Tanzania and in Uganda only one project was successful. As was explained in subsection 7.2.1, it is the amount of investment in the successful projects rather than the number of these projects which is a better indicator of whether or not there was a movement towards the reduction of industrial imbalances. However, knowing the number of the successful and the unsuccessful projects helps to show the extent to which either of the two types of performance was spread in each country.

The amount of investment in the successful projects in Kenya was shs. 56 million and the amount in similar projects in Tanzania was shs. 99.30 million. Because the amount in Tanzania exceeds that in Kenya, it means that from the standpoint of medium scale projects there was a movement towards a reduction of industrial disparities between the two countries. This movement is represented by Shs.43.3 million. However, if both the successful large and medium scale projects in the two countries are considered together, there is still a very big gap in effective investment in favour of Kenya. It is represented by shs. 1430.7 million.[4]

The gap in effective investment between Kenya and Uganda in the medium scale projects was shs. 30 million in favour of Kenya. This represented a movement,

TABLE 7.2: Medium Scale Projects Cofinanced by EADB in Kenya, Tanzania and Uganda
(in millions of shillings and in percentages)

Name of Project (1)	Cost (2)	EADB Loan (3)	(3)/(2) as % of (4)	Loan to Projects as % of ££ EADB Loans (5)	Commercial Performance (6)
KENYA					
1. EMCO Steel Works	22.10	7.50	33.90	22.80	Failure
2. East African Fine Spinners	30.00	2.00	6.70	6.10	Success
3. Kenya Rayon Mills	26.00	10.50	40.40	31.90	Success
4. Dawa Pharmaceuticals	40.80	7.90	19.40	24.0	Failure
5. Unisack	32.70	5.00	15.30	15.20	Failure
Total	151.60	32.9	21.7	100.	
TANZANIA					
1. Fibreboard	25.50	6.00	23.50	7.70	Failure
2. Nyanza Salt Mines	25.00	14.20	56.80	18.10	Failure
3. East African Kenaf	34.00	11.00	32.30	14.10	Failure
4. Tiper	34.00	11.00	32.30	14.1	Success
5. Tanganyika Dyeing and Weaving	40.20	20.00	49.70	25.6	Success
6. Mwanza Tannery	31.50	8.00	25.40	10.2	Failure
7. Kibo Papers	25.10	8.00	31.90	10.2	Success
Total	215.3	78.2	36.3	100.	

TABLE 7.2 (Contd.)

Name of Project (1)	Cost (2)	EADB Loan (3)	(3)/(2) as % of (4)	Loan to Projects as % of EADB Loans (5)	Commercial Performance (6)
UGANDA					
1. Nyanza Textiles	26.0	10.0	38.5	21.3	Success
2. Lake Victoria Bottling	36.3	10.0	27.5	21.3	Failure
3. Sanyu Tissues	30.0	8.0	26.7	17.0	Failure
4. Poultry Produces	22.9	9.0	39.3	19.1	Failure
5. Printpak	31.2	10.0	32.0	21.3	Failure
Total	146.4	47.0	32.1	100.	
Grand Total	513.3	158.1	30.8		

Sources: Compiled and computed from:

1. East African Development Bank's Annual Reports, 1969-77.
2. Commercial performance of projects obtained from EADB projects files and EADB's "Reports of Approved Projects".

albeit small, towards the divergence of industrial disparities between the two countries. The divergence becomes enormous if the difference in effective investment shown by the large scale projects is added to the shs. 30 million. The total amount becomes shs. 1720.2 million.

Because the average size of projects in the three countries was almost the same, the medium scale projects in Kenya did not play as significant a role in widening industrial imbalances between her and Uganda as the large scale projects did. The average size of the medium scale successful projects in Tanzania was bigger than the average size of their counterparts in Kenya. This means that there were two intertwined forces which worked towards the reduction of investment differentials between the two countries.

It is instructive to examine again the amount of the Bank's funds which was involved in both the successful and the unsuccessful projects. In Kenya and Tanzania, the amounts in the successful projects were shs. 12.50 and shs. 39 million respectively. Since the amount in Tanzania is greater than that in Kenya, then according to the principle of discrimination in favour of the former stipulated in the charter, the Bank had achieved its task in so far as the medium scale projects were concerned. The industrial imbalance reduction effect is shs. 26.5 million. It should be realised, however, that the Bank's effectiveness had been very largely accidental because it had no control over the determinants of the success of the projects.

The amount of the Bank's money in the one medium scale successful project in Uganda was shs. 10 million. As this amount is less than that involved in the two medium scale successful projects in Kenya, shs. 12.5 million, it means that the Bank, in principle, had been ineffective as an instrument for reducing industrial disparities between the two countries. However, there was very little difference, shs. 2.5 million, between the amounts in Kenya and Uganda.

The Bank's loans involved in the unsuccessful projects in Kenya, Tanzania and Uganda were shs. 20.4, shs. 39.2 and shs. 37 million respectively. A total of these amounts forms 61 per cent of the loans the Bank had lent to the medium scale projects. This was too high a proportion of the Bank's funds to be tied up. The solution to this problem, as was mentioned earlier, was to raise the number of successful projects. As will be seen in the next section, this is not something which the Bank on its own could bring about.

7.2.3 The Performance of Small Scale Projects

The largest number of projects cofinanced by the EADB came from the small scale class. Forty such projects were financed. Eleven of them were in Kenya, ten were in Tanzania and nineteen were located in Uganda. Table 7.3 below indicates that ten out of eleven projects in Kenya were successful, while in Tanzania seven out of ten were also successful. The amount of investment in those successful projects was shs. 94.66 million in Kenya and shs. 86.70 million in Tanzania. There was, therefore, a small gap in effective investment of shs. 7.96 million in favour of Kenya.

In Uganda, only one small scale project succeeded. The disparity in effective investment between her and Kenya was shs. 91.62 million in favour of the latter. This meant that there had been a movement towards the divergence of industrial imbalance between the two countries. If the three classes of projects are taken together, the amount of effective investment in Kenya is found to exceed that in Uganda by shs. 1811.82 million. This divergence in industrial imbalance is consistent with the results in Chapter 5.

The overall disparity in effective investment between Kenya and Tanzania - when the three classes of projects are considered together - is shs. 1438.7 million. This shows that the Bank participated in the process of the divergence of industrial imbalances between the two countries, which is the opposite of what had been expected.

TABLE 7.3: Small Scale Projects Cofinanced by EADB

(in millions of shillings and in percentages)

Name of Project (1)	Cost (2)	EADB Loan (3)	(3)/(2) as % of (4)	Loan to Projects as % of ££ EADB Loans (5)	Commercial Performance (6)
KENYA					
1. Metal Box Co.	14.00	6.00	42.8	15.7	Success
2. Plastic & Rubber	3.00	1.20	40.0	3.1	"
3. Kenya Toray	8.80	4.80	54.5	12.5	"
4. Raymond Woollen Mills	11.00	2.10	19.1	5.5	"
5. C.P.C. Industries	14.57	4.00	27.4	10.4	"
6. ICDC III	30.00	3.00	100.	7.8	"
7. Kamco Engineering I	3.46	1.40	40.5	3.6	"
8. E.A. Wool Industries	17.76	5.00	28.1	13.0	"
9. Raymond Woollen Mills II	17.52	2.22	12.7	5.8	"
10. J.K. Industries	18.10	8.00	44.2	20.9	Failure
11. Kamco Engineering II	1.55	0.60	38.7	1.6	Success
Total	112.76	38.32	34.0	100.	

TABLE 7.3 (Contd.)

Name of Project (1)	Cost (2)	EADB Loan (3)	$\frac{(3)}{(2)}$ as % of (4)	Loan to Projects as % of ££ EADB Loans (5)	Commercial Performance (6)
TANZANIA					
1. Mafia Coconut	8.00	1.90	23.7	3.5	Failure
2. Raleigh	5.00	1.75	35.0	3.3	"
3. Tanzania Bag Corp.	15.00	7.60	50.7	14.2	"
4. Aluminium Africa I	17.00	5.00	29.4	9.3	Success
5. Aluminium Africa II	7.20	6.00	83.3	11.2	"
6. Kibo Match Co.	17.96	5.00	27.8	9.3	"
7. Kibo Paper Industries	14.80	4.76	32.2	8.9	"
8. Tip Soap Glycerine	3.00	2.00	66.7	3.7	"
9. Casement Africa	10.14	6.20	61.1	11.5	"
10. Tanzania Food Corp.	18.60	13.50	72.6	25.1	
Total	116.70	53.71	46.0	100.	
UGANDA					
1. Africa Ceramics	9.00	2.00	22.2	3.5	Failure
2. Agricultural Enterprises	16.30	4.50	27.6	7.8	"
3. Ugma Steel Engineering	12.00	1.50	12.5	2.6	"
4. Uganda Tea Growers	13.00	3.20	24.6	5.6	"

TABLE 7.3 (Contd.)

Name of Project (1)	Cost (2)	EADB Loan (3)	(3)/(2) as % of (4)	Loan to Projects as % of ££ EADB Loans (5)	Commercial Performance (6)
UGANDA					
5. Musicraft	2.10	0.80	38.0	1.4	Failure
6. Papco	8.00	3.20	40.0	5.6	"
7. Uganda Bottlers	9.00	5.50	61.1	9.6	"
8. Uganda Tea Authority	7.00	3.60	51.4	6.2	"
9. Ugastat	2.00	0.97	48.5	1.7	"
10. Techno Plastic	2.00	1.00	50.0	1.7	"
11. United Carbide	5.40	2.00	37.0	3.5	"
12. Budongo Saw Mills	10.00	7.65	76.5	13.3	"
13. Uganda Tanneries	15.12	7.00	46.3	12.2	"
14. Associated Match	5.22	4.00	76.6	6.9	"
15. Moon Enterprises	2.08	1.10	52.9	1.9	"
16. V.I.P. Industries	4.00	2.00	50.0	3.5	"
17. Sapoba	5.04	3.00	59.5	5.2	Success
18. Uganda Clays	8.08	2.00	24.7	3.5	Failure
19. Kabale Industries	5.90	2.50	42.4	4.3	"
Total	141 .24	57.52	40.7	100.	
Grand Total	370 .70	149.55	40.3		

Sources: Compiled and computed from:

1. East African Development Bank's Annual Reports, 1969-77.
2. Commercial Performance of projects obtained from EADB projects files and EADB's "Reports of Approved Projects".

The amount of the Bank's funds involved in the successful small-scale projects in Kenya was shs. 30.32 million and in Tanzania it was shs. 42.46 million. Because the sum in the latter is greater than that in the former, it means that the Bank's loans to the small scale projects had contributed to the reduction in effective investment between the two countries. The balancing effect is shs. 12.14 million. This result must be reconciled with what was seen earlier that the effective investment gap was in favour of Kenya. If the amount of the Bank's loans in Tanzania had not been greater than that in Kenya, the effective investment gap would have exceeded the shs. 7.96 million seen above.

The difference in the Bank's loans to the successful projects in Kenya and Uganda (which may be worked out from Table 7.3) is shs. 27.32 million in favour of the former. The Bank, therefore, was involved in the process of the divergence of effective investment. The obverse had been expected to happen.

It is important to examine from another perspective the amount of the Bank's money which had gone to the small scale successful and the unsuccessful projects in the three countries. The amounts in the successful projects in Kenya and Tanzania were, as is shown above, shs. 30.32 and shs. 42.46 million respectively. This means that in the former 79 per cent of the Bank's funds had gone to the successful projects, while in the latter the corresponding figure is also 79 per cent. The Bank's money in the unsuccessful projects is, of course, represented by 21 per cent. This was the least proportion of the Bank's funds in the three types of the unsuccessful projects in Kenya and Tanzania. In Kenya, 30 per cent of the Bank's loans had gone to the unsuccessful large scale projects and 62 per cent had gone to the unsuccessful medium scale ones. The corresponding figures for Tanzania are 65 per cent for the former class of projects and 50 per cent for the latter class.

With the benefit of hindsight arising from the above findings, it can be argued that the Bank should have lent a greater proportion of its funds to the small scale projects. This is because a greater number of them, in Kenya and Tanzania, succeeded than was the case for the other two types of projects. In future, the Bank should bear in mind this lesson of experience when it is considering projects to finance. More important, the factors which were responsible for the impressive performance of the small scale projects should be carefully considered. More will be said about this in section 7.3.

The importance of the Bank to its member countries from the standpoint of the small scale projects deserves to be commented on. Table 7.3 shows that the Bank's contribution to the cost of those projects was 34 per cent in Kenya. This was a higher share than in the other two class of projects. The shares in the large and medium scale were 4.1 and 21.7 per cent respectively. But in spite of its contribution being the highest in percentage terms among the small scale projects, in absolute terms the greatest amount had gone to the large scale projects. This allocation of the Bank's funds may be justified on the ground that the large scale projects contribute more to the economy in terms of employment, net savings in foreign exchange and in structural transformation than the small scale projects.

In Tanzania also, the share of the Bank's contribution to the cost of the small scale projects at 46 per cent was also higher than its share of the cost of the other two class of projects. But unlike in Kenya, the small scale projects in Tanzania had received the least amount compared to the other two class of projects. In view of the finding that the small scale projects had performed better than either of the other two classes, more funds should have been allocated to those projects if the Bank had been able to predict that outcome in advance.

In Uganda, the Bank's share of the cost of the small scale project was, as Table 7.3 indicates, 40.7 per cent. This was also a higher contribution than the Bank's share of the cost of either of the other two classes of projects. But in absolute terms the amount allocated to the small scale projects ranked a close second to that allocated to the large scale projects (see Tables 7.1 and 7.3). Due to the abysmal performance of projects in Uganda, one cannot say with a reasonable degree of confidence how the Bank should have allocated its loans to the three classes of projects. All one can say is that smaller projects are often easier to manage than the larger ones. And since, as will be seen later in this chapter, management is a very important factor for the success of a project, the Bank may consider to allocate more of its funds to the small scale projects in Uganda.

It was learned from an interview with the Bank's Director of Operations that one of the considerations borne in mind when deciding on the distribution of loans was financial prudence. This term meant, <u>inter alia</u>, not putting too much money in a few projects; it was instead spread to many projects. It was, correctly, assumed that the probability of many projects becoming unsuccessful was lower than that of a small number of projects failing. An inspection of Tables 7.1 to 7.3, columns 5, shows that the Bank carried out its policy of financial prudence for most of the time. The exception was in the large scale projects in Uganda (see Table 7.1). But, as may be seen from Table 7.3, the Bank spread its funds most to the small projects in Uganda. This did not, however, guarantee a higher degree of success than in the other two countries where the risks were less evenly spread. It follows from this that the distribution of funds to as many projects as possible, *per se*, does not ensure that they will succeed. Therefore, while financial prudence is a sensible practice, the Bank also needs to devise a method of ensuring that most of the projects it will cofinance will succeed. It can derive such a method from a careful study of the determinants of success and failure of projects. More will be said about this point in section 7.3.

7.2.4 An Overview of Bank's Performance

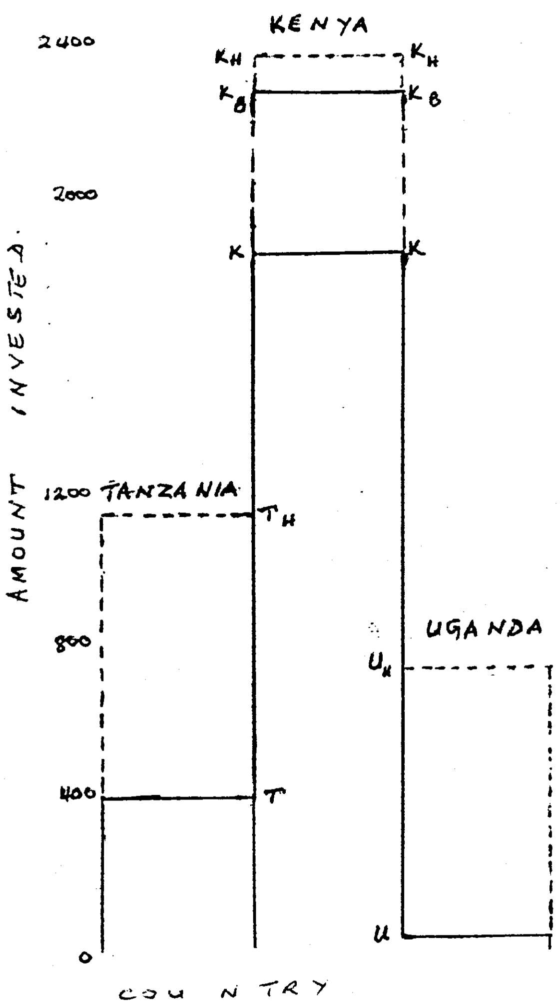
It was seen in the previous three subsections that the Bank was an ineffective instrument for reducing industrial imbalances between Kenya and the other two countries. This was because Kenya not only had more successful projects than either of those two countries, but also the amount of investment in the successful projects in Kenya was greater than either in Tanzania or Uganda. It was also shown that the different sizes of projects - they were, on the whole, larger in Kenya than in the other two countries - explains the gap in effective investment between her and Tanzania and Uganda. This subsection brings together the performance of the three types of projects which is used to give an overview of the ineffectiveness of the Bank.

The investments in the three classes of successful projects in Kenya, Tanzania and Uganda are shown in Figure 7.1 below. The amount in Kenya was shs. 1841 million. The corresponding amount in Tanzania was shs. 404 million. This means that there was a gap of shs. 1437 million in favour of Kenya; it is represented in Figure 7.1 by KT. The investment gap between Kenya and Uganda was shs. 1810 million and is represented by KU.

In order to understand how difficult it was for the Bank to correct industrial imbalances between Kenya and the other two countries, the results in the previous paragraph will be compared with what could have ideally occurred. The ideal would have happened if all the projects the Bank cofinanced had succeeded. This is shown also in Figure 7.1 by the dotted lines superimposed on the actual results discussed above. The gap in investment between Kenya and Tanzania would have been shs. 1216 million in favour of the former. This is represented by K_H T_H in Figure 7.1. It should be realised that this distance is shorter than KT. The difference between the hypothetical and the actual situation which K_H T_H and KT represent is shs. 221 million. This means that the investment gap between Kenya and Tanzania would have been less if all the projects in the two countries had succeeded. Nevertheless, a big gap in investment of shs. 1216 million would have been present.

Figure 7.1

A Comparison of Amount of Investment in (EADB Projects) Kenya, Tanzania and Uganda (in million of shillings)



For Kenya and Uganda, the investment disparity under the hypothetical scenario would have been shs. 1617 million or K_H U_H in Figure 7.1. Since this is 185 million less than the actual investment gap seen earlier, the conclusion is again that if all the projects the Bank had cofinanced in Kenya and Uganda had succeeded, there would have been a greater movement towards reducing industrial imbalances between the two countries than did actually happen. And if equality in investment between the two countries was to be achieved, shs. 1625 million should have either been generated in Uganda or should have been allocated to her by the Bank.

But the Bank, as was explained in Chapter 6, did not have sufficient funds to lend from 1975 onwards. It could not, therefore, lend the above sum to Uganda in order to equalize investments there with those of Kenya. The equalization of investment between Kenya and Tanzania would have required shs. 1216 million. Therefore, the total amount the Bank needed for balancing investments between Kenya and the other two countries was shs. 2841 million.

In chapter 6, it was noted that the Bank had not fully complied with the lending formula. The question which needs to be answered now is whether or not the non-compliance made a significant difference to the reduction of investment gap between Kenya and the other two countries. It will be recalled that at the end of a five year period the Bank was expected to have allocated the funds it had in such a way that Kenya would have received 22.50 per cent of the total funds lent, and that Tanzania and Uganda would each have received 38.75 per cent of those funds.

The Bank lent shs. 549 million during the nine years, 1969-1977. If the lending formula had been fully complied with, Kenya should have received shs.123.5 million and Tanzania and Uganda should each have been allocated shs. 212.7 million. The Bank's "balancing effect" would, therefore, have been the amount by which the sum allocated to either Tanzania or Uganda exceeded the sum allocated to Kenya. The amount in question is shs. 89.2 million.

The impact this amount would have had on the reduction of industrial imbalances is illustrated by going back to the hypothetical situation discussed above. This is the scenario where all the projects cofinanced by the Bank had succeeded. In that scenario, the investment gap between Kenya and Tanzania would have narrowed slightly, from shs. 1216 to shs. 1127 million in favour of the former. This reduction in investment differentials is represented in Figure 7.1 by K_B T_H, which is a shorter distance than K_H T_H. The balancing effect is K_H K_B, which means that less investment would have taken place in Kenya because the Bank would have allocated less money to her.

The gap in investment between Kenya and Uganda under the total compliance with the lending formula scenario would also have been reduced from shs. 1617 to shs. 1528 million. The reduction corresponds again to K_H K_B (the balancing effect) in Figure 7.1, while the disparity in investment between the two countries is represented by K_B U_H. It is clear that the Bank's "balancing effect" in both Uganda and Tanzania would have been overwhelmingly offset by the "disparity effect".

This disparity effect was due to two factors, the higher number of successful projects in Kenya than in either of the other two countries and because the projects in Kenya, especially the large scale ones, were bigger than those in Tanzania and Uganda. The latter factor will now be examined briefly. Table 7.1 shows that Kenya had five projects in which the amount invested in each was over shs. 100,000. Tanzania had only one such project. All the three projects in Uganda were over that mark, but the total investment in them was shs. 1648 million less than that in the large scale projects in Kenya. Investments in the large scale projects in Tanzania was shs. 1284 million less than the amount invested in similar projects in Kenya. The amount of investment in the medium and small scale projects in Tanzania was greater than that in the two classes of projects in Kenya. This meant that it is the large scale projects in that country which were responsible for the investment gap between her and Tanzania.

The amount of investment in both the large and the medium scale projects in Kenya was greater than that in similar projects in Uganda. And the amount of investment in the small scale projects in the latter was bigger than investment in the former. However, due to an enormous gap in investments in the large scale projects which was in favour of Kenya, the overall gap, as was noted above, was in favour of Kenya. As long as the Bank was not able either to determine[5] the size of projects in its three member countries or to lend large amounts to offset disparity in investments, it was unrealistic to expect it to reduce industrial imbalances between Kenya and her two partner states.

7.3 The Identified Determinants of Performance of Projects

This section intends to discuss the identified determinants of the performance of the projects which the Bank (EADB) cofinanced in Kenya, Tanzania and Uganda. The aim of this discussion is twofold. First, it is designed to shed more light on how unrealistic the reduction of industrial imbalances objective was. Second, it should offer insights into what can be done to encourage industrial development in the three member countries of the Bank.

Factors which determined the performance of the projects fall into two categories, macro and micro. The former affected the latter. For instance, the success or failure of projects due to high or low demand depended on whether or not an economy was depressed. The effect of the macro and micro determinants on the performance of projects are discussed both in this section and in the appendix.

The main factors which were identified by the Bank as the determinants of the success of projects are shown in Table 7.4 below. The factors which led to the failure of projects, as will become clear in the course of the discussion, are largely the converse of the determinants of success. There is, therefore, no need to have a separate table and a detailed discussion of the determinants of the failure of projects.

The factors in Table 7.4 are ranked according to how frequently they were cited as being responsible for the success of projects. Competent management comes first. The Bank had actually singled out the managerial factor as the most essential determinant of success of projects early in its second five year term of lending activities.[6] Competent management is characterised by a high degree of accuracy in predicting conditions which will influence the performance of projects, the existence of contingent plans in case the unexpected happens, and a constant drive by the management to make a project a

TABLE 7.4: Rank and Frequency Distribution of Determinants of Success of Projects

Factor	Frequency
1. Competent Management	15
2. High Demand	14
3. Non-Tariff Protection and Government Assistance	8
4. Tariff Protection	7
5. Adequate Supply of Inputs	6
6. Price Rise	5
7. Constant Availability of Technicians	4
8. Exemption of Inputs from Import Duty	1
9. Diversification of Products	1
10. High Quality of Product	1
Total	62

Sources: Compiled from:

East African Development Bank's Annual Reports, 1969-77, and from projects files kept by EADB.

commercial success. These characteristics were learned from interviews with many officials of the Bank during fieldwork. The view that the managerial factor is of great importance is shared by the World Bank. It has remarked that the shortage of entrepreneurs (who may be managers of their own enterprises) in the developing world, is a major obstacle to their economic development.[7]

High demand, as Table 7.4 indicates, ranks second and was almost as frequently cited as the competent management factor. It should be realised that if the management team running an enterprise had been the same team which decided the project to undertake, then it had an opportunity to influence the success of the project it chose. This could have been done by selecting a project whose products were or would in the future be in high demand. It would not be valid to argue that without the benefit of hindsight revealed above, those who selected a project to undertake could not have known the great importance of the pressure of demand. Any reasonable person intending to set up a business has to try to find out how much he will be able to sell. And if the sales seem to be low and not likely to generate a reasonable return on the capital to be invested, then he may have to abandon that project and look for another one. The ability to estimate accurately the demand for a given product depends mainly on assembling carefully data on how much of that product has been consumed in the recent years, on the factors which have influenced that consumption and on making a realistic projection of the future demand. A competent team of managers, operating in a predictable economic environment, should be able to predict with a high degree of accuracy the size of demand. A project in the appendix called the Panafrican Paper Mills (PPM) shows how the competent management and high demand factors made that project commercially successful.

In the third place among the determinants of success of projects are the non-tariff protection and the Government's assistance given to projects. The non-tariff protection took the form of banning of imports of competing products. The PPM project, mentioned above, received non-tariff protection for some years. Government's assistance also included helping a project to obtain the necessary land, where that was a problem, ordering some Government departments to buy products of a given project and finding ways of helping projects in problems. Projects which were assisted in such ways are found in the appendix.

Tariff protection ranks next to the non-tariff protection and the Government assistance. From the point of international trade, tariff protection was better than a ban of imports. But the latter was a more effective method of ensuring that the products of a project would be sold. In other words, the banning of imports of competing products enhanced the demand for local products more effectively than tariff protection. Creating high tariff walls, as was done in a number of cases for the EADB cofinanced projects,[8] was a second best way of enhancing the demand for the locally produced goods.

The availability of inputs is the fifth ranked determinant of the success of projects. For some projects which used imported inputs the availability of such imports depended on whether or not the country in which a project was located was faced with a foreign exchange shortage problem. For those projects which used mainly local inputs, their availability depended largely on whether or not the project had adequate working capital.[9]

The price rise for the products of a project is ranked after the availability of inputs. The prices of a number of goods deemed to be essential were controlled by the national government in order to protect the consumer. Producers of such products had to obtain permission to increase prices. The extent to which the price rise helped a project to become a commercial success depended on how high the price was raised. In one extreme case a price rise of nearly 94 per cent was granted and despite a fall in sales in comparison with the previous year, greater profit was realised.[10] This case illustrates a gross deterioration of the economic welfare of the consumer and a trade off of consumer welfare for commercial profit. This trade off was discussed in chapter 3 of this study.

Constant availability of competent technicians was yet another determinant of the success of projects. Some projects had expatriate technicians who were employed on the basis of contracts for a given period.[11] When the expatriates left, those projects which had not trained local people and which were not able to attract the type of technicians they needed from other sectors of the economy, had production interrupted. This reflected lack of foresight on the part of management. Technicians should have been trained while the expatriate staff were still around and should have had a reasonable time of working alongside the foreign technicians.

Exemption of inputs from import duty is listed among the determinants of success of projects. But, as Table 7.4 indicates, it was not a frequent determinant. This factor helped a project to become commercially successful by reducing production costs since imported inputs were duty-free. Projects which in the future are most likely to benefit from such a form of subsidy are the ones whose inputs will be mainly imported. Those projects could, however, run into problems in the period of foreign exchange scarcity. The Arusha Pharmaceuticals in the appendix and Dawa Pharmaceutical illustrate those two conflicting points.

Diversification of products helped one project to become profitable.[12] Instead of putting too much of one product on the market, a variety of products which were in some ways similar were produced. This seems to have been a sensible business strategy of matching supply with demand for different types of goods. Such a strategy is most probably likely to be a product of the competent management mentioned earlier.

Finally, high quality of product was also identified as one of the factors which contributed to the success of a project.[13] This factor is closely related to the high demand one in the sense that a high quality product will face pressure of demand provided that it is reasonably priced. Producing goods of high quality is important, especially for those projects whose products face competition from imports. In future, the Bank may have to bear that in mind when its staff are appraising projects to finance.

An important question which must be answered now is the extent to which the Bank controlled the determinants of success of projects discussed above. It had hardly any influence over those determinants. In the light of this answer, it is inevitable to conclude again that the Bank was asked to carry out a very difficult task indeed, the reduction of industrial imbalances. More reasons to back this conclusion will be discussed later.

Meanwhile, factors shown in Table 7.4 will be revisited with a view to suggesting ways in which the Bank could help to improve the success rate of projects it will finance in the future. To begin with, it needs to have a systematic method of assessing the determinants of the success and failure of projects. Insights gained from that can then be used to enhance the success of projects. For instance, it could carefully and critically assess whether or not there is adequate demand for the product to be produced. Given the importance of Government's non-tariff protection and its assistance to projects, it would be commercially strategic if projects were selected from those fields of economic activities which have been designated as priority areas. Projects from such areas would not only stand a good chance of being assisted by the Government, but they would most likely also be protected by a high tariff. If that commercially advantageous strategy is not conceived by the formulators of projects the Bank could advise them to consider it. Another factor which the Bank could ask those who come to it for loans, is to have an efficient team of managers to run their projects.

The effect of taking the four factors (demand, non-tariff and tariff protection, Government's assistance as well as efficient management) may be assessed in cumulative frequency terms shown in Table 7.4. These factors account for 44 out of 62 cumulative frequencies shown in the table. This represents 71 per cent of the total number of times factors listed in the table are cited as being the determinants of the success of the projects cofinanced by the Bank.

The strategy mentioned above of selecting projects to be undertaken from Government's priority areas of economic activity, may also facilitate obtaining permission to raise the price of the product. Constant availability of well-trained technicians, as was argued above, is a problem which a competent team of managers (capable of planning for the future) should be able to solve. This team should also be able to procure the working capital in both local and foreign currency.[14] These two additional factors, price rise and availability of technicians, raise cumulative frequency to 53 or 85 per cent of the total in Table 7.4. Improving the quality of a product is also something in the power of management to influence. And so are the other two determinants of the success of projects, the exemption of inputs from import duty[15] and the diversification of products, wherever that is applicable.

Some Determinants of Failure of Projects

It is clear that the linchpin of the success of projects was the competence of those who ran them. It must, however, be pointed out if the economic environment in which they operate is a very difficult one, their competence alone will not enable projects to succeed. The economic climate in Uganda in the 1970s was so bad that even an able management team would not have successfully run projects there. To make matters worse, the turnover of managers in many projects cofinanced by the Bank was so rapid that those projects were virtually lacking sense of direction.[16] No wonder, therefore, that almost all the projects in Uganda failed.

In Kenya and Tanzania where the conditions conducive to the success of projects were better than in Uganda, the most frequently cited cause of failure of projects was poor management. As was explained earlier, this factor is the converse of the most commonly cited determinant of the success of projects cofinanced by the Bank. It was also explained above that a competent management team could have positive influence over many factors responsible for the success of projects. The opposite could be true if projects were run by incompetent managers. One characteristic of the projects incompetently managed was the absence of proper planning and one of the manifestations of that was inadequate supplies of inputs.[17] Shortage of inputs is, actually, mentioned as one of the major causes of failure of projects.[18] Liquidity problems and the scarcity of foreign exchange were the other causes of failure of projects. The liquidity problem arose from lack of sufficient working capital. The scarcity of foreign exchange is a problem which was faced mainly by those projects which depended heavily on imported inputs. Before the Bank introduced a policy (in the 1980s) to provide loans for purchasing foreign inputs, a number of the projects it had co-financed had their production targets reduced by lack of sufficient supplies of inputs.[19]

Technical faults were also cited as the cause of failure of some projects.[20] The persistence of this problem was due to the lack of well-trained and experienced technicians. As was explained earlier, that problem could have been avoided if those who ran projects included in their plans how to ensure that qualified technicians would be always available.

Finally, yet another major factor which led to the failure of a project was the lack of power supply (electricity) due to the inability of a parastatal organisation to fulfil its duty of making power available in the region where a project was located.[21] This project is an example of the importance of the availability of the co-operant factors (discussed in Chapter 3). The Bank should carefully consider this factor when it is appraising projects to finance. Other less frequently cited causes of failure of projects which the Bank should not totally ignore are shown in the appendix.

<u>Summary</u>

This chapter set out to evaluate the effectiveness of the East African Development Bank (EADB) from a new perspective which is an extension to the perspectives seen in chapter 6. The perspective, as was seen, is how the actual performance of projects helped or hindered the EADB as an instrument for reducing industrial imbalances between Kenya and her two partner states in the East African Community.

It was found that Kenya not only had more successful projects than either of her partners, but also that the amount invested in those projects was greater than the amount invested in similar projects in Tanzania or Uganda. In other words, there was what this study called an "effective investment" gap in favour of Kenya. It was also found that this investment gap was due to the fact that Kenya's capacity to generate investment was much greater than that of either of her two partner states. This is clearly shown by the large scale class of projects. It was demonstrated that even if the EADB had allocated the funds it had strictly in accordance with the prescribed formula, the "balancing effect" arising from that act would have been overwhelmingly offset by the "disparity effect" from the non-Bank sources of finance for projects. This led to the conclusion that the reduction of industrial imbalances goal was unrealistic.

The chapter also discussed the main determinants of success and failure of projects which the EADB had cofinanced. Competent management was found to be the single most important factor which enabled projects to succeed in an economy with predictable conditions. Several other determinants of the success of projects, it was argued, depended on this type of managerial factor. The failure of projects was found to be due to incompetent management. It was argued that this type of management also influenced other factors which contributed to the failure of projects.

In future, the Bank could contribute more to the economic growth of its member countries than it has done in the past by doing the following. First, it could combine both the theory of project appraisal and the lessons of its twenty years of experience concerning the determinants of performance of projects to ensure that the projects it will select for financing have very high chances of succeeding. Due weight will have to be attached to the management factor. Second, it will have to increase its efforts in searching for funds to lend, especially funds carrying low interest rates (soft loans).

Notes

1. As was explained in Chapter 6, the Bank tried to sell the East African-oriented projects to the Common Market Secretariat, but to no avail. If it had succeeded, it would have had to raise capital to lend to such projects which were large scale in nature. This might have called for either an increase in the authorized capital of the Bank or for an increase in the amount it could borrow, or a combination of both.

2. Guaranteeing the loans to projects was consistent with the declared policy of promoting industrial development. The three large scale projects needed to be guaranteed because their products, steel products, cement and salt, were among those considered by policy-makers in Uganda to be essential for the country.

3. East African Development Bank, Annual Report, 1970, p. 1.

4. This amount represents the difference between effective investment (investment in successful projects) in Kenya and Tanzania.

5. The size of investment to be undertaken was determined by the sponsors of a project long before they approached the Bank for a loan.

6. East African Development Bank, Annual Report, 1974, p. 2.

7. World Bank (1972), World Bank Operations, (Baltimore: Johns Hopkins University Press), p. 91.

8. Cases in print are the Panafrican Paper Mills, the Rift Valley Textiles, the Nanyuki Textiles and the C.P.C. Industrial Products. These projects were financed by the Bank.

9. The Dawa Pharmaceuticals in Kenya, the East African Kenaf, and the Mwanza Tannery projects in Tanzania were adversely affected by not having adequate working capital.

10. The project in question is the Tanganyika Dyeing & Weaving Mills, See East African Development Bank, Tanganyika Dyeing & Weaving Mills, Report on Approved Projects (1980), p. 47.

11. The Mwanza Tannery project cited above had its production disrupted when the experienced foreign technicians left at the end of their contract.

12. The project in question was in Kenya. It was engaged in producing rubber and plastic products. It was appropriately called the Rubber and Plastic Company.

13. The project which benefitted from the high quality of its product was the South Nyanza Sugar Company seen earlier.

14. Foreign currency was not as scarce as many people have claimed. The East African Development Bank, the Tanzania Investment Bank, as well as the Uganda Development Bank had substantial foreign currencies to lend. The real problem was and still is how to utilize in the best possible manner those currencies so that later on it would be possible to repay the loan.

15. A project which illustrates well the advantage of utilizing imported inputs which were free of import duty is the Chef Magic in Kenya. It was also financed by the Bank.

16. This was learnt from the person who had been for many years the head of the Bank's regional office in Uganda.

17. The J.K. Industries illustrate well this problem of the absence of planning. See East African Development Bank, J.K. Industries, Report on Approved Projects, (1980), p. 36.

18. The shortage of inputs problem is illustrated by the East African Kenaf Industries and the Tanzania Bag Corporation. Both of these projects which were financed by the Bank were in Tanzania.

19. Cases in point are the Arusha Pharmaceuticals in Tanzania, Dawa Pharmaceuticals in Kenya.

20. Examples of projects which were adversely affected by technical problems included, the Lake Katwe Salt in Uganda, Nyanza Salt Mines and Fibreboard in Tanzania.

21. The parastatal in question is the Tanesco, a power and lighting company, in Tanzania.

CHAPTER 8

SUMMARY AND CONCLUSIONS

8.1 Introduction

This study had two broad objectives. The first was to investigate the nature, causes and the dynamics of industrial and trade imbalances in the former East African Common Market (EACM) mainly from 1962 to 1977. The second was to carry out evaluation of the mechanisms which were designed to make the EACM more equitable than it had been in the past.

8.2 Summary of Findings

The main findings of this study are summarised on chapter by chapter basis below. The introductory chapter explained that policy-makers in Uganda, and especially in Tanzania, were so sensitive to their trade deficit with Kenya that that sensitivity became a threat, in the early 1960s, to the economic co-operation between the three countries. In that chapter, it was also explained that the root cause of the trade imbalances was the uneven distribution of industries among the three countries. Furthermore, that chapter outlined how instruments which were designed to make the

East African Common Market more equitable than it had been, were supposed to operate.

Chapter 2 tried to show the magnitude of industrial and trade imbalances from the mid-1950s to the early 1960s as well as providing historical explanations of the industrial disparities in the EACM. The historical accident which involved the settlement of more Europeans in Kenya than in either Tanzania or Uganda was cited as one of the explanations. This group of people had been exposed to how manufacturing industries were set up and run. This know-how was used in establishing some of the earliest manufacturing enterprises in Kenya long before similar industries were set up in Tanzania and Uganda.

The second explanation was that the Government in Kenya adopted interventionist policies, long before her partner states did, and that facilitated industrial development in the country. This means that the industrial imbalances in the EACM can be explained in terms of the early - late starter framework.

Another broad explanation of the industrial imbalances concerns a number of factors which made Kenya a more attractive industrial site in the EACM. First, she had a bigger population of consumers with high purchasing power (European and Asian settlers). Second, the relative concentration of industries in Kenya (in comparison with Tanzania and Uganda) meant that there were greater prospects for investors to reap the benefits of such a concentration of industries - technical interdependence among producers and pecuniary gains - by locating plants in Kenya instead of building factories in the other two countries. The third factor is that Kenya was the financial centre in the EACM. The fourth factor is that Kenya had more facilities to service and repair machinery than Tanzania and Uganda had. Finally, the Kenyan Highlands which was the hub of industrial activities in the country was strategically situated to serve some of the high purchasing power regions of Uganda and Tanzania. The existence of a well developed (by African standards) transportation system ensured that those regions of the two countries were easily reached by suppliers in the Highlands.

Chapter 2 also tried to show a causal relationship between industrial and trade imbalances using the goods traded in the EACM.

Chapter 3 provided a theoretical framework in which this study is placed. Four aspects of different branches of economic theory were reviewed. The first was the customs union theory. While some parts of that theory were found to be relevant, it was noted that the distributional aspect had been inadequately dealt with. Locational theory was reviewed next. The stipulation that the choice of an industrial site in initial stages of economic development may be accidental, was considered relevant to what had obtained in the EACM. The theory of circular and cumulative causation, the third branch of economic theory reviewed, was also considered to provide a good explanation of why industrial imbalances between Kenya and her two partner states persisted. Finally, litereature on capital absorptive capacity was surveyed. The theory that there is a close relationship between the performance of an economy and its capital absorptive capacity was also found to be applicable to what was happening in the EACM between 1968 and 1977. Chapter 6 demonstrates clearly through fund absorptive achievement the relevance of that theory.

Chapter 4 first critically examined instruments designed to make the operation of the EACM more equitable than it had been before. Second, it also analysed the changes in industrial development in the three member countries of the EACM as well as the changes in intra-EACM trade.

This chapter has several arguments and observations. On the Distributable Pool (DP), two arguments are advanced. The first is that the scheme did not offer a significant amount of financial "compensation" to Tanzania and Uganda for their trade imbalance with Kenya. The second is that the DP arrangement failed to tackle the cause of industrial disparity in the EACM. It will be recalled that industrial disparity was responsible for trade imbalances.

The Kampala Agreement which tried to distribute evenly some industries, to rationalise production in some of those industries and to regulate intra-EACM trade was criticised for being, on the whole, a movement towards reducing the potential benefits from economic co-operation. It was, however, pointed out that often a trade-off of benefits for an equitable operation of an economic integration scheme is inevitable if such a scheme is to be politically cohesive.

Chapter 4 showed that the manufacturing sectors of Kenya, Tanzania and Uganda expanded between 1962 and 1967. It was found that the expansion in Kenya had been greater than in either of her two partner states. Therefore, industrial disparity between Kenya and the other two countries had widened. It was also found that Kenya's balance of trade surplus with these two countries had greatly increased between the two years. This was not surprising given that the main reason why trade imbalances existed was the unequal level of industrial development in the three countries, and given that the inequality has become greater in 1967 than it had been in 1962.

Chapter 5 covered the period when instruments designed to bring about balanced industrial development in the East African Community were in operation. The period is 1968-1977. The instruments were the Transfer Taxes and the East African Development Bank. The latter instrument, as was explained before, is the subject of extensive investigation in Chapters 6 and 7. The results of that investigation are outlined later in this chapter.

An _a priori_ assessment of what the Transfer Taxes could realistically be expected to achieve are as follows. First, the system of protective tariff could not be expected to make a noticeable impact in reducing industrial imbalances because the presumption that all that was required for industrial development equalization was to protect nascent industries in the less industrialised partner was wrong. It could have been foreseen that barring drastic adverse conditions taking place in the more industrialised partner state, it was likely to generate more investment for industry than the less industrialised partner. This was partly because the former was keen to promote industrialisation, partly because it had created several financial institutions to promote industrialisation, and also because it was pursuing a strategy that had enabled industries to be established and flourish. The strategy was to rely mainly on private enterprise as the main agent of industrial development. The less industrialised partners were also keen to promote industrial development and had financial institutions created to facilitate the realization of that objective. But their strategy of relying on public enterprise as the principal means of industrialisation could not be expected to generate such amounts of investment in industry which would match those in the more industrialised partner. This is because the Governments of the less industrialised partners simply had limited financial resources to channel to their industrial sectors.

Moreover, as was seen in Chapter 7, making finances available does not necessarily lead to projects being implemented and producing as had been expected. The availability of finance will lead to "effective investment" if co-operative factors are also present. Such factors which included pressure of demand, government assistance of various types given to projects, and the buoyance of the economy, could be expected to be more available in Kenya than in the other two countries.

All in all, the balanced industrial development goal was found to be, from an a priori evaluation standpoint, an unrealistic goal. Similarly, the Transfer Taxes could not be expected to be an effective instrument for contributing to an equal distribution of industries between the three members of the East African Community.

Chapter 5 also examined the actual changes in the industrial sectors of Kenya, Tanzania and Uganda between 1968 and 1977. It was found that for both Kenya and Tanzania industrial production had expanded. The expansion in the former had been greater than in the latter, which means that the industrial imbalance between the two countries had widened in favour of Kenya. This was contrary to what the Treaty for East African

Co-operation expected to happen. It was explained that the industrial development divergence occurred despite the fact that production expanded fast in both countries. The divergence was due to the faster rate of growth of production in Kenya and because the increase in absolute terms was greater in that country than in Tanzania.

In Uganda, industrial production in 1977 was substantially lower than it had been in 1968. This was a result of the mismanagement of the economy by the Amin government. The contraction of industrial production in Uganda, while in Kenya production had risen, meant that the industrial imbalances between the two countries had also widened.

Chapter 5 further examined the changes in intra-EACM trade. First, it was found that by 1977, trade imbalances between Kenya and the other two countries were greater than they had been in 1968. This was to be expected because, as was demonstrated in Chapter 2, trade imbalance was mainly due to industrial imbalance and it was seen that between 1968 and 1977 industrial disparity between Kenya and the other two countries had increased. Second, it was found that both Kenya and Tanzania increased their exports (Tanzania's exports to Uganda declined after 1971 due to political animosity between the two countries following the assumption of power by Amin). The expansion in the intra-regional trade was consistent with one of the raison d'être of an economic block. Uganda's exports to the other two countries declined because of the general fall in production in the economy.

The Ugandan situation illustrates a point that for a member of an economic integration scheme to benefit from the existence of a large regional market, she needs to increase production to satisfy some of the demand in that market. The requisite for this is the presence of policies which facilitate production to take place. Such policies were lacking in Uganda and these were present in the other two countries.

Chapter 5 marked the end of analyses which sought to shed light on the nature, the causes and the dynamics of industrial and trade imbalances in the East African Common Market. The next two chapters examined in depth the results achieved by a regional development bank, the East African Development Bank (EADB) in its two major objectives, the reduction of industrial imbalances and bringing about industrial complementarity among its three member countries. It will be recalled that the EADB was supposed to reduce industrial imbalances by allocating more funds to Tanzania and Uganda than it allocated to Kenya. So, this system of discriminatory allocation of finance was supposed to contribute to more investment taking place in Tanzania and Uganda than in Kenya, thus reducing the existing industrial imbalances.

Chapter 6 evaluated the effectiveness of the EADB as an instrument for correcting industrial imbalances between Kenya and the other two countries from three angles. The first was whether or not it complied with the prescribed lending formula. It was found that in the initial five year period it did. But in the subsequent four year period it did not. Taking the two periods together, it was revealed that the EADB deviated from the lending formula in a manner which gave an edge to the persistence of industrial disparity. That means that Kenya had been allocated more finance and the other two countries were allocated less than was stipulated by the lending formula.

The second angle was "the fund absorptive achievement". This term refers to the fraction of the funds allocated to each country which was disbursed to the country in a given period, five years in the first instance and four years in the subsequent period. It was found that fund absorptive achievement in Kenya was the highest in the three countries. It was explained that the EADB had hardly any control over the determinants of fund absorption which were largely macro factors. Since finance absorption was highest in Kenya, it was concluded that the Bank could not be an effective instrument for reducing investment gap between that country and Tanzania and Uganda.

The third perspective from which the EADB's effectiveness was evaluated is that of the Non-Bank sources as being the main source of disparity in investment in the manufacturing sector of Kenya and the other two countries. It was found that the "disparity effect" arising from the fact that more finance was provided by the Non-Bank sources in Kenya than was the case in either Tanzania or Uganda, overwhelmingly offset the EADB's "balancing effect". This term refers to the amount by which the EADB's allocations to either Tanzania or Uganda exceeded the allocation to Kenya. Because the EADB did not control the amount of loan to projects provided by the Non-Bank sources, and since that was the principal source of investment disparity, it was concluded that the Bank had been asked to carry out a very difficult task indeed. This was particularly so because the Bank had not been given the necessary financial resources with which to effect that task.

Chapter 6 also showed that the Bank completely failed to make its three member countries' economies complementary in industrial field. This was partly because there was no agreement between those countries on the harmonisation of industrial development in the East African Community. The other reason is that there were neither incentives for producers in the community to rationalise production nor was there a scheme to compensate those producers who would close down certain lines of activity in the interest of rationalisation.

Chapter 7 evaluated the effectiveness of the East African Development Bank in reducing industrial imbalances using the performance of projects it had cofinanced. This is a better measure of the EADB's effectiveness because unlike the fund allocation, disbursement criteria, it shows whether or not a project under investigation came into production and was a profitable business. The fulfilment of the latter condition, as was explained earlier, enabled the project to repay the Bank's loan.

The projects the EADB cofinanced were classified into three in Chapter 7, large, medium and small scale projects. Taking all these projects together, it was found that both the number and the amounts of investment in the successful projects were greater in Kenya than in either Tanzania or Uganda. This meant that the "effective investment gap" (defined in Chapter 7) was in favour of Kenya. Therefore, the EADB had been ineffective since, according to its charter, it was supposed to reduce industrial imbalances by allocating more funds to the other two countries. It was explained that there seems to have been a confusion between making available funds and those funds being "effectively utilised". This term refers to funds being invested in projects which later on turned out to be commercially successful.

It was also found that Kenya had, on the whole, larger scale projects than either of the other two countries. This was another major explanation as to why the Bank was ineffective. Furthermore, it was found that the amount of the EADB's funds involved in the successful projects in the three countries was greatest in Kenya. That went against the principle behind industrial imbalances reduction arrangement which was that less amount should go to Kenya and that more should go to the other two countries. While this outcome meant that instead of the EADB being an instrument for correcting industrial disparities, it had contributed to their increase; that institution was not blamed for this result. This is because it scarcely had any influence over the determinants of performance of projects.

Chapter 7 also examined a variety of factors which were responsible for the success and failure of projects the EADB had cofinanced in the three countries. Those factors included the level of demand for a given product, the quality of management, government assistance, tariff protection, price rise for a good produced by a given project, and the availability of inputs. It was found that competent management was the single most important determinant of projects' success. Conversely, where that factor was absent projects failed.

Chapter 7 further revealed that because the Non-Bank sources of finance generated more investments in Kenya than in the other two countries, the EADB could not have significantly offset the tendency towards investment disparity between her and the other two countries even if all the projects in Tanzania and Uganda had succeeded.

8.3 Future Policy Implications Derived from Study Findings

Policy-makers in Eastern Africa appreciate the potential benefits from regional economic co-operation. This is demonstrated by an agreement to create a preferential trade area in that region. If that economic integration scheme is going to work smoothly, it is necessary that the member countries' policy-makers have correct expectations of what might or might not be achieved. The lessons of experience of the East African Common Market are an important input which can help in shaping realistic expectations.

First, it will have to be realised that it is extremely difficult for all member countries to gain equally from the operation of an economic integration scheme. What each member should strive for is to exploit the presence of such a scheme so that its economic welfare will be better than it would have been if it had not become a member. Such exploitation could involve inducing both domestic and foreign investors to undertake economic activities geared to supplying more than one member country's markets. This, as was seen in Chapter 3, would not only increase employment of the domestic resources but it would also contribute to an improvement of a member country's balance of payments position.

The second lesson which the EACM's experience teaches is that where there is a high degree of free movement of trade and where member countries' capacity to satisfy demand in the region differ, trade imbalances are most likely to occur. Provided that a member country's exports are rising and provided it is not paying too high a price by importing too many high cost products of partners, trade imbalances should not very much worry national policy-makers.

The third lesson from the EACM's experience is that it is extremely difficult to rationalise production in an economic integration scheme in the absence of two cardinal requisites. One is an agreement among members on how the productive capacities to satisfy the demand in the economic block will be equitably allocated. The other is to have an arrangement which will motivate producers in the integration scheme to comply with the system of rationalisation set by the representatives of the member countries.

Finally, the EACM's experience shows that using a regional investment bank to correct industrial disparities in that integration scheme failed. This was chiefly because making finance available to the less industrialised members was not a sufficient condition for industrialisation. Other co-operative factors needed to be present for that to happen.

The East African Development Bank (EADB), as was explained in Chapter 1, is no longer required to bring about a reduction in industrial imbalances between Kenya, Tanzania and Uganda. The restriction that the Bank should finance only industrial projects has been removed. It is free now to finance projects from the manufacturing, agricultural, infrastructural, tourism and any other sectors. The Bank is also expected to provide technical assistance to its clients and to play the roles of a consultant and an agent of potential investors.

The EADB should mobilize soft loans which it will in turn lend at lower rates of interest than those prevailing in the world and on the East African money markets. The expansion of the sectors from which it can select projects to finance implies that there is scope for the increase of its lending activities. It should also pay particular attention to how it can contribute to raising the success rate of projects it has or will finance. To achieve this goal, it may partly draw on its experience concerning the determinants of the success and failure of projects it cofinanced.

If the EADB succeeds, there is reason to think that it can attract finance from the World Bank, the European Investment Bank and other sources. Both of these institutions were actually willing to lend the EADB substantial sums in recent years. The EIB was keen on financing, through the EADB, East African-oriented projects. The EADB should increase its efforts in identifying East African-oriented projects particularly in Tanzania and Uganda, where such projects were fewer in the past.

A useful policy which the EADB could adopt is to attach a very heavy weight to the quality of management when projects are being appraised. The Bank's client could be asked to have a contingent plan about hiring managerial services should the performance of a project be hampered by managerial incompetence. The Bank should also increase its vigilance especially for those projects which have shown signs of being mismanaged.

The Mediator for East African Community Affairs recommended that the EADB should play the role of a technical advisor to potential investors. In order to play that role effectively, the staff of the Bank need to be trained in project appraisal. This calls for an acquisition of theoretical knowledge as well as practical experience. A secondment of some of the Bank's staff to institutions such as the World Bank and the Inter-American Development Bank could provide invaluable lessons.

The Mediator also recommended that the EADB should play the role of a merchant bank. This would be an important role to play but at a future date after the EADB has steadily built a reputation of not being merely another of those financial institutions in East Africa. There are some people who think that the EADB is not clearly distinct in its functions from national financial institutions such as the Industrial Development Bank in Kenya, the Tanzania Investment Bank and the Uganda Development Bank. There is truth in this body of opinion.

One of the ways in which the EADB could make itself distinct is for it to be actively involved in raising agricultural production. Periodic shortages of food in East Africa has recently cost a lot in terms of financial and human resources. As an incentive for increasing agricultural productivity, potential clients could be charged lower interest rates (they could be given soft loans) than clients engaged in other economic activities. The assumption here is that the EADB would continue to obtain loans on concessionary interest rates.

In conclusion, it must be stressed that the EADB may only be able to play a constructive part in the economic growth of its member countries if national and international co-operative factors are present. It must also be reiterated that the potential benefits from the operation of that institution are likely to accrue to a member country in proportion to the effort it will make to exploit whatever advantages the Bank might offer.

APPENDIX I

List of Projects

The Performance of Selected Projects Cofinanced by the Bank

The nature and the performance of selected projects cofinanced by the Bank are examined in this appendix with a view to shedding further light on the effectiveness of that institution in its principal objective, the reduction of industrial imbalances between Kenya, on the one hand, and Tanzania and Uganda, on the other. The primary aim of the exercise is to identify the factors which affected the performance of individual projects and to assess the extent to which the Bank had a control over those factors. The outcome of the assessment should enable one to say whether or not the Bank had been efficient. The examination of the determinants of the performance of the selected projects is also expected to offer insights into factors which assisted or hindered industrial development in the East African Community.

The projects to be examined are drawn from the three categories, large, medium and small scale. The successful projects (commercially profitable) are discussed first, and those which failed are discussed next. This order applies to projects which were located in Kenya and Tanzania; Uganda is an exception because in the large scale category of projects none succeeded. In some cases, the examination of the operation of projects is not as deep as the author would have wished because of insufficient data. Some clients of the Bank did not comply with the Bank's requirement that regular reports of a project's performance should be sent to it.

The Performance of Large Scale Projects Cofinanced by EADB

The Panafrican Paper Mills

The Panafrican Paper Mills (PPM) project which was conceived in the late 1960s, was a large scale project designed to produce pulp and paper in Kenya. This project which was the first integrated pulp and paper plant in the East African Community, was initially estimated to cost K Shs. 250 million.[1] By the time it came into production, in the 1970s, it had cost K Shs. 355 million. This escalation of cost and its implication for the commercial performance of the project is discussed below later.

The plant was to be located at Webuye, 450 Km. North West of Nairobi, a place where employment opportunities were scarce. The main raw materials were trees from the Government forests 145 Km. from the plant. It had been estimated that these forests had more than adequate trees to satisfy the plant's demand. The designers of the project had, however, a plan of planting trees near the factory so as to reduce the transportation costs. The theoretical capacity of the plant was to be about 48,000 tonnes of paper per annum.

The main investors in the PPM were the Kenyan Government, the Orient Paper Mills of India (OPM), the International Finance Corporation and the Finance Development Company of Kenya. Those investors formed a limited liability company to implement and to run the Panafrican Paper Mills. The OPM, which had a good record in running pulp and paper businesses, was chosen to manage the new company. The OPM was actually a shareholder in the Panafrican Paper Mills company.

The Bank was one of the minor sources of finance for the project. Its total contributions to the revised cost of the project (K Shs. 355 million) was K Shs. 13.92 million or 3.9 per cent.[2]

It seems reasonable to expect that with this low level of contribution to the cost of the project, the Bank's influence over the running of the PPM was likely to be correspondingly low. The Bank had, however, a policy of making loans on condition that it would have a say in the management of the business of a loan recipient. There is evidence later in this section to show that in a number of times the Bank's advice was not heeded.

The performance of the Panafrican Paper Mills was initially disappointing. To begin with, production did not start in the last quarter of 1973 as had been scheduled; the plant actually came into production in November, 1974. This delay was the main cause of the cost overrun mentioned above. Even when production started, there were a number of technical problems which kept on interrupting production. These problems took about a year to eliminate. The result of those interruptions was low capacity utilization which, in turn, led to high unit costs.

When output increased later, the products of the PPM did not have adequate demand because there were plenty of rival imported goods. Although the Government was the main investor in the PPM, it had not protected its company either through tariff or by restricting imports of competing products. The Government refused to do either of the two things because the project had not come into production as had been planned and also because when production did start, it was sporadic. A major financial consequence of the low demand for the products of the PPM was a liquidity problem, which took about 16 months to solve. The company was also faced with the problem of rising costs of production which was partly due to the devaluation of the Kenyan shilling in October 1975 and partly due to the enormous price increases following the 1973 Israeli-Arab conflict. The PPM burned oil as a source of power (the price of oil had quadrupled since 1973) and this item formed about 38.5 per cent of the total manufacturing expenses in 1975.[3]

To solve the above problems, the management of the PPM took the following steps. First, it passed through the Industrial Production Committee (which, among other things, assesses industrialists' need for protection) and secured a loan on imports of paper. Second, it commissioned consultants to study how the marketing of the PPM products could be improved. The recommendations of the consultants were implemented. Third, it applied for price increases for its products from the Price Controller. A price rise of between 10 and 15 per cent was granted in 1977 and the following year permission to raise price by 30 per cent was being sought.[4] Fourth, by the late 1970s, the company's scheme to set up a school to produce well-trained technicians was now paying dividends. Production was so smooth that even the theoretical capacity had now been surpassed.[5]

The above remedial measures changed the financial fortune of the PPM from being a loss-making business (K Shs. 2.99 million loss was incurred in the financial year 1975-76) to being a profit-making company. Net profit of K Shs. 1.02, 1.9, 2.5 and 1.6 million were made in 1977, 1978, 1979 and 1980 respectively.[6]

As was stated at the beginning of this section, its primary goal is to identify the determinants of the performance of projects and to evaluate the extent to which the Bank influenced those determinants. It seems reasonable to assume that the crucial factor which enabled the PPM company to succeed was its experienced management team. It took the right steps to solve the company's problems by going through the right channels in seeking a ban on imports and in seeking permission for the price increases. The task of saving the company was made easier by the fact that the Government was the principal investor in the project. Although at first it was reluctant to help, it would have been surprising if the Government, having invested heavily in a project of very significant potential benefit[7] to the economy, had completely refused to give the PPM the assistance it needed to succeed.

The commissioning of consultants to advise the PPM on an effective marketing strategy was also a correct step to take when its products faced a stockpile of competing imports. The need for this strategy became, however, less important after the banning of imports since the company was the sole source of paper products in the country.[8] Before the banning of imports, the company had managed to secure a market for its products in the Middle East. This market was later to offset some of the loss of sales to Tanzania and other Eastern African countries which was caused by the break-up of the East African Community in 1977.

The Bank contributed hardly anything to the commercial performance other than the provision of a small amount of finance. The Bank itself at the time of implementing that project did not have sufficient experience to enable it to combine its main function of lending with that of consultant (adviser). With now twenty years of experience, the Bank ought now to be in a position to combine the two roles in order to improve the rate of success of its clients.

The South Nyanza Sugar Company

The South Nyanza Sugar Company was set up by the Kenyan Government in conjunction with other investors to produce white sugar. The plant to produce this type of sugar was to be located in Western Kenya where plantations of sugar cane would be developed. One of the major attractions of this project was a large number of jobs which it would create. It had been estimated that 3000 new jobs would be created.[9]

The capacity of the plant to be installed was 60,000 tonnes per annum and it was planned that at a later date production would be increased to 90,000 tonnes per year.[10] The cost of the project was estimated at K Shs. 632.4 million in 1977 and the Bank's contribution towards this cost was a loan of K shs. 20 million,[11] the maximum amount the Bank was permitted to lend. Although it lent the project the maximum amount it was allowed, its share of the cost of the project was only 3.2 per cent. There were seven other sources of finance for the project. Of the eight sources of finance for the South Nyanza Sugar project, the Kenyan Government was the biggest, its contribution of K Shs. 186.5 million forms 29.5 per cent of the total cost of the project.[12]

The management of the South Nyanza Sugar Company was given to one of the minor investors in the project, the Metha Group of companies. This Group had had long experience in the production of sugar in Uganda and in Kenya. Its experience in the latter country does, however, indicate that its managerial competency was questionable. Policy-makers in Kenya ought, therefore, to have exercised thorough scrutiny with regard to the managerial record of the Metha Group before giving it the right to manage the South Nyanza Sugar Company.

The project's initial performance was unsatisfactory because of a variety of problems it faced. This was because there were no adequate supplies of sugar canes. The insufficient supply of canes inputs was due to the fact that no sufficient land on which sugar canes could be grown had been acquired. This reflected inefficiency on the part of the Government (the biggest shareholder) because it had power to acquire enough land.

The second problem is that the project was poorly managed.[13] The Metha Group which was chosen to manage the South Nyanza Sugar project had, as was mentioned above, a tainted record in management. The Group had a sugar factory in Kenya, at Muhoroni, which had been badly managed. The Bank reported that the management of the South Nyanza Sugar Company (SNSC) left a lot to be desired in the initial years of operation. It was even alleged that the Metha Group's business transactions were entangled with those of the SNSC, with the result that K Shs. 3.5 million of the latter's company could not be accounted for.[14] This allegation, if it were true, would be surprising considering that right from the outset, the Metha Group as a managing agent had been given attractive financial incentives to implement and to run the project.[15]

Other problems which the project encountered were these: First, the price of sugar was low, the price of this product was Government controlled mainly in order to protect the consumer. Second, the company had inadequate working capital because of delays in payments for sugar which had been delivered. The delays were due to the inefficiency of the organisation which marketed sugar.

Although commercial production started in January, 1980, full development of the sugar cane estates was expected to occur at the end of the following year. The Bank reported that the management of the South Nyanza Sugar project was confident of producing the 60,000 tonnes per year which the plant was capable of in the near future. The management based its optimism on the fact that between January and November, 1980, 32,191 tonnes had been produced. This output was just over 50 per cent of the annual output and yet production had taken place for eleven months. This modest capacity utilization was mainly due to the insufficient supplies of the sugar canes cited earlier. This problem was expected to be solved when the sugar canes on the estates had reached the desired maturity by December, 1981. The management was also optimistic because the average yield per hectare was higher than had been forecast.[16]

The South Nyanza Sugar project later became a commercial success (a profitable business). One of the principal reasons for its success is the high demand for the type of sugar it produced. The quality of its white sugar was the best produced in the country. Because of this attribute, it was reserved for export.

The satisfactory commercial performance of the South Nyanza Sugar project was due to the following factors. First, sugar canes were available in sufficient quantities to enable the plant to operate at high capacity.[17] Second, the demand for the type of sugar it produced, as was explained above, was high. Third, management of the project improved following the criticism of the way the business was run.

The Bank's contribution to the commercial success of the South Nyanza Sugar project, apart from providing the K Shs. 20 million loan, was insignificant. It neither played a part in solving the problem of inadequate supplies of sugar canes nor did it have anything to do with the good quality of sugar the project produced. The Bank may, however, have contributed to the improvement of management through its criticisms of the way the project was run. But it is more probable that the management would have paid more attention to the criticisms from the Government than those from the Bank. Therefore, the fear of the former more than of the latter may have led to the improvement in management. The Metha Group had reasons other than losing the financial benefits associated with efficient management of the South Nyanza Sugar company. They had other business interests in Kenya which could be adversely affected by a bad record in management.

The Nanyuki (Mount Kenya) Textiles Limited

The Nanyuki Textile Mills, later renamed Mount Kenya Textiles, illustrate some of the major problems which projects that were not commercially successful faced. This project falls in the categories of import-substituting industries. It was expected to produce textiles such as Khangas, Vitenge and drills for industrial uniforms. The first two of these products were already being produced in Tanzania. There was, however, still room for the output of textile products in the East African Community.[18]

The project was to be located in northern Kenya. Its main input was the locally grown cotton. The estimated cost of the project in 1975 was K Shs. 102.75 million and the Bank's loan was K Shs. 20 million.[19] This amount of loan meant that the Bank's share in the cost of the project was 19.5 per cent. The Kenyan Government was interested in the Nanyuki Textile Mills mainly because it was expected to create 750 jobs in the northern part of the country where employment opportunities were scarce. Since the major input for the project was local cotton, it was expected that some foreign exchange would be saved.

The project was such a commercial failure that it had to go into the hands of a receiver. Two main factors explain its failure. The first is inefficient management. This was characterised by the lack of planning for the company's activities. The second was a fall in demand for the company's products due to the depression of the Kenyan economy in the late 1970s. However, even during the period when the economy was buoyant (in 1976-77 when the prices of coffee and tea on the world market were high) the company had not produced enough to exploit the existing high demand.

Corrective measures taken were to appoint a new manager and to provide more finance to the company so that it could be rehabilitated. Of the K Shs. 164 million which was required to enable the plant to operate smoothly, the Government contributed K Shs. 70 million, or 42.7 per cent, the Industrial Development Bank (a Government set-up institution to assist industrial development) provided K Shs. 10 million.[20] Both of these contributions were in the form of equity. Therefore, the Government was directly and indirectly involved in the attempt to make the Nanyuki Textiles a viable project.

The company ceased to be under receivership in 1979. However, it was not until towards the end of 1980 that approximately 80 per cent of the plant had been rehabilitated. Production in that year was 1.6 million metres of cloth. This was only 16 per cent of what the plant had originally been expected to produce. It was anticipated that once the plant had been fully rehabilitated in March, 1981, its output would be 3 million metres per year. But even if this target had been reached, this would have been only 30 per cent of the output which was given at the time of seeking a loan from the Bank in 1975.

The above discrepancy between what had been planned and what took place was explained by the inefficiency of management. Another part of the explanation could well be unrealistic estimation of the output of the plant.

It is reported that if the factory were to operate on two-shift basis, 3 million metres per annum would be produced.[21] And an additional shift would raise production by 1.5 million metres. It is also reported that the spinning section had second-hand machinery, some of which had been scrapped. In order to operate at say, 90 per cent capacity, six shifts had to be worked. This is, of course, unrealistic since most factories operating at very high capacity are on three-shift basis.

A noteworthy point is that while there was an inadequate spinning capacity, the weaving capacity was enough for the output of 13 million metres per annum. This lack of synchronisation was attributed to a poor procurement system by the former management. This suggests lack of expertise in the running of an integrated textile mill. The lack of know-how in setting up this type of project is further demonstrated by the fact that the section dealing with finishing was too small to cope with the large installed weaving capacity.

A question which needs to be answered is the degree to which the Bank may be held responsible for the failure of the Nanyuki Textiles. To a very large extent the Bank may not be blamed for the commercial failure of this project. To begin with, it was not responsible for the appointment of the management team. Second, it could not influence one way or the other the state of the

Kenyan economy. As was explained above, when the economy was in depression, the demand for the Nanyuki's products fell. Third, the manager of the regional office of the Bank (EADB) in Kenya wrote to the managers of the Nanyuki Textiles asking them to inform him how the company was faring.[22] The management of the company seemed to be resigned to failure. Otherwise, they could have sought the advice of the Bank, or better still, they could have commissioned experts in integrated textile industry to study the problems of the Nanyuki Mills and to suggest solutions. It will be recalled that this is what the Panafrican Paper Mills' management did when their company was in problems.

The Bank can not, however, be totally exonerated. It had on its staff many engineers who could have spotted some of the technical problems the company faced. Secondly, there is evidence on its files that it was aware that the textile was .... "the sick industry of East Africa".[23] In the first instance, it should not have given the maximum amount (K Shs. 20 million) it was allowed to lend to a project in an industry it knew to be sick. In future, the Bank ought to study carefully the industries in which projects submitted to it for loans belong. This may help it in categorising a project as being a low, medium or high risk. Commercial prudence would dictate that high risk projects (and these include the textile project such as the Nanyuki project) should not be financed by the Bank.

The Rift Valley Textiles Limited

The Rift Valley Textile Mill is another integrated textile mill in whose financing the Bank participated. The project was estimated to cost K Shs. 235 million and the Bank's contribution towards this cost was a loan of K Shs. 3 million, or about 1.3 per cent of the total cost.[24] Rivatex (which is the short name for this project) was expected to produce plain, dyed, and printed cotton fabrics. Its annual output was supposed to be 12.2 million square metres.

The project was to be located in Western Kenya, at Elderet. The Government was interested in this project primarily for two reasons. The first is that it was expected to create 900 new jobs in an area which had a low level of employment. Secondly, the project would use local cotton which meant that no foreign exchange would have to be found for purchasing the major input.

Rivatex started commercial production in 1977 and immediately ran into problems. It produced at such low capacity that its unit costs were high. This was due to the fact that the demand for the company's products was low, particularly during the period when the Kenyan economy was in depression. There were stocks of unsold cloth. This meant that it would have been senseless to operate at high capacity level after overcoming the problems faced at the early stages of production.

The company was also faced with a problem of inefficiency of the management. As was argued in the case of the Nanyuki Textile Mills, the inefficient management explanation was a broad one which included insufficient knowledge of how an integrated textile mill could be successfully run. This argument is also valid for the Rift Valley Textiles project.

The result of the problems Rivatex faced are reflected by the poor commercial performance of the company. It made losses in 1977, 1978 and 1979. The cumulative total in the last year was K Shs. 110,380.[25] The Bank had no hope that Rivatex would overcome its problems in the foreseeable future. The company had failed to repay both the capital and interest which were due in June 1979 and December 1978 respectively.

An important question which needs to be answered is why the Bank was involved in two similar projects which were in an industry that had been described as the "sick industry of East Africa". The Bank had considered both projects to be viable. It may be excused for this assessment which turned out to be wrong because of the confusion regarding data and information on the demand for textiles in the East African Community.[26] Moreover, both the Bank and the sponsors of the project could not accurately forecast future changes in the Kenyan economy which adversely affected the company. In the future, the Bank would have, however, to bear in mind the cyclic nature of the textile industry when it is approached for a loan by a potential client from that subsector.

The Aluminium Africa Limited

The Aluminium Africa project is selected as a case study because of the light it sheds on some of the determinants of the commercial success of projects in Tanzania. The Aluminium Africa company had been engaged in the production of a variety of products for a long time before it sought a loan from the Bank. The Al Af (as the company will be abbreviated from now onwards) was established in Tanzania in 1960 by the Chandaria family business group mentioned in chapter 4.[27] This company had a foundry, hot and cold rolling mills and a finishing facility for aluminium sheets. It was one of those industries which were set up to meet the East African Common Market's demand.

The Al Af needed to expand its scale of operation. It required T Shs. 69.2 million for the expansion. The Bank gave the company a loan of T Shs. 8 million to meet part of the expansion costs.[28] The company did not have difficulties in raising the remaining finance because its commercial performance record had been good. It had made a profit in each year from 1965 to 1972.[29]

The main inputs of this company, unlike the four companies discussed in the case of Kenya, were imported. One would be right to expect that in a period of scarce foreign exchange this company would be adversely affected. However, one would also have been correct to assume that since the company had no rival in the country and since it was manufacturing essential products for the operation of some key industries, that the company would have been put on the priority list for the allocation of foreign exchange. Therefore, no major disruption of its activities would have occurred.

The company was added, in 1973, to the list of industries considered to be "major means of production" in the sense of the Arusha Declaration of 1967. The Al Af became partly a Public Corporation and partly remained in the hands of its original owners. The Treasury held 60 per cent of the share capital of the company and the remaining shares were held by a private investment company called the Mabati, which was in turn owned by the Chandarias. The original owners continued to manage the company. This seems to have been a correct decision since the company had been efficiently managed as is reflected by its persistent profitable performance.

The company continued to perform satisfactorily. Between 1973 and 1976, profit was made in each year; in the last one, net profit after tax was T Shs. 21.97 million.[30] The company attributed this good performance to aggressive marketing tactics and to the diversification of the existing production lines which the expansion had made possible. There were several other explanations for the company's success.

First, as far back as 1969, the East African Common Market's governments had agreed to maintain a high common external tariff on the products of the Al Af.[31] This protection was still in operation in the 1970s. Second, the company was handed to a professional group of managers called the Comcraft Services of London. Third, there was a reduction in import duty paid on inputs, the duty dropped from 35 per cent ad valoreum to 10 per cent.[32] Finally, the company was allowed to increase the price of its products by 30 per cent.[33] The importance of this big price rise is demonstrated by the fact that production in 1980 was 37,205 tonnes or 78 per cent of what it had been the previous year, and yet profit was T Shs. 56.94 million in 1980 compared to T Shs. 42.8 million in 1979.[34] The Bank had no influence over the above determinants of the profitable performance of the company.

The General Tyre of East Africa Limited

The operation of the General Tyre Company offers further insight into the determinants of commercial success of projects. The choice of this company for examination is based on two considerations. The first is that the General Tyre, being one of those "East African Industries" that the Kampala Agreement (seen in Chapter 4) dealt with, deserves attention in order to learn something about rationalisation of industrial production in the East African Community. The second consideration is that the performance of this company was one of the best of the projects the Bank cofinanced, and therefore throws light on the factors which led to that success.

The General Tyre Company was formed in Tanzania in order to produce tyres, tubes and accessories for vehicles in Eastern Africa. It was envisaged that its plant which was to be set up in Arusha would satisfy about 60 per cent of the demand in Kenya, Tanzania and Uganda.[35] There were also plans, at the outset of the formation of the company, to export its products to Rwanda, Burundi, Ethiopia, Malawi and other Eastern Africa areas later in the life of the project.

The project was initiated by the National Development Corporation (an institution set up by the Government and charged with promoting the economic development of the country) and a U.S.A. company, the General Tire and Rubber Company. The NDC held 74 per cent of the company's (GTEA) shares and the remainder was held by the GT & R.[36] It was estimated that the project would cost T Shs. 85 million. The Bank's contribution to this cost was a loan of T Shs. 8 million, which was given in 1969.[37] And production was expected to start in 1971. Output when the plant was operating three shifts was supposed to be 145,000 tyres. This level of production was to be maintained from 1972 to 1975. The company was managed by the General Tire which had long experience in the production of tyres worldwide.

The above output fell far below demand. Motor car tyre consumption in the East African Community in 1970, 1971 and 1972 was 421,000, 491,000 and 458,000 units for the three years respectively.[38] In 1971, the three EAC countries' shares of the total consumption were 52.5 per cent for Kenya, 29.3 per cent for Uganda, and 18.1 per cent for Tanzania. By 1972, Kenya's share had dropped very slightly to 51.5 per cent, Tanzania's had substantially increased to 33.6 per cent and Uganda's share had drastically fallen to 14.8 per cent. Since the consumption of tyres was highest in Kenya, if there had been no interference with the market forces in order to redress industrial imbalances in the East African Community, it is probable that a foreign investor would have located a plant where the demand was greatest. However, since the supply fell far short of demand, several plants of the size of the Tanzanian one could have operated in the three countries. Note that even if the target of 145,000 tyres per annum had been met, this would have satisfied only 29.5 per cent of the demand in the EAC in 1971, and 31.6 per cent in 1972. This was far short of the 60 per cent demand which the company had forecast that its production would satisfy.

The plant came into production late in 1970, which was inside the schedule. It faced no initial problems such as those seen above in the case of the Panafrican Paper Mills. In 1973, the company decided to expand to satisfy the high demand for tyres in the East African Community. Production was expected to be raised to 236,000 units in 1974 and was to be stepped up again to 294,000 units by 1977.[39] The company sought and obtained a loan of T Shs. 8 million for the expansion which was estimated to cost T Shs. 13.32 million.[40]

The expansion was carried out smoothly and in 1976 production had gone up to 260,954 units.[41] The company made a profit in that year as it had in the previous years. The Tanzanian market absorbed 68.9 per cent of the 1976 production and the remaining percentage was exported. Kenya, despite having set up a tyre plant in collaboration with the Firestone of the U.S.A., imported 52,403 tyres from the General Tyres company. This meant that 64.6 per cent of the company's exports went to Kenya. Uganda bought 16,295 units from the General Tyre in 1976, which forms 20 per cent of total exports. Clearly, Kenya and Uganda were important markets for Tanzania since they accounted for 84.6 per cent of the total exports. However, it is important to stress that while the General Tyre was an East African Community oriented firm (95.2 per cent of its output was consumed in the three member countries) Tanzania was the most important market.

The General Tyre Company was a commercial success for three principal reasons. First, as was noted above, the demand for tyres exceeded the company's capacity to satisfy that demand. As long as the quality of the GTEA tyres was reasonable (and it was) and as long as their prices were competitive (which they were because of tariffs on imports of rival products), whatever quantity put on the market would be sold. Second, and more important, the company's activities were in the hands of the General Tire which had had long experience in tyre production in many parts of the world. The importance of efficient management as one of the crucial determinants of the success of a company, was stressed in Chapter 7. A good management team will do all it can to exploit the existing demand. The third factor which facilitated the commercial success of the company was the arrangement between this company and the General Tire of U.S.A. to give raw material credit facility to the Arusha plant. This meant that the danger of the plant coming to a standstill because of lack of inputs was eliminated.

The General Tyre Company is a good example of how in a mixed but predominantly socialist economy, a public enterprise may harness the expertise of private foreign company to produce a good which is needed. Given the high demand for many consumer goods in Tanzania and given the failure by many producers to exploit that demand, the G.T.E.A. is a source of important lessons.

The Lake Katwe Salt Company

The Lake Katwe Salt Company is one of the three large scale projects which the Bank cofinanced in Uganda. Like the other two projects, it was a commercial failure. The examination of the nature and the reasons for the failure of this project provide lessons to potential investors in a similar line of business.

The project was designed to produce salt in the Western part of Uganda using mainly salty water of the Lake Katwe. The Ugandan Government was interested in this project for three principal reasons. First, it was expected to contribute to the expansion of industrial production to which the Government had, rather belatedly, come to attach much importance. Second, the project was not only expected to save the country foreign exchange through a reduction of imports of salt, but it was also supposed to earn the country foreign exchange through exporting the by-products such as potassium chloride, which was needed for increasing sugar cane yield.[43] Third, the project was supposed to create jobs, estimated at 210.[44]

The cost of this project was put at U Shs. 184.14 million in 1975 and the Bank contributed U Shs. 20 million.[45] The capacity of the plant, when fully operational, was 50,000 tons per year. This would have been more than adequate for domestic demand because the average annual consumption of salt in Uganda was about 28,400 tonnes per annum.[46] The surplus quantity could have been exported to Zaire, near whose border the project was located, or to Rwanda and Burundi, which are also close.

The project has been a failure for three broad reasons, political, technical and financial. The political hostility towards European "capitalists" during the Amin Government made it difficult for a West German firm to discharge its duties as the main contractor of the project. The progress which had been made by 1979 was to some extent wasted when the Germans working on the project had to flee the country due to a civil war. By the time they returned, eight months later, some machine parts needed repairing. Curiously, a short time after returning, the contractors wanted to conduct test-runs, a thing which a firm of consultants hired by the Government on behalf of the Lake Katwe Company objected to.[47] The ground for objection was that the main process line was not ready. The testing took place and proved the consultants right because serious problems were exposed.

The Government ignored these findings and pressed for the plant to be commissioned in June, 1980. With this phase over, it seems that the main contractor assumed his obligations to be over and the German staff had left by the end of the year. But the plant was not operating. The desire for the contractor to pull out may be explained by the difficulties the foreign staff had experienced in Uganda and by the fact that the project had exceeded the three to four years period which is how long its implementation had been expected to last. The Government's pressure to have the project commissioned hurriedly is hard to understand. It may be that the Government thought that it could save itself further financial assistance to the project by bringing it into production as soon as possible. The opposite was to happen.

Between June and December 1980, when the plant was idle, machine parts were spoilt. The estimates of the cost of the project at the latter date was U Shs. 300, and more funds were required to repair the spoilt parts and to solve other problems. The underestimation of costs, as Little and Mirrlees (1974) point out, is a common problem in the developing countries.[48] This is likely to be particularly so in economies such as the Ugandan one where undertaking most forms of economic activities involved a lot of uncertainties.

Some of the uncertainties are illustrated by specific problems the Lake Katwe Salt project faced. Several vehicles of the company were "grabbed" by the Ugandan Government armed forces. There were frequent power failures during the test runs. There is no reason to believe that this power failure would not have disrupted the running of the project. There was another type of uncertainty which could not have been foreseen. This was the development of algae in the water, which the plant was going to use. The water treating plant that had been installed had no facility to remove the algae.

The project faced two other major problems, both of which were of technical nature. First, there were major faults in the crystallising and separating systems. Because of these faults, the final product contained impurities. There was a divided opinion about the cause of those faults. Both the managers of the project and the Bank believed that the fault was a technical one. Those who installed the plant, on the other hand, argued that the lack of skilled technicians was to blame. The author is inclined to side with the experts who set up the plant, for the following reasons. It is common in the less developed world for projects not to operate smoothly soon after commissioning because even the well-trained staff take time to become used to the machines. It will be recalled that in the case of the Panafrican Paper Mills, (which was a great commercial success) it took a year for the machines to run smoothly.

The second technical problem was corrosion in some heat exchangers and pumps in salty water. The solution was to eliminate the gases which caused the corrosion. No solution had been found for this problem, because the cause was still unknown. These problems should have been anticipated by the expert contractors if they were not unique to the Lake Katwe Salt project. If they could not be anticipated, they should have been solved fast enough before they had a devastating effect on the rest of the machines.

Once again a question which must be now answered is whether or not the Bank could have helped this project to succeed. The answer seems to be that it could not have greatly helped. To begin with, although the Bank had trained engineers, none of them had practical experience in salt production. Second, the Bank did not go to inspect the progress of project implementation to ensure that the job was being done properly. Third, both the political unrest and the difficult economic climate in Uganda which greatly contributed to the delay in the implementation of the Lake Katwe Salt project, were beyond the power of the Bank to influence. The Bank is most likely to continue to be powerless over the third factor. Therefore, the extent to which it can contribute to the economic growth of its member countries will depend on whether or not the conditions conducive to the success of projects are present in the economy where the project is located.

The Mtibwa Sugar Estate Limited

The study of the operation of the Mtibwa Sugar Estate company shows how the Tanzanian Government's assistance, in conjunction with a capable firm of international managing agents, and pressure of demand, transformed this company from being a "sick" project into being a promising business venture. But this took about 8 years to happen.

The Mtibwa Sugar Estate (from now onwards to be referred to as the M.S.E.) was set up by Greek settlers in Tanzania in 1961, and was located 65 miles from Morogoro, on the Morogoro - Korogwe road. This is not far from Dar-es-Salaam. The factory at the Estate had been neglected. In anticipation of a fast growth of demand for sugar in Tanzania, the Madhvani Group, (which already had a huge sugar estate in Uganda), bought the M.S.E. in 1966.[49] The new owner intended to rehabilitate the plant so as to raise the production of sugar from 7000 to 45,000 tons per annum.[50] If this target had been met, in 1970 the M.S.E. would have satisfied 44.8 per cent of the national consumption of sugar.[51] Considering that there were two other sugar estates in Tanzania, the M.S.E. would have made a major contribution with that 6½ fold expansion in output.

This scale of expansion also required a large investment, T Shs. 69 million, and the Bank's share in this cost was a loan of T Shs. 10 million given in 1969.[52] Even before the expansion was completed, the National Agricultural and Food, a parastatal, was approached by the Madhvani Group and asked to become an equal partner. It agreed in 1970. This was most probably a calculated move on the part of the Madhvani Group which was designed to facilitate accessibility to various forms of Government assistance that would make the project commercially profitable.

The sugar canes which the plant had used had come from the estate itself and from the outgrowers, the two sources had contributed 60 to 70 and 30 to 40 per cent respectively of the canes required. Because of the inadequate rainfall, it was considered necessary to irrigate the estate if the expanded production was to be achieved. The owners of the M.S.E. were prepared to incur the expense of establishing irrigation facilities on condition that the Government waived off excise duty which was said to constitute 30-40 per cent of the company's total operating expenses.[53] The irrigation facilities were not installed in the early and mid 1970s because the tax was not waived.

In the late 1970s irrigation was introduced. As a result, output rose from 7 to 15.5 tons.[54] It will be recalled, however, that way back in 1969 it had been estimated that after modernising the plant, 45,000 tons would be produced in each year. In 1980, output was up again to 25,119 tons, which was still only 55.8 per cent of the original production target. However, this was a remarkable achievement since the company had never in its history produced that much sugar.

The other factors which had led to such an increase in output were the reconditioning of the machinery and the improvisation to manufacture spare parts when they could not be imported because of the scarcity of the foreign exchange. It was also reported that the factory engineers and technicians were committed to the success of the factory.[55] This was largely attributable to the introduction of an efficient firm of international management services.

The pressure of demand for sugar, as this quotation shows, meant that the potential for the commercial success of the M.S.E. was bright (providing the costs of operating were kept low). "Since local demand is higher than locally available sugar, there are no selling problems".[56]

The Government was directly involved in negotiations which led to a loan that made the irrigation possible. Therefore, the Madhvani Group's calculation paid off. It is important to recall that the Kenyan Government itself tried to help the South Nyanza Sugar Company and that that help enabled the company to succeed. The Mtibwa Sugar Estate seemed to be on the road to success but it had taken too long. In this connection, the author learned from the Director of the Bank's operations that, on the whole, projects with problems in Kenya tended to take a shorter time to find solutions than projects in Tanzania. This, coupled with the fact that Kenya had a higher rate of success of projects than either Tanzania or Uganda, made a nonsense of the balanced industrial development objective.

The Bank did not contribute anything to the improvement of the M.S.E.'s performance. The Bank may, however, be playing a useful role in the future if it advised its clients to set up contingent funds, which could be in a form of loans, in case the need for services of managing agents might be required.

The Arusha Pharmaceuticals Limited

The Arusha Pharmaceuticals Company is one of the projects cofinanced by the East African Development Bank which was a commercial failure. The study of the operation of this project offers insights into the negative effects of the scarcity of foreign exchange, the inconsistency between the stated government policy of promoting domestic industries and what actually took place.

The National Development Corporation (NDC) initiated the idea of substituting many of the human and veterinary drugs. The Arusha Pharmaceuticals was expected to produce about 40 different drugs. The NDC invited a Finnish public enterprise pharmaceutical company to set up and manage the production of that assortment of drugs.[57] The plant was to be located in Arusha, and it was assumed that when it began to operate (one shift) it would produce drugs worth T Shs. 115.7 million.[58] Production was scheduled to start in January, 1979.

The raw materials for the project would all be imported. It was estimated that the value of the raw material to be imported in 1979 and 1980 would be T Shs. 12.9 and 18.3 million respectively.[59] The estimate for the entire cost of the project in 1976 was put at T Shs. 63.7 million and the Bank lent the Arusha Pharmaceuticals T Shs. 16 million.[60] The economic benefits of this project were the expected creation of 262 new jobs and an annual saving of T Shs. 18.6 million of foreign exchange through a reduction in the import bill of foreign drugs. The Government was interested in the project and this is shown by the fact that it guaranteed the loan the APL obtained from the Bank.

Production did not start in January 1979 as had been expected, instead it started in June 1980. This delay is largely to be explained by the fact that neither the NDC nor the Finnish company had had experience in implementing a pharmaceutical project in the conditions of Tanzania. At the end of 1980, drugs worth T Shs. 8.2 million had been produced. This was only 7.1 per cent of the anticipated production.

This poor performance was due to the following factors. First, the project did not have adequate raw materials because of the scarcity of foreign exchange. For example, in 1980, the management of this project applied for T Shs. 8.5 million to the Bank of Tanzania and it was allocated only T Shs. 1.5 million.[61] Note that the amount applied for was 46.4 per cent of the budget for imports of the raw material seen above. The project was allocated even less amount in 1981. An application for T Shs. 13 million was lodged with the Bank of Tanzania, but only T Shs. 1 million was approved. While it is understandable that the country was faced with a severe foreign exchange problem, the

Government could have tried to help this important industry to obtain the necessary foreign exchange from other sources. For instance, with the Government's guarantee, a loan could have been obtained from capital markets in the world. Given the importance of healthy people to the proper functioning of the economy and given the priority the Government attached to the structural transformation of the economy through industrialisation, arrangements should have been made by the Government to secure the T Shs. 8.5 and T Shs. 13 million the company required.

The second major problem for the Arusha Pharmaceuticals was the inefficiency of the management.[62] An imaginative management team could have done the following to secure the foreign exchange required for purchasing imports of the raw materials. It could have arranged to obtain credit from the Finnish pharmaceutical company. It will be recalled that the management of the General Tyre had made such an arrangement and the foreign exchange scarcity in the country had had no adverse effects on its operations. It could also have tried persistently to remind the Government that all should be done to secure the necessary foreign exchange needed for importing raw materials. Furthermore, it could have tried to concentrate on the production for export in order to earn foreign exchange. If the company had shown that it was capable of earning foreign exchange, most probably the Government would have placed it high on the list of companies to be allocated substantial amounts of foreign exchange. Finally, though not exhaustively, an imaginative management group could also have tried to obtain supplementary loans from both the East African Development Bank and the Tanzanian Investment Bank. Both of these institutions often gave loans in foreign exchange. The interview the author had with a senior member of the TIB, in 1982, revealed that a substantial amount of foreign exchange had very often been available for a well-formulated and efficiently managed project.

The third problem of the APL was high unit costs. As was seen above, the plant produced at about 7.1 per cent of the rated capacity. Because of the high unit costs, a 30 per cent tariff protection which the APL's products enjoyed was inadequate. The National Pharmaceutical Company and the Christian Missionary Society, which were in charge of importing drugs required by Tanzania, had the power to regulate the amount of imports in a manner that protected the local industry[63] (there were four more drug producing companies but their output was very small). The two organisations did not restrict imports with a view to protecting the Arusha Pharmaceuticals. The scarcity of the foreign exchange ensured that limited quantities of drugs were imported.

A further problem the APL faced is that its products were considered to be of inferior quality to the imported rivals. The usually high quality of some imported goods tends to make consumers willing to pay more for those products than the local low quality similar products. This makes moderate tariff protection ineffective.

The problems of the Arusha Pharmaceuticals could probably have been eased if the Bank had had a larger part of foreign funds, and if it had a policy of providing working capital to its clients who badly needed it. As was seen in Chapter 6, the Bank had from 1975 onwards found it hard to obtain substantial funds to lend. This was even more so after the break-up of the East African Community in 1977. The Bank introduced a policy of lending to its clients working capital for purchasing raw materials in the 1980s. This is a step in the right direction. The Bank could also have helped the company if it had brought some subtle pressure to bear on the Tanzanian Government so that it could allocate more foreign exchange required for the inputs. This needed, however, to be preceded by appointing an efficient team of managers.

The Performance of Medium Scale Project Cofinanced by EADB

The EMCO Steelworks (K) Limited

The EMCO Steelworks is one of the many projects cofinanced by the East African Development Bank which was a commercial failure in the early and mid 1970s. By 1979 and 1980, the company was making profit largely because it had implemented remedial measures which consultants had recommended. The operation of this project is important because of a variety of lessons it gives on the determinants of commercial success and failure of a project.

The initiators of the EMCO project, the Madhvani Group, intended to set up a plant to produce iron and steel products such as iron bars, angles and billets. The project was estimated to cost K Shs. 22.1 million and towards this cost the Bank gave a loan of K Shs. 7.51 million in 1971.[64] The products of this project were mainly to be consumed by the construction industry. It was estimated that 75 per cent of its output would be sold to that industry.[65]

The EMCO, like the Steel Corporation of East Africa which was based in Uganda and was also owned by the Madhvani Group, intended to use scrap iron from Kenya and some ingots from Uganda. The source of the latter input was the Steel Corporation. The estimated capacity of the EMCO was 24,000 tons per annum.[66] It was expected that all the output of the EMCO would be readily consumed and that there would still be room for imports. It was estimated that by 1973 the production of iron and steel products would be 114,000 tons and consumption was put at 204,000 tons.[67]

The demand for iron and steel products in the East African Community was greatest in Kenya and Uganda's demand was slightly greater than Tanzania's. For instance, in 1969 Kenya consumed 77,900 tons, Uganda used 43,700 tons and Tanzania consumed 41,600 tons.[68] Investors in the iron and steel industry expected Kenya to continue to consume more than either of the two countries. This is one of the most probable reasons why several iron and steel plants were set up in Kenya in the early 1970s.

The EMCO plant came into production in 1972 as had been expected. However, it did not produce anywhere near the planned level of output. In that year, about 8223 tons were produced. This was about one third of what should have been produced. The explanations offered for producing below expectations are these. The first is the inadequate supply of inputs. It will be recalled that the principal sources of the project's inputs were Kenya and Uganda. The EMCO did not obtain as much scrap iron from Kenya as had been anticipated. This is partly because other iron and steel plants which also used scrap iron had been set up in the country. The supplies from Uganda were also cut off when Asians were expelled from the country in 1972. Madhvani was one of those who left the country and as a result his Steel Corporation, which was supposed to give ingots to the EMCO, ceased to operate. The EMCO tried to obtain inputs from Eastern Europe, but they were very expensive.

The consequence of the inadequate supply of inputs was that unit costs were high.[69] This problem was compounded by utilizing expensive inputs from Eastern Europe. The low level of production mentioned above was partly caused by frequent breakdown of machines. A further explanation for the low volume of production is the high rate of rejection. This was a problem which could be solved by skilled technicians.[70]

A question which needs to be answered is whether or not the inadequate supply of inputs could have been forecast. The answer seems to be affirmative. It ought to have been known to the Madhvani Group that by setting up two more plants in Kenya, their original plant in Uganda which had used scrap iron from Kenya, and the two new arrivals, would be competing for a limited stock of scrap. However, the political events which culminated in the expulsion of Asians from Uganda and which resulted in the cut of supplies of inputs to EMCO could not be forecast.

As a step towards solving the problems of EMCO, the management of this company took a right decision in commissioning a firm of consultants, Mukand Iron and Steelworks Limited of India, to study and recommend ways of saving this company further financial losses. Losses had been incurred from 1972 to 1976.[71] Some of the recommendations of the consultants were implemented and as a result, no major breakdowns occurred and the rate of rejection was sharply reduced. There is also evidence that the skills of technicians had substantially improved.[72]

Following the implementation of the remedial measures, the EMCO company made a profit of K Shs. 2.4 million in 1979 and in the following year, the profit was K Shs. 1.9 million.[73] This drop in profit was attributed by the Bank to a less than expected volume of sales. An interesting point about the profitable performance of the company in the two years is that the volume of sales was around 50 per cent of the rated capacity of the plant. If the company could make profit by selling about 12,000 tons, then it could have made greater profit by operating near full capacity, assuming that it had managed to obtain inputs at reasonable prices.

The demand for iron and steel products, as the Bank noticed, depended on the state of the Kenyan economy. During an economic recession the construction industry was also depressed and as a result the demand for reinforcing bars was low. Also, a government's monetary policy of restricting credit reduced the demand for iron and steel products. This came about by deferring government and private projects. The restriction of credit also had an adverse effect on the EMCO because the company was forced to give credit to its customers who needed iron and steel products but who could not pay cash immediately. The result of giving credit to the EMCO's clients was that the company had to arrange for overdraft facilities which meant it was incurring costs of borrowing at the time when interest rates were high.

The iron and steel companies in Kenya were producing a limited range of products. Because of this, although the demand for a variety of iron and steel products exceeded the installed capacities, the market for the few products manufactured in the country seem to have been saturated. The solution which the Bank proposed in 1972 was the diversification of products. By 1980, the EMCO was in the preliminary stages of diversifying; it intended to produce different sizes of bars, angles, T-sections, window sections and flats. Notice, however, that it had taken about 8 years to do what the Bank had recommended.

The Bank had also expressed concern in 1970 about the likelihood of the EMCO running short of scrap iron inputs. This kind of critical evaluation of projects, as the author learned from interview, declined after the departure of expatriates such as those from the United Nations Industrial Development Organisation (UNIDO). The author also learned that the Appraisal Department of the Bank was generally weak. This department is of great importance to the Bank for the selection of economically viable and technically feasible projects. It should, therefore, have competent and critical project evaluation officers.

The Performance of Small Scale Projects Cofinanced by EADB

The Kibo Paper Industries Limited

The Kibo Paper Industries, as its name suggests, was in the business of producing a variety of paper products in Tanzania. Like the EMCO company, it started as a commercial failure and later became a profitable business. The main factors behind the early failure of the Kibo Paper Industries were the inefficiency of management and technical faults. Once these were put right, the company became a commercial success since the demand for its products was high. The K.P.I., unlike the EMCO, was from 1970 a predominantly public owned enterprise; the National Development Corporation owned 76 per cent of the shares of the company, the National Milling Corporation held 14 per cent of the shares and the remainder were owned by the Workers Development Corporation. The company had, however, started as a private enterprise in 1965.

The performance of this company in the 1960s was so bad that in 1969 it was placed under a receiver. Since, as was mentioned above, its major problem was an inefficient management team, its chances of commercial success depended on giving it an efficient team of managers. With this solution in mind, in 1971 the NDC appointed an international firm of managers, Packages Limited of Lahore (Pakistan). This firm had successfully managed packaging, printing and paper-making businesses in Pakistan. The new management team had by 1973, solved the technical problems and were steering the company on a course of commercial success. In fact, that year it made profit for the first time in many years.[74]

During the same year, the management wanted to add two lines of production for multiwall paper sacks and packaging materials. This diversification of the products of the K.P.I. was estimated to cost about T Shs. 14.8 million and the Bank was approached and it gave a loan of T Shs. 4.7 million in 1973.[75] The diversification contributed to the satisfactory performance of the company. For each year between 1974 and 1976, profit was made and the company, as the quotation below shows, was efficiently run. "The K.P.I. is one of the best managed companies in Tanzania".[76] This evaluation was made by the Bank after the company had approached it for another loan for further expansion in 1976. A loan of T Shs. 8 million was granted to enable the company to carry out an expansion estimated to cost T Shs. 25.06 million.[77]

After the expansion was completed, the company continued to perform satisfactorily. Net profits after tax amounting to T Shs. 10.1 and T Shs. 20.6 million were made in 1978 and 1979 respectively.[78] This satisfactory performance was due to the pressure of demand for the K.P.I. products and also because the same efficient team of managers was still running the company. The demand for a range of products the K.P.I. produced was 4080 tonnes in 1973 and the annual growth rate of these products was estimated to be 10 per cent. This rate of growth meant that 7228 and 7951 tonnes would have been consumed in 1979 and 1980. The actual consumption was 8749 and 10882 tonnes respectively for the two years.[79] Because of the increase in the cost of raw materials, profits in 1980 were lower than those made in 1979 although the volume of sales was higher in 1980.

The K.P.I. company shows a conflict between promoting industrial development in a less industrialised member of the East African Community and the promotion of industrial complementarity. It will be recalled that the Bank was expected to achieve the two goals. The dilemma the Bank faced is that at the time the K.P.I.

approached it for a loan (1973), there was already another firm, in Kenya, E.A. Package Industry Limited, engaged in the production of goods similar to those the K.P.I. intended to produce. By giving a loan to the K.P.I., the Bank participated in the duplication of plants in the Community, which was inconsistent with the promotion of industrial interdependence, or industrial complementarity. Ideally, what the Bank should have done was to bring together the two companies so that an agreement on how to rationalise production could be worked out. It was seen in chapter 6 that the Bank's efforts to bring together owners of iron and steel plants had failed to produce an agreement on rationalisation. This had happened despite the fact that all the producers in Kenya were adversely affected by the absence of a rationalisation arrangement. It is most probable that even if the Bank had ignored its failure and brought together the K.P.I. and E.A. Package Limited, no agreement would have been reached. The K.P.I., unlike the iron and steel companies, was doing very well in the national market. There was, therefore, no incentive for it to engage in the rationalisation of production. At any rate, even in the early 1970s, the signs of the break-up of the East African Community were present; for this reason, it made more sense to concentrate on building national industries. A more realistic way in which the Bank would have contributed towards making the partner states of the East African Community complementary in industrial field was to finance projects which intended to export part of their output to the other partners.

A noteworthy point about the K.P.I. is that though most of its inputs were imported, its production did not fall even during the severe foreign exchange scarcity period of 1979-80. It was allocated foreign exchange to import inputs largely because it had proved its capacity to meet targets it had set.

The Bank could use the performance of this company as a model for other projects. It is important to realise that the Bank had not been responsible for the determinants of the success of the Kibo Papers. But in future, it could influence the performance of a project if the managerial factor is of crucial importance. It could insist on the project it will finance to be run by an efficient team of managers. It will be seen ahead in the case of the Ugma project that the Bank had actually done that.

The C.P.C. Industrial Products

The C.P.C. Industrial Products is the last of the commercially profitable projects operating in Kenya which will be discussed in this appendix. The examination of the operation of this project will illustrate the extent to which the Kenyan Government went to ensure that the project succeeded. The products of this company enjoyed a high tariff protection; the inputs were highly subsidised and their regular supply was guaranteed by the National Milling Board. This extensive assistance should remind us of the observation by Cooper and Massell that governments in the less developed world attach much importance to industrialisation (see chapter 3 of this thesis). Because of that, a high price in terms of national income foregone is paid.

The C.P.C. Industrial Products project was designed to produce starch, glucose syrup, maize oil, maize cake and other related products.[80] The main raw material was yellow maize. The project was sited at Eldoret in the neighbourhood of which there were grown yellow maize. The estimates of the cost of this project were K Shs. 14.57 million.[81] The sponsors of this project, C.P.C. Europe Limited and the ICDC of Kenya, sought and obtained a K Shs. 4 million loan from the Bank in 1973.[82] The C.P.C. Europe Limited, which was the majority shareholder, was to manage the new project in Kenya.

The project took longer than expected to be implemented. This was largely due to delays in shipping the machinery required and also because of the shortage of cement.[83] The delay in implementation resulted in cost overrun of K Shs. 3 million. Production started in March 1976. By the end of the year the plant was not yet on course to an annual production of 10,485 tonnes, which is what was expected to be produced.

Production in 1977, 1978 and 1979 was 6600, 7192 and 7704 tonnes respectively. Despite this modest level of production, in relation to the rated capacity, the C.P.C. Industrial Products made profit in each of the three years.[84] However, by September 1980 the plant was operating at full capacity. Around this time, the management of the company had plans to expand production by installing another plant. There were, however, those who thought that the expansion would be an unwise step to take because there was already a problem of inadequate supply of maize. This input had turned out to be a very expensive one. This problem, together with high costs of energy, contributed to a sharp fall in profits in 1980 from a peak of 1978.[85]

A key factor which enabled the C.P.C. company to become a commercial success is the subsidy it received for its main input, yellow maize. The management team had been able to secure authorization to buy at a price below that prevailing on the maize market. It bought a bag of maize at K Shs. 59 when the market price was K Shs. 88.50.[86] This was part of the investment agreement. Another important element of that agreement was a guarantee that the C.P.C. would be supplied regularly with the quantity of maize it required. The regular supplies ensured that the plant was not idle for lack of inputs, hence its ability to reach the rated output.

This arrangement was about to be terminated in 1980 because with the Kenyan Government having to import virtually all the maize required in the country (maize is the staple food for most Kenyans), it found it hard to import extra quantities for the C.P.C. The Bank's officials were of the opinion that if the subsidy and the guarantee of regular supplies were removed, the company would cease to be a profitable business.

Another factor which helped the company to succeed is the high protective tariff duty imposed on the rivals of its products. The duty on imports of rival products was 50 per cent.[87] This was actually less than what the management of the C.P.C. wanted. They had sought a total restriction of imports which would have given them a monopoly of the Kenyan market. The fact that volume of sales had persistently gone up from 1976 to 1980 suggests that there was pressure of demand for the C.P.C. products. This also contributed to the commercial success of the company.

Other factors which enabled the company to perform well were. First, the installation of a generator so that production would not be disrupted by power supply cuts. Second, improvements were made in the engineering section. Third, both the spare parts and other inputs such as chemicals were stockpiled whenever there were signs that import restrictions would be imposed in the near future. Fourth, a water reservoir was built so that production was not hindered by water shortages in Eldoret.[88]

The negotiating skills of the C.P.C. Europe Limited deserve to be commented on. The management of this company foresaw that supplies of maize would be inadequate unless there was a Government guarantee. As was seen above, that guarantee was obtained. The Government wanted an industry and the C.P.C. wanted a return on its investment. This investment was expected to create 124 jobs and to save the country some foreign exchange by producing locally a variety of goods which were formerly imported. Since some of the products were expected to be exported, some foreign exchange was also supposed to be earned. A net foreign exchange contribution of the project was estimated at K Shs. 40 million in the life time of the project.[89] These expected benefits are the probable reasons why the Government subsidized and guaranteed the maize input of the project.

It is easy with the benefit of hindsight to argue that the Government ought to have realised that the supply of maize would in future be inadequate. It is important, however, to realise that in 1973 when the agreement between the Government and the C.P.C. was made, there was no shortage of maize in the country. The Government should, however, have tried harder than it did to encourage the production of maize so that there would be adequate supplies for peoples' consumption and a surplus for the new industry. This would have been consistent with the objective of raising peoples' income.

In future both national governments and the Bank should critically examine the proposed source of inputs. It may be helpful for the Bank to request a loan seeker to indicate an alternative or alternative sources of inputs, should the original one prove to be inadequate. The costs which may be incurred in order to obtain inputs from alternative sources should be taken into consideration and contingent plans should accordingly be made. Once again, it is important to point out that the Bank did not influence the determinants of the success of this project.

The J.K. Industries

The J.K. Industries, a company set up to produce a variety of plastic goods,[90] became a commercial failure business venture. Yet according to the Bank, it could have been a profitable business if it had been efficiently managed. This view was based on the fact that there was high demand for the type of products it produced. The study of the operation of this project will show once again how inefficient management can ruin a business venture with a potential to become a commercially profitable project.

The owners of the J.K. Industries obtained a loan of K Shs. 7 million from the Bank in 1975.[91] Because of the great potential which the Bank saw in this project, it also paid K Shs. 1 million as a share in the equity of the company. The entire cost of the project was estimated at K Shs. 18.1 million. Since 8 products were to be produced, machines of various capacities were to be installed. All the eight items were to be produced using imported plastic resins.

Because of depending on imported raw material, there was risk of disruption of production whenever there was a severe scarcity of foreign exchange unless the management was able to convince the Government to place it on the list of those industries which would be given priority during the rationing of the foreign exchange. Three of the items the company intended to produce, syringes and bobbins and wind-on-spools, could have been used by an imaginative team of management to secure preferential allocation of foreign exchange. The syringes were to be sold mainly to the Ministry of Health. Given the importance policy-makers attached to health, and also given the high priority industrial development was accorded by the Government, it should not have been hard to use the production of syringes and bobbins and wind-on-spools required by the textile mills as a bargaining instrument for securing a guarantee of a regular allocation of foreign exchange. Moreover, it had been estimated that at full production, the project would save the country about K Shs. 3.6 million per annum of foreign exchange.[92]

The demand for some of the items the J.K. Industries intended to produce and the capacity to be installed were as follows. The consumption of syringes in 1974 was about 950,000 pieces. The capacity to be installed was 2.5 million, on a three-shift basis.[93] The annual demand for bobbins was around 1.2 million units, but the company intended to set up machines with 6 million capacity also on a three-shift basis.[94]

The value of all the goods the company intended to produce is shown in Table 7.A1 below. Table 7.A1 shows that in 1977 there was an enormous gap between what was expected to be produced and the actual production. In the following year though the gap narrowed, the production was still only at 28 per cent of the target set. In 1979, production was 58 per cent of the expected output which was a very substantial improvement on the previous year's level of production. It is no surprise that in that year a profit of about K Shs. 1 million was made.[95] But in 1980 the value of output declined and as a result a loss of K Shs. 1.34 million was incurred.[96]

Many reasons have been given why the J.K. Industries failed commercially. First, and most important, the company was badly managed. The Bank reported that there was no proper planning for the activities of the company and that production activities were not co-ordinated. This is an indictment of the Managing Director who should have seen to it that a company had a proper plan and that its activities were synchronised. Poor management manifested itself in the absence of proper budgets, inadequate supplies of raw materials and spares and low morale of the staff. With these problems, it is not surprising that targeted output was not met. Power cuts also contributed to low capacity utilization.

TABLE 7.A1: Values of Expected and Actual Output J.K. Industries

(in K Shs. 000, and in current prices)

	Expected (1)	Actual (2)	(2) as % of (1)	Deviations
1977	21,056	834	4%	- 20,222
1978	21,273	6056	28%	- 15,217
1979	21,524	12579	58%	- 8,945
1980	21,802	10440	48%	- 11,362
1981**	22,109	13473	61%	- 8,636

Source: Calculated from East African Development Bank's project file: J.K. Industries, Reports from Clients, NRB/PS/16D/58/I.

In spite of low output, the company could have done better than it did were it not that the cost of raw materials rose sharply. It is claimed that the company could not pass on to the consumer part of the rise in price because one of its major customers was the Government. In the same vein, it was argued that the price of one of its products, toothbrushes, was controlled by the Government's price rise watchdog. The management of the J.K.I. should have applied for permission to increase price. It was seen that the Panafrican Paper Mills was granted such permission. Given the disarray the company was in, it is not surprising that no attempt was made to seek permission for increasing the price of those products which formed the backbone of the company's sales, the tableware.

There was, however, another important exogenous factor which contributed to the bad performance of the company in 1980. This was the restriction of credit facilities which the Government implemented in 1979-80. As was seen before, credit restriction had a general adverse effect on demand in the economy. This is reflected by the fact that J.K.I. turnover in 1980 was lower than it had been in 1979.

The Bank tried to help the J.K.I. The manager of the Bank's regional office in Kenya recommended that a team from the Bank should visit the J.K.I. and identify its problems.[97] The visit took place, but the recommendations of the team which included establishing systems for running the activities of the company, were not implemented. The author is of the opinion that the Bank should, right from the start, have insisted on the company having a management team which had a record of successful management of the type of activities which were to be undertaken.

The Casements (Africa) Limited

The Casements Limited company had been producing a variety of metal products for the construction, fire-fighting and fishery industries in Tanzania since 1966. In the mid-1970s, the management of this company wanted to increase the capacities of various plants in order to satisfy the rising demand. Since the main raw materials were imported, the company could meet the growing demand if it had regular supply of foreign exchange. The study of the operation of this company will throw light on how the scarcity of foreign exchange for purchasing inputs can hinder full exploitation of the commercial potential of a company. This company, like the J.K. Industries, its potential to become a profitable business was high because the demand for its products was high. Also, like the J.K. Industries, it was the only company of its kind in the country. But unlike the J.K. Industries, the Casements Limited was managed by an efficient firm of managing agents, the Comcraft Services of London.

The expansion programme which the owners of the Casements intended to carry out, involved increasing the output of steel doors and windows and an introduction of a new line to produce aluminium louvre windows.[98] For the former, the expansion was to be from 500 to 900 tonnes and for the latter, it was estimated that 120,000 louvres would be produced each year.[99] This programme was expected to cost T Shs. 10.14 million and the Bank's contribution was a loan of shs. 6 million.[100]

The demand for the company's products, as was mentioned above, exceeded its production capacity. It may be seen from Table 7.A2 that the company produced in 1970 only 41 tonnes or about 5.8 per cent of the total consumption. In the following year, it more than quadrupled its output of 1970, but this was still about 33.7 per cent of the total consumption in 1971. The decline in consumption in 1971 and 1972 was due to the Government's take-over of buildings (an integral part of extreme socialist measures designed to put in the hands of the public the ownership of important assets) as part of the implementation of socialist policies. The fear of having one's building nationalised led to the suspection of building for a number of people. However, as the table indicates, consumption in 1973 was substantially higher than it had been in 1972. By 1974, it was exactly equal to what it had been before the nationalisation of buildings, 711 tonnes. During that year 410 tonnes were produced. This was about 82 per cent of the installed capacity.

Demand was estimated to grow at 5 per cent annually.[101] At that rate of annual growth, it was estimated that demand would exceed domestic supply from 1975 to 1985. By 1979, demand would be greater than the 900 tonnes of output of steel doors and frames which was to be the new level of production (seen above).

TABLE 7.A2: Production and Consumption of Steel Doors and Windows in Tanzania, 1970-74
(in tonnes)

Year	Production	Imports	Consumption
1970	41	670	711
1971	189	371	560
1972	232	90	322
1973	245	176	421
1974	410	301	711

Source: Calculated from East African Development Bank's project file, Basic Data, PS/16B/61/I.

The commercial performance of the Casements company was satisfactory apart from 1971 and 1972. In these two years, capacity utilization was 8.2 and 37.8 per cent respectively. It is no surprise that at such low levels of production losses were made. When capacity utilization climbed to 82 per cent in 1974 a profit of over T Shs. 1 million was made.[102] After the expansion programme was completed, around 1979, the company's profit was up, T Shs. 1.5 million.[103] The statistics found on the file do not indicate the contribution of the expansion to the profit made. However, the quantity of louvres produced in 1979 is shown, 214,000 units, and in the following year output was even higher, 248,918 units.[104] It will be recalled that it had been estimated that 120,000 would be produced per year. But by 1980 the target had been raised to 294,000 units.[105] This meant that 84.7 per cent of the target was achieved, which is good considering that the Tanzanian economy was in a bad state.

The company experienced a number of problems. The most serious, as was stated earlier, was the insufficient supply of foreign exchange. The years 1979, 1980 were a period of severe shortage of foreign exchange in Tanzania since the limited amount the country had was spent on arms during the war between this country and Uganda. The scarcity of the foreign exchange led to inadequate allocations and this, in turn, resulted in a fall in production for some of the items traditionally produced. For instance, the output of door and window frames, H/Douglas and Styropor for 1980 was lower than it had been in 1979.

The closure of the border between Tanzania and Kenya, following the break-up of the East African Community, is another factor which adversely affected the Casements Africa. Before the closure of the border, this company had sold louvres, fire-fighting equipment and styropor to Kenya. These products were in the late 1970s hardly being exported to Kenya.

Yet another problem which the Casement faced in 1980 was low sales. This seems to contradict the point made above, that there was pressure of demand for the company's products. There is no inconsistency because the Tanzanian economy was depressed in 1980. Most economic activities, construction inclusive, slowed down.

The company surmounted the above problems mainly because it was in the hands of a capable firm of managing agents. It is interesting to recall that the J.K. Industries, which also depended on the availability of foreign exchange like the Casements, failed. As was mentioned above, the former was badly managed while the latter was well managed. Also it was seen that the Arusha Pharmaceuticals which was badly managed had great difficulties in obtaining allocations of the foreign exchange it required for purchasing raw materials. It seems reasonable for the government to show reluctance to allocate the scarce foreign exchange to a company which cannot show ability to run its business efficiently. A company such as the Casements which was well managed and which had earned the country some foreign exchange, would deserve to be a regular receiver of the necessary amount required to purchase foreign inputs. The Bank should, however, be cautious with projects which depend heavily on imported inputs.

The Mafia Coconuts Limited

The Mafia Coconuts company produced coconut related products such as coconut oil, copra cake, coil fibre and shell flour in Tanzania. Towards the end of the 1960s, the management of the company decided to develop two coconut plantations on the Mafia Island (80 miles South-East of Dar-es-Salaam) and to modernize and enlarge the existing processing facilities. This vertical integration programme was intended to satisfy the existing high demand in Tanzania for the above listed products. If the development had been successful, it could also have satisfied demand in some other parts of Eastern Africa. Tanzania has the largest area in East Africa which is suited to large scale plantation of coconut. Yet the Mafia Coconut project was a commercial failure. The causes of its failure will be examined below.

The development of the two plantations and the modernisation of the processing facilities were expected to cost T Shs. 8 million and the Bank's contribution to this cost was a loan of T Shs. 1.9 million, which was supposed to finance the processing section.[106] Other sources of finance were H.J. Stanley and Sons (the managers of the Mafia Coconut company) the Tanzanian Development Finance Company (in which the Government had majority shares), the National Food Corporation (a member of the National Development Corporation which, as was noted earlier, was set up by the Government to facilitate the economic development of the country) and Mr. R.A. Appleby. It is noteworthy that the NDC relied on a company, H.J. Stanley and Sons, which had had experience in coconut production.

Four processing plants were to be set up. The plant for extracting coconut oil had a capacity of 1000 tonnes per year, and the plants, those for processing copra cake, coil fibre and shell flour were to produce 666, 1720 and 630 tonnes per year respectively.

It may be seen from Table 7.A3 that in neither of the three years did the Mafia company achieve the target it had set itself. The output of coconut oil and copra cake, which were the backbone of the company's

TABLE 7.A3: The Expected and Actual Production of the Mafia Coconut Company, 1971-1978

(in tonnes)

Year	Coconut oil		Copra cake		Coil Fibre		Shell Flour	
	Expected (1)	Actual (2) (2) as % of (1)	Expected (1)	Actual (2) (2) as % of (1)	Expected (1)	Actual (2) (2) as % of (1)	Expected (1)	Actual (2) (2) as % of (1)
1971	300	177 (59%)	202	94 (46%)	1021	277 (27%)	450	53 (12%)
1974	760	322 (42%)	505	214 (42%)	1402	613 (44%)	542	140 (26%)
1978	1000	418 (42%)	666	236 (35%)	1720	Nil (0 %)	634	132 (21%)

Source: Compiled from East African Development Bank's project file, Mafia Coconut, Basic Data, PS/16B/8/I.

activities, increased in each of the three years. By 1979, the production of coconut oil was 349 tonnes[107] which was lower than the previous year's output of 418 tonnes (Table 7.A3). Copra cake output in 1979, at 193 tonnes, was also lower than the production of 236 tonnes[108] in the preceding year. Considering that these two activities were supposed to be the mainstay of the company, the deterioration in output was bound to have an adverse effect on its commercial performance.

This is indeed what happened. In 1979 a loss of T Shs. 1.2 million was made.[109] And because of capacity underutilization, (seen in Table 7.A3) unit costs were high and as a result the company had made a loss for most of the time between 1971 and 1979. The accumulated losses stood at T Shs. 1.48 million by 1978.[110]

The capacity underutilization had been mainly due to low yield of the coconuts. In order to raise the yield, fertilizers were needed. However, the cost of fertilizers was too high to be afforded by the company which had not been able to make profits to be ploughed back.

The problem of inadequate production was also linked to weak management of the Mafia Coconut company. The Bank had expressed lack of confidence in the management of this company in 1975. However, it had no authority to change a team of managers in a given company. At any rate, because its loan formed a small fraction of the total finance the company had used, its authority over the company was correspondingly small. The National Development Corporation, together with the National Agriculture and Food Corporation, could, however, have removed the management of the Mafia Coconut company. It will be recalled that the two corporations were majority shareholders. New management was not appointed until 1980.

Other remedial measures taken were as follows: First, a loan of T Shs. 10.3 million was obtained from Holland in order to redevelop the Mafia Coconut plantations. Therefore, in future, fertilizers could be afforded. Second, Holland also gave a grant of about T Shs. 4 million so that a well-qualified General Manager, Chief Engineer and consultants could be hired. Third, a coconut seed multiplication unit was to be set up so that coconut seedlings with a high yielding potential could be produced. Fourth, it was decided that the Mafia Coconut could in future supplement its supplies by purchasing coconuts from smallholders. The above corrective measures were effected between 1980 and 1981. When the author last visited Tanzania, in mid 1982, no positive results in terms of commercial performance had been reported. The Bank was, however, optimistic about the performance of the new project, because it considered that the right remedial steps had been taken.

The Ugma Steel and Engineering Corporation

The Ugma Steel and Engineering Corporation is the last of the selected case study projects which were cofinanced by the Bank that will be discussed. This project's performance illustrates two major factors which had adverse effects on many projects in Uganda. The first is the political change which took place in Uganda bringing in a new regime that mismanaged the economy and neglected industrial development which the previous government had given priority. The second factor was the absence of indigenous entrepreneurs capable of running a company such as the Ugma after its Asian owners had been thrown out of the country by the Amin Government. The study of this project also shows how the Bank was willing to help a business proposal whose potential impact on the economy was promising. This willingness was to be expected since the Bank's effectiveness as an instrument for fostering industrial development depended on such business ventures with a potential of becoming commercially profitable.

The Ugma Steel and Engineering Corporation came into existence in 1960, in Uganda, and started operations in 1962. It was created to fulfil the engineering needs mainly of the Lugazi Sugar Estates and the owner of the company was the Mehta Group whose main line of business was the production of sugar in Uganda.[111] The Ugma's products included pump components, roller shells, mill liners and balls, as well as jaggery rolls. The company intended to undertake expansion and diversification programmes in the late 1960s, which were estimated to cost U Shs. 12 million. The Bank, after carrying out an extensive appraisal of that project, approved a loan of U Shs. 2 million in 1969.[112] Another financial institution, the Development Finance Company of Uganda, gave the company a loan of U Shs. 3 million. This company took a pari passu charge with the Bank over the assets of the Ugma. The implication of this with regard to the financial prudence by the Bank is discussed later.

The financial performance of the Ugma Corporation had been persistently bad from 1962 to 1967. Losses had been incurred in each year and by the latter year, the cumulative losses were U Shs. 2.2 million.[113] This bad performance was due to two interrelated factors. One was poor management and the other was the lack of an effective distribution and marketing system.

Despite the company's bad financial record, the Bank decided to lend it U Shs. 2 million. The Bank's decision was influenced by two broad considerations, the significant economic potential of the project and the company's readiness to reorganise itself along lines which would make it an efficient business venture. The economic contributions of the Ugma project were these:

First, it was to supply Uganda with all the metric weights it needed; it was also expected to satisfy all the demand for machetes, spades, shovels and picks. Second, it was expected that it would supply some inputs (ingots) to the only iron and steel mill in the country. Third, it was to export agricultural implements to Kenya, Tanzania and Rwanda, thus earning the country foreign exchange. This is something it had done in the past. The fourth attractive aspect of the Ugma project is that it was to create new jobs. Finally, the Ugma had an apprenticeship scheme to train youngsters, 10-15 per year, so that the company would have an adequate supply of skilled workers.

The readiness of the company to reorganise how the business was to be run is shown by the following measures it took. To begin with, new staff, including a technical supervisor, were recruited. Second, a person with good professional qualification in business management and who had long experience in the iron and steel engineering was put in charge of the expansion and diversification programmes. Third, a qualified cost accountant was one of the members of new staff who was expected to establish a cost accounting system in a company where there had been none previously. Fourth, a more experienced person was recruited to supervise production. Fifth, two new members, one from the Bank and another from the Development Finance Company of Uganda (DFCU) were appointed to join the four Board of Directors of the company. Finally, the Chief Engineer of the most reputable firm which manufactured sugar mill equipment in India, was made the Ugma's consultant. One year after the above measures were effected, the company's losses fell from U Shs. 1.2 million to U Shs. 0.69 million.[114]

It was seen above that the Bank was not the sole sponsor of the Ugma project. The Charter of the Bank specifies that financial prudence should be exercised. This is what the Bank was doing by committing itself to only 16.7 per cent of the total cost of the project. It was learned from the Director of Operations that the Bank always attached heavy weight on avoiding the risk of putting too much money in one project.

The Bank also tried to ensure the commercial profitability of the Ugma Company by making loan approval conditional on several factors. First, the General Manager of the company could only be changed with the consent of the Bank and the DFCU. The Bank had confidence in the existing General Manager. Second, and related to the first point, a managing agent could be employed after the approval of the Bank had been given. Third, monthly reports of the performance of the company had to be sent to the Bank. The study of these reports would indicate if the company was making satisfactory progress. If it was not, then remedial measures would be recommended before a long lapse of time had made the problem more grave. Fourth, the company was not supposed to borrow from anywhere without prior consent of the Bank. Finally, the Bank was entitled to call for opinion of independent consultants if the company was in problems and if there were grounds to doubt the opinion of the consultants the company had chosen.

The above great efforts the Bank made to ensure the success of the Ugma were not confined to that project alone. Many other projects which the Bank financed in its early years of operation were expected to be well-managed and were also supposed to comply with conditions similar to those indicated above. The Bank, as was learned from one of its senior members, became less stringent particularly after the expatriates from the UNIDO and academic institutions had left.[115]

The Ugma Company was a commercial failure principally because its Asian owners were expelled from Uganda by Amin. Apart from one indigenous Ugandan who was a Sales Manager, the rest of the managerial staff were Asians. Their departure led to the closure of all activities. Unlike most other properties of the departed Asians, the Ugma assets were not relocated, partly because both the Bank and the DFCU had priority over the assets of the company. The other part of the explanation is that to run profitably, the activities of the Ugma required skilled people who were not in a hurry to make profits overnight. People with relevant skills, managerial and technical know-how, were few in Uganda. And those with patience to lay foundations for future profits were, and still are, very scarce indeed.

This may be explained mainly by two factors. One is that some people correctly argue that if the purpose of doing business is to make profit, why not try to achieve that objective more easily by importing commodities which are in high demand. This takes a shorter time than building up a factory. The second line of argument is that given the political instability in the country, why should one set up a factory which could either go up in flames at the time of political changes or which could be misappropriated. A combination of these interrelated ways of reasoning is probably the main reason why some foreign exchange lines of credit extended to Uganda by the World Bank, the EEC, the USAID, have not been utilized.[116] Unless the political situation improves and unless greater incentives are given to prospective industrialists, the Bank may find itself with diminishing Ugandan clients in the future. The consequence of this is that the structural transformation of the Ugandan economy which the Bank is supposed to bring about, will not take place on the desirable scale. Unfortunately, the Bank is incapable of creating both the political and economic climates conducive to the success of projects it will finance in the future.

1. East African Development Bank, *Panafrican Paper Mills*, *Basic Data*, file PS/16B/12/I.

2. EADB, *Annual Report*, 1973, p. 5.

3. Basic Data file, op. cit.

4. EADB *Panafrican Paper Mills*, *Report of Client*, file NRB/PS/16D/12/III.

5. Production per annum was 49,807 tonnes of paper which was 3.8 per cent above the theoretical capacity. Ibid.

6. EADB *Report on Approved Projects* for the Year Ended 31-12-1980, p. 20.

7. The project was supposed to create 1125 jobs, to save the country Shs. 210 million in its lifetime, to earn some foreign exchange and to generate Shs. 142 million revenue for the Government. See EADB, Basic Data file, op. cit.

8. The banning of imports was replaced several years later by a 50 per cent import duty. Ibid.

9. EADB *South Nyanza Sugar Company*, *Basic Data*, NRB/PS/16B/69/I.

10. Ibid.

11. EADB *Annual Report*, 1977, p. 7.

12. Ibid.

13. EADB *Report of Client*, file NRB/PS/16D/I.

14. Ibid.

15. For implementing the project, the Metha Group had been promised an annual fee of U.S.$135000 up to the time of commissioning. An annual fee of U.S.$99,000 after commissioning as well as 5 per cent of operating profits of the company had also been promised. Ibid.

16. The expected average yield was 125 tonnes per hectare and the actual turned out to be 175 tonnes per hectare. See EADB Report on Approved Projects for the Year Ended 31-12-1980, p. 34.

17. Ibid.

18. Room for expansion of output was, however, in some, not all lines. See Y.P. Ghai (1974), "East African Industrial Licensing System: A Device for Regional Allocation of Industry?, Journal of Common Market Studies, Volume XII, Number 3, p. 292.

19. EADB Annual Report, 1975, p. 8.

20. EADB Report on Approved Projects for Year Ended 31-12-1980, p. 41.

21. Ibid.

22. EADB Nanyuki Textile Mills, Report of Client, file NRB/PS/16D/54/I.

23. Ibid.

24. EADB Annual Report, 1975, p. 8.

25. EADB Report on Approved Projects, op. cit., p. 31.

26. Y.P. Ghai (1974), op. cit., p. 284.

27. A summary of the history of the Aluminium Africa is found on the project's file kept by the EADB. See Aluminium Africa, Basic Data, file PS/16B/17/I.

28. EADB Annual Report, 1972, p. 8.

29. Al Af, Basic Data file op. cit.

30. Ibid.

31. The products of Al Af were protected by a 48 per cent tariff. See Al Af, Basic Data file, op.cit.

32. Ibid.

33. EADB Report on Approved Projects, op. cit., p. 43.

34. Ibid.

35. EADB Report and Recommendations of Director General to Board of Directors, file B.P.23/73.

36. Ibid.

37. EADB Annual Report, 1969, p. 7.

38. EADB General Tyre (EA), file B.P. 11/69.

39. EADB file B.P. 23/73 op cit.

40. EADB Annual Report, 1973, p. 7.

41. Ibid.

42. Ibid.

43. There were a number of sugar cane estates in Kenya whose yield was low. These were the targeted export market for the potassium chloride to be produced by the Lake Katwe Salt company. See Lake Katwe Project, Project Rehabilitation Report, January 1982 at the EADB.

44. See EADB Annual Report, 1975, p. 7.

45. Ibid.

46. Lake Katwe Salt, Project Rehabilitation Report, op. cit.

47. EADB Report on Approved Projects, op. cit., p. 1.

48. I.M.D. Little and J.A. Mirrlees (1974), Project Appraisal and Planning for Developing Countries, (London: Heinemann), p. 9.

49. EADB Mtibwa Sugar Estates, Basic Data, PS/16B/25.

50. Ibid.

51. The estimated demand for sugar in Tanzania in 1970 was 100,500 tons. Ibid.

52. EADB Annual Report, 1972, p. 8.

53. Under the United States system, an excise duty is an indirect tax levied on business rights. It is measured by the money value of sales. The Tanzanians applied this system to the Mtibwa Sugar Estates.

54. EADB Mtibwa Sugar Estates, Report on Approved Projects, op. cit., p. 48.

55. Ibid.

56. Ibid.

57. EADB Arusha Pharmaceuticals, file PS/16B/66/I.

58. Ibid.

59. Ibid.

60. EADB _Annual_ _Report_, 1976, p. 7.

61. EADB _Arusha Pharmaceuticals_, _Report on Approved Projects_, op. cit., p. 56.

62. This was learned from the Head of the Follow-Up Unit in the EADB.

63. The combined output of these four drug companies was about 8 per cent of the import bill of Shs. 178 million in 1975. See _Arusha Pharmaceuticals_, PS/16B/66/I, op. cit.

64. EADB _Annual_ _Report_, 1970, p. 6.

65. EADB _EMCO Steelworks_, _Basic Data_ file NRB/PS/16B/I.

66. Ibid.

67. Ibid.

68. Ibid.

69. EADB _EMCO Steelworks_, _Report from Client_, NRB/PS/16D/I.

70. This is the view which was held by the EADB's officials. See EADB _EMCO Steelworks_, _Report on Approved Projects_, op. cit., p. 38.

71. The cumulative losses between 1972 and 1976 were Shs. 12,253,000. See _EMCO Steelworks_, _Report from Client_, op. cit.

72. See _EMCO Steelworks_, _Report on Approved Projects_, op. cit. p. 38.

73. Ibid.

74. See EADB _Kibo Paper Industries_, _Basic Data_, PS/16B/43/I.

75. EADB Annual Report, 1973, p. 7.

76. EADB Kibo Paper Industries, Report from Client, PS/16D/43/I.

77. EADB Annual Report, 1976, p. 7.

78. EADB Kibo Paper Industries, Report on Approved Projects, op. cit., p. 44.

79. Ibid.

80. EADB C.P.C. Industrial Products, Basic Data file NRB/PS/38/I.

81. Ibid.

82. EADB Annual Report, 1973, p. 5.

83. C.P.C. Industrial Products, Basic Data, op. cit.

84. EADB C.P.C. Industrial Products, Report from Client, NRB/PS/16D/38/I.

85. The fall in net profit was from Shs. 1.86 million to 0.86 million. See EADB, C.P.C. Industrial Products, Report on Approved Projects, p. 24.

86. C.P.C. Industrial Products, Basic Data, op. cit.

87. Ibid.

88. The four factors are cited by the Bank in Report on Approved Projects, op. cit., p. 24.

89. C.P.C. Basic Data, op. cit.

90. EADB, J.K. Industries, Basic Data, NRB/PS/16B/I.

91. EADB Annual Report, 1975, p. 5.

92. J.K. Industries, Basic Data, op. cit.

93. Ibid.

94. Ibid.

95. EADB, J.K. Industries, Report on Approved Projects, p. 36.

96. Ibid.

97. EADB, J.K. Industries, Report from Client, NRB/PS/16D/58/I.

98. EADB Annual Report, 1976, p. 5.

99. EADB Casements Africa, Basic Data file PS/16B/61/I.

100. EADB Annual Report, 1976, op. cit., p. 5.

101. Casements Africa, Basic Data file, op. cit.

102. Casements Africa, Reports from Client file PS/16D/61/I.

103. EADB Casements Africa, Report on Approved Projects (1980), p. 57.

104. Ibid.

105. Ibid.

106. EADB Annual Report, 1969, p. 1.

107. EADB Mafia Coconut, Report of Approved Projects (1980) op. cit., p. 58.

108. Ibid.

109. Ibid.

110. EADB _Mafia Coconuts_, _Basic Data_ file PS/16B/8/I.

111. EADB _Report and Recommendation of Director-General to Board of Directors on Ugma Steel and Engineering_.

112. EADB _Annual Report_, 1969, p. 7.

113. _Report and Recommendation of Director-General_, op. cit., p. 2.

114 Ibid.

115. This was learned from the Director of Research in the Bank.

116. This raises an important point about how political uncertainty creates economic uncertainty and both of these factors impede finance absorption.

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