

The political background and regional economic effects of EPAs

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A case study of the SADC countries



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Bachelor Thesis
International Development Studies
Specialization in rural economics and development
Wageningen University

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February 2011, Wageningen

Table of contents

Abstract	iii
Preface	iv
1. Introduction	1
2. A brief history; where EPAs the only option?	4
2.1 <i>Introduction</i>	4
2.2 <i>The Lomé Conventions: Europe's collective solution to colonial history.</i>	4
2.3 <i>The Cotonou Agreement: a political agreement.</i>	5
3. Political aspects; the influence of interest, ideas and institutions on the EU's position.	8
3.1 <i>Introduction</i>	8
3.2 <i>Conceptual framework</i>	8
3.3 <i>Interest: primarily economic?</i>	10
3.4 <i>Institutions: the legal context.</i>	11
3.5 <i>Ideas: the role of regionalism.</i>	12
3.6 <i>summary</i>	13
4. Economic aspects; theories on trade and economic integration	14
4.1 <i>Introduction</i>	14
4.3 <i>Economic integration: forms and aims.</i>	16
4.4 <i>Partial equilibrium model: trade and welfare effects of EPAs.</i>	17
4.5 <i>Summary</i>	19
5. Case study; EU-SADC EPA	20
5.1 <i>Introduction</i>	20
5.2 <i>Economic characteristics</i>	20
5.3 <i>Economic integration in Southern Africa.</i>	22
5.4 <i>The main features of the EU-SADC EPA.</i>	24
5.6 <i>Summary</i>	27
6. Summary and conclusions	28
6.1 <i>Summary</i>	28
6.2 <i>Conclusion</i>	29
Appendix I – trade effects of an EU-SADC EPA	v
Bibliography	vi

Abstract

The trade agreement of the Lome Conventions were followed up by agreements that include trade as well as political issues, the EPAs. The EU has stake in a strong multilateral trade regime and the inclusion of political issues in EPAs will strengthen her position.

EPAs provoke development through strengthening of the regional economy. The role of regionalism in the development debate grew after the successful regional integration of the EU. This research includes a case study which examines the negotiations and assumed impact of the EU-SADC EPA. The overlapping memberships of regional integration initiatives in southern Africa made the EU-SADC EPA negotiations complex. At the same time this proliferation of regional integration initiatives shows the attraction to regional integration, for which EPAs are a symbol.

This study assumes that the EU-SADC EPA will lead to a reallocation of resources from the industrial sector towards the agricultural sector in SADC countries, based on their comparative advantage in agricultural products. Partial equilibrium analyses shows that we expect trade creation, through the increase of import in SADC countries. Only the animal agriculture and processed food sectors experience effects of trade diversion. The total trade volume and exports do not significantly change under an EPA, because the SADC countries already had preferential market access to the EU. This study conclude that the overall effect of EPAs depends on the adjustment abilities of the SADC countries since all SADC countries can expect tariff revenue losses. The capacity to switch from trade revenue to domestic revenue will be crucial for SADC countries.

Preface

This report is written as thesis for the Bachelor of Science program International Development, department development economics at the Wageningen University. The topic followed from the course Macroeconomics and International Trade at Wageningen University, where EPAs were mentioned in a case study on the banana regime in ACP countries. By doing a minor in international relations at the University of Amsterdam the political process behind EPAs caught my attention. Studying International Development, learnt me that most development problems can only be understood in the historical, economical, political and sociological context. Within this report I tried to give insight in the EPA negotiations and their assumed impact by examining the context as complete as possible within my limitations.

Writing this thesis gave me the opportunity to enhance my research skills and to apply theories and techniques learned during my studies at Wageningen University and University of Amsterdam.

I wish to thank those individuals that contributed to this report. My supervisor Dr. R. Haagsma for his constructive criticism and enthusiasm during the whole thesis process, I know that this report is much better for his helpful comments. My friend and fellow student Evelien Thieme Groen for reading my thesis over and over again. In addition, I would like to thank anyone who helped me creating ideas and motivated me to keep up with the project.

Chapter 1

Introduction

After the decolonialisation, the first agreement between the European Union (EU) and African, Caribbean and Pacific (ACP) countries was signed. This agreement, the Lomé agreement, was mainly an economic agreement. This means that the agreement was primarily concerned with trade issues. However, an important shift in the EU-ACP relation occurred. This shift, away from pure economic issues and towards the inclusion of political issues, is embodied in the Economic Partnership Agreement (EPA) negotiations. EPAs are free trade agreements between groups of ACP countries and the EU. The shift, of the EU, towards a political agreement can be explained from the new paradigm in development economics which became more dominant since the end of the 1990's. According to the new development economics paradigm the market is no longer the only generator of growth, the importance of institutions also need to be recognized according to this view. The rise of the new development economics paradigm can be seen as a reaction on the disappointing results of the traditional market driven approach towards development.

The need for a new agreement occurred because the old agreement, the Cotonou agreement (which is the follow-up of the Lomé agreement), based on a World Trade Organisation (WTO) waiver, would expire at the end of 2007. The new agreement that had to be created did not necessarily to be EPAs, but because of an internal European compromise and the rejection of other possibilities by the European Commission (EC) EPAs came into existence. The EU decided to go for the EPA regime, but what were their exact reasons? And why did we not hear the opinion of the ACP countries? In order to answer these questions a closer look on the historical and political process towards EPAs is needed, especially because the EC was eager on sticking to the deadline of end of 2007. Although in the beginning of 2007 it was already apparent that the majority of the ACP countries would not agree on full EPAs with the EU.

EPAs are meant to integrate the regional economies of the ACP countries into the global economy (Nordeman, 2008). Although the EU wanted to promote economic development through these agreements, some scholars and NGOs were against the agreements. For example Drieghe (2008) argues that the development friendly image of the EU is seriously damaged by enforcing the ACP countries into (interim) EPAs. Why are EPAs so important for the EU that she have stucked by the deadline and thereby risked to damage their image? This question will be addressed by analyzing the interest of the EU, since we can only understand the current agreements by defining its political, economic and legal context.

Next to this, the questions whether developing countries are gaining from this 'liberalisation project' or whether EPAs only bring gains for the EU are often heard. Economic analysis of the trade and welfare impacts of EPAs on ACP countries are helpful to

answer this impact question for the ACP countries. Based on partial equilibrium models we can expect EPAs to cause trade creation, which means that the agreement will cause an increase in trade between the EU and ACP countries. This phenomenon is based on efficiency improvements. On the other hand we can expect that the rise in trade with the EU will cause a decrease in imports from the rest of the world in ACP countries, this effect is called trade diversion. Because EPAs are meant to remove trade barriers, which will lead to trade liberalisation, tariff revenue losses in the ACP countries can be expected. Changes in tariff revenues, which are a significant part of the government revenues in most ACP countries, need to be taken into account when we discuss the effect of EPAs. Although of course the long-term effect on ACP countries also depend on their ability to shift to a new tax system. However, this question is not addressed in this paper, as the partial equilibrium model used in this paper is a static model and therefore a tool to analyze the short and medium run. It is essential to analyze the trade and welfare effects in order to get an idea about the impact of EPAs on ACP countries.

This paper includes a case study of the EPA between the EU and the Southern African Developing Community (SADC). The Southern African region is interesting for its aim to achieve regional integration. All countries are members of one or more regional integration association. They are motivated to integrate, but these overlapping memberships also leads to a complex situation. Since not all participating countries of the EU-SADC EPA negotiations are a member of the Southern African Customs Unions (SACU) is it difficult for them to speak and negotiate as a bloc. Along with the overlapping integration initiatives, the SADC countries are also interesting for its economic differences. The Southern African region includes least developed countries (LDCs) as well as the relative wealthy South Africa. These economic differences have complicated the negotiations. The presence of economic diversity makes it valid to expect different effects of the EU-SADC EPA across SADC countries. By answering the impact question for SADC countries, economical interest from SADC countries can be analysed. As a final comment on the choice for the SADC countries I want to point out that the availability of data was also of significant importance, particularly since this paper is a literature study.

The aim of this paper is to gain insight into the political process behind the EPA negotiations and the assumed economic impact these agreements have. Practically this means that I will set out the main features of the negotiations and will give a welfare analysis as well. I will look to the EPA negotiation process, why did the EU chose for EPAs? This question is highly political. So to get a sharp picture of the EU-SADC EPA negotiations both economic and political analyses are needed as the EPA regime is complex in its reasons and its assumed impact. My central question is: What drives the EU interest in EPAs, and is there an economic interest for SADC countries based on the assumed impact on trade relations?

The remainder of this paper is organised as follows. Chapter 2 explores the history of EU-ACP trade relations that paved the way for EPAs. This is done by examining the great events in history, such as decolonialization and dominant discourses in the trade relation between the European and ACP countries. In Chapter 3 the political context of the EPA policy of the EU is discussed. In this chapter the concepts of interest, ideas and institutions are used to explore by which factors the EU EPA policy was mainly driven. Chapter 4 sets up an economic framework, consisting of theories on economic liberalization and integration and a partial equilibrium model. With a partial equilibrium model it is possible to analyse the potential trade and welfare effects of introducing an EPA. This is followed in Chapter 5 by an application of the political and economic concepts on the EU-SADC EPA case. The case study is based on the theories and concepts given in the previous chapters. Finally, Chapter 6 contains a summary and conclusion.

Chapter 2

A brief history; Were EPAs the only option?

2.1 Introduction

The origin of the co-operation between the EU and ACP countries has to be placed within the historical context of decolonisation and the rise of a new form of inter-state relations between North and South. The aim of this chapter is to describe the historical context of EPAs.

Section 2.2 will provide a description of the Lomé Conventions and the context in which they were created. Section 2.3 will give insight into the Cotonou Agreement, which can be seen as a major shift in the trade relation between the EU and ACP countries. Section 2.4 will examine the main features of the EPA negotiations. The final section will contain a summary.

2.2 The Lomé Conventions: Europe's collective solution to colonial history.

After the Second World War the rapid process of decolonisation took place. At the same time a liberal international order came into being. In the post-war years the inter-state relations were institutionalised in multilateral organisations, such as the United Nations (UN), the World Bank (WB), International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT).

The Lomé Convention of 1975 built on the historical relation between Europe and ACP countries. For the creation of the Lomé Convention the establishment of the European Community and the dismantling of European empires were the most important events. During these days African countries were seeking for an extension of international support in the areas of trade and aid. The Lomé Convention was fundamentally a colonial arrangement, to maintain imperial relations of European countries. With the Lomé Conventions market access to the EU was given to be on a non-reciprocal basis. This means that most agricultural products and minerals of ACP countries could enter the European market duty free. For products, such as sugar, the agreement agreed on a quota system which guaranteed preferential access to the European market (Brown, 2000).

The Lomé Convention was regularly updated. These updated versions of the agreement kept its non-reciprocal nature and equal partnership as a cornerstone for cooperation. Development cooperation was assured through the European Development Fund. With Lomé II (1981) and III (1985) the expenditures of the European Community on aid and investment increased. In the second half of the 1990s, running up to the expiration of the IV Lomé Convention (signed for ten years in 1989), the EU's position started to change. Under influence of the neo-liberalism the EU started to call for a relationship based on

‘conditionality’, such as: respect for human rights, democracy and the rule of law (Fontagné *et al.*, 2008).

2.3 The Cotonou Agreement: a political agreement.

After twenty-five years the EU-ACP relation moved into a ‘new phase’, according to the European Commission (EC). Past development efforts had led to disappointments and along with the creation of the WTO and its liberalising trend it was time for a new effective agreement. In 2000 the Cotonou agreement was signed. The Cotonou agreement can be seen as a compromise solution to the different voices at that time, and paved the way for EPAs. The agreement was innovative in its emphasis on trade and investment as a generator of aid. But the route that was chosen with Cotonou, destination EPA, left other options aside. Instead the EC could have chosen for (Pilegaard, 2009):

- Renewal of the waiver. This would have made it possible for non-LDCs to avail their access to the Generalized System of Preferences (GSP). Goods from the ACP countries could still have entered the EU market duty free and without reciprocity. This is in line with an Enabling Clause of the WTO rules. But the EC rejected this as not acceptable to the WTO as they did not want to make the effort of negotiating.
- Abolition. Making the Lomé conventions an umbrella and thereby continue negotiating bilaterally. This option was never seriously considered by the EC. The EC was disappointed in the development results and did not want to continue on the same foot. The idea that there had to become a new agreement that included institutional issues was dominant in the EC. Therefore abolition was rejected by the EC.
- Ad hoc agreements with individual and different group of countries. For example, special preferential trade agreements with the LDCs. This option was also rejected, since they did not want to have a proliferation of agreements.

None of the EU members were keen on the option of splitting up the ACP countries into smaller FTAs. But it was what happened, as it was in line with the WTO rules. The Cotonou Agreement is not so much a compromise between the EU and ACP countries, but is the result of give and take between EU member states. It is most outstanding in the sense that Cotonou is a framework agreement, but does not involve details about the partnership they agreed on. It can be said that the Cotonou agreement is a political statement to shift away from Lomé IV (Pilegaard, 2009). While the Commission always argued that Lomé was non-ideological and non-political, the new agreement had a clear political dimension. Therefore the scope of the Cotonou agreement is much broader (Brown, 2000). In order to create an effective agreement, the agreement included political issues.

These characteristics (incorporating institutional issues) are going hand in hand with the development discourse in the 1990’s and the beginning of the 20th century. Development specialists started to believe that economic growth only could be achieved when there are

certain preconditions, especially strong institutions. ‘Good governance’ is the term that is often used for this institutional preconditions and refers to a strong institutional structure. The first reference to ‘good governance’ can already be found in Lomé IV which stated that: *“respect for human, democratic principles and the rule of law, which underpin the ACP-EU Partnership, shall underpin the domestic and international policies of the Parties and constitute essential elements of this Agreement”* (ACP-EC, 2000: Article 9). So with the incorporation of institutional issues the relation between the EU and ACP countries was not longer merely economic, but also had a unambiguous political character.

2.4 Wide –ranging EPAs: discussions on development effects.

The Cotonou agreement agreed on the establishment of splitting up the ACP countries into regional grouping who were going to negotiate on Free Trade Agreements (FTAs). The WTO waiver was going to expire at the end of 2007, so the FTAs had to come into being before that date, otherwise the WTO rules would have been violated. But 2006 turned into 2007 and there were still no agreements in sight. This worried the EC as the end of 2007 was set as the absolute deadline.

NGO’s criticized the EU for the fact that they stuck to the idea of EPAs and their deadline. NGO’s and ACP countries raised again the alternatives as summed up in Section 2.3, an extension of the waiver. But the alternatives were not seriously considered by the EC and therefore there was a strong incentive for ACP countries to conclude agreements before the end of the year driven by the fear that they were left without any agreement and that would have worsened the trade positions of these countries.

The EC was aware of the fact that they needed to give some positive signals. And they did, in April 2007 the EC promised to open up its markets completely for ACP countries, while there would come a list of sensitive products, products that are excluded from liberation and a transition period for every negation group of ACP countries. The sensitive products are determined per group of countries, according to their production pattern. The transition period depends on a country’s economic position, countries in a stronger economic position will have a tighter schedule for liberalisation. With this promises the Commission stressed that EPAs were ‘a tool for development’. Also the representatives from the Directorate General Development, who advise the EC in their policy in their external relations with developing countries, became increasingly involved in the negotiations. The attention to development assistance can also be seen as a response to the internal criticism received from pro-development member states.

To understand the transformations of EPA negotiations it is important to notice the ‘absolute deadline and no-alternatives-situation’. Although the negotiations started very slowly a crisis character was created by the deadline. For both parties a failure would have turned out negative, as the ACP countries risked to lose their export incomes and the EC

feared a bad reputation. Especially ACP negotiators felt like they were placed with their back against a wall.

Despite the pressure the EC realized that she was not going to be able to agree on full EPAs before 2008. The solution to this problem was found in interim EPAs. These interim EPAs only cover goods, market access and some development aspects, but the more sensitive issues such as government procurement were left for the full EPA negotiations. Finally only the Caribbean ACP countries agreed on a full EPA, while other regions agreed on interim EPAs. In total thirty-six out of seventy-seven ACP partners participate in an interim or full EPA (Elgström, 2009).

2.5 Summary

This chapter gave an historical overview of the ACP-EU trade agreements and the negotiation process behind it. The first Agreement, the Lomé Convention, came into being against the background of decolonialization and institutional liberalism. The Lomé Conventions were followed up by the Cotonou Agreement in 2000 after disappointment in the EC about the lack of development results. The Cotonou agreement had a more political character and paved the way for EPAs. After a troubled negotiation process with a hard deadline, the EC agreed on interim EPAs with different regions. Only the Caribbean ACP countries agreed on a full EPA.

Chapter 3

Political aspects;

The influence of interest, ideas and institutions on the EU's position.

3.1 Introduction

In the previous chapter the history of EPAs was examined. This chapter will analyze the EU's position in the EPA negotiations. Although EPA is mainly an economic agreement, the reasoning behind EPAs is not primarily economic. The EU also has political objectives, which will be analyzed by the concepts of interests, institutions and ideas. Within all three concepts political developments are seen as the result of political decision making and the interaction between individuals, groups and states (Burgoon, 2010). It is important to note that the concepts all describe another part of the political process but together they will give a more complete idea about the appeal for cooperation within the trade domain. This chapter will give an overview of the EPA negotiations and how they are influenced by each concept and which of the concepts has the strongest influence on the negotiations from an EU perspective.

This chapter is mainly about the position of the EU during the negotiations, because the EU 'forced' ACP countries into EPAs. The concepts of interest, institutions and ideas are explained in Section 3.2. This is followed by an analysis based on these concepts. Section 3.3 will shine a light on the interest of the EU in EPAs. Then Section 3.4 about the influence of the WTO as an institution. Section 3.5 will describe the ideas on regional integration in relation to EPAs. This chapter will end with a summary.

3.2 Conceptual framework

In international relations studies the debate about interest, institutions or ideas is central. The question is which of those concepts matters most when it comes to a state's strategy and behaviour. Interest, institutions and ideas are key concepts to explain important political developments, such as international cooperation and foreign policy. Within all three concepts political developments are seen as the result of political decision making and the interaction between individuals, groups and states. So when there are two political actors, the preferences and political power of each state will determine their strategy and choice. The interaction between these states will be influenced by their strategy and again by their political power. The outcome of the interaction is the product of this whole process (Burgoon, 2010). As said, the main question is which of the concepts (interest, institutions and ideas) has the strongest influence on the outcome. This debate is not new, it can be seen as an debate between realism - self interested states compete for (economic)power; liberalism – believes in global economic ties and the strengthening of peace through institutions; constructivism – international politics is shaped by persuasive ideas and collective values. Although it is clear

that EPAs are a liberal trade agreement, the political process behind EPAs is driven by a combination of interest, institutions and ideas.

The material position of a state determines its interest and its political power. The strategy a state chose is the consequence of its material position. According to Cox material capabilities are the resources a state has, including organizational capabilities (Cox, 1986). Therefore you can say it is the potential of a state that determines a state’s interest. When a state is in a strong economic position and has strong organizational capabilities, it is to presume that a state will use its resources to maintain its position in the world. This position can be the absolute position, it wants to be the leading country or it can be the position in a certain field to present themselves in a certain way, for example as active and involved state in the field of sustainability and development. When a state has strong organizational institutions, it may participate actively in international institution to reach it own goals.

Institutions can be defined as routines or structures of behaviour on all levels of the global politics. International institutions are able to influence the power relations within and between states. They can do this by carrying out rules and treaties. An example of this type of institutions is the EU. She can punish her members if they violated the EU laws. In that sense the EU differs from international institutions such as the WTO. The WTO is able to provide a legal framework wherein they try to diminish trade protection. By this they provide information to states, influence their strategy and facilitate and influence the negotiations between states (see figure 1). I draw a schematic figure (figure 1), which shows where the WTO can influence trade policies.

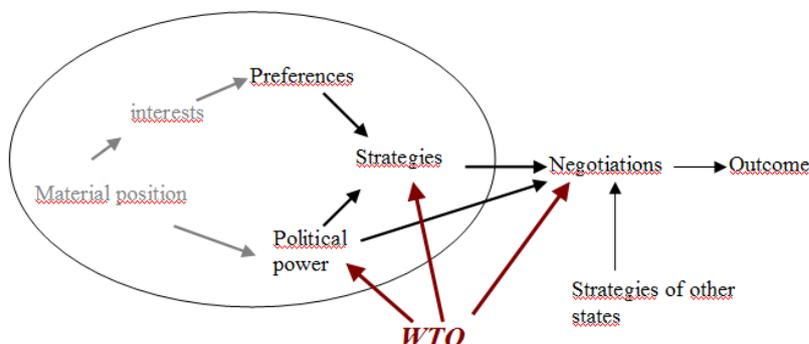


Figure 1:WTO influences on trade negotiations

Ideas are a central theme in constructivism. The core concept of constructivism is that reality is a social construction, in other words individuals create there own realities based on their ideas. Ideas are beliefs held by individuals. Ideas are a mental maps shaped by knowledge, culture, language and rules (Barnett in: Baylis, Smith and Ownens, 2008).

We can distinguish three types of ideas, namely world views, principled beliefs and casual beliefs. World views are not purely normative, a good example is religion. Principled beliefs are normative ideas. Causal beliefs are beliefs about cause-effect relationships which derive authority (for example scientific researchers) from the shared consensus of recognized elites. Ideas influence political developments by clarifying goals, I quote: “*Ideas influence*

policy when the principled or casual beliefs they embody provide road maps that increase actors' clarity about goals or ends-means relationships, when they affect outcomes of strategic situations in which there is no unique equilibrium, and when they become embedded in political institutions."(Goldstein and Keohane, 1993: 3). Both principled and causal beliefs have a deep impact on political actions. Because causal ideas change quite quickly (for example through scientific innovations) and have influences on preferences and political power, they can lead to specific policy shifts. Causal beliefs can even influence the interpretation of interests.

3.3 Interest: primarily economic?

Under the Lomé conventions, most products from ACP countries could enter the European market without a tariff. This rule excluded most agricultural products, while this is the dominant sector of production in most ACP countries. With EPAs the EU is following the WTO legal framework and substantially all trade is liberalised. Especially for ACP countries this means that they have to open their markets. The question whether this is beneficial or not for the consumers, producers and government revenues in ACP countries will be addressed in Chapter 4 and 5. The question addressed here in Section 3.3 is about the EUs economic interest in a liberalising trade agreement.

For most European countries other EU states are the most important trading partners. When it comes to intercontinental trade, the trade between the EU and ACP countries does not play a significant role in the BNP of European countries. However economic gains can be made through a broad trade agenda. I quote: "*The economic relevance of traditional trade from the EU to the ACP countries may be limited but the potential of ACP markets could be more attractive for European investors and service providers*" (Faber and Orbie, 2009: 6). So EU regulation in this area can be beneficial for EU businesses.

I want to stress that the policy of the EU is not only influenced and formed by its member states, but that various societal interest groups (i.e., firms, farmers, environmental groups, etc.) influence the EU's interest. Interest groups have strategies to maximize the probability that their specific interest will succeed. Their most important strategy is lobbying. Lobbying can lead to specific policies that reflect their preferences. When they act collectively there is a bigger chance that they will succeed. Therefore interest groups make coalitions to capture the EU's broader trade policy agenda. On the one hand you have the groups that promote free trade, like multinationals, and on the other hand you have the groups that oppose free trade, for example European farmers that want to protect their own market. The interaction within Europe, so the dynamics, resources and strategies of both camps determine the shape of the EU's trade strategies. The liberalization of ACP markets is beneficial for investors and the business industry. That Europe agreed on a transition period

for certain products, such as sugar, in opening up its markets, can be traced back to the farmers influence in Brussels (Aggarwal and Fogarty, 2004).

If the economic interest of the EU is limited, how can the EU preference for EPAs be explained? The EU has a strong interest in a stable WTO trade regime. The EU has been a major economic player in the international trade relations since the accomplishment of the internal market project. This is called the ‘bloc size’ effect: since the EU is economically more important, she has more to gain from a stable WTO system. However the WTO is voluntary based, there is some space for flexible interpretation of the rules. But when the EU will interpretate the rules more flexible, they risks that the United States will engage in to flexible applications of the WTO rules (Faber and Orbie, 2009: 56). Next to this the inclusion of WTO plus issues¹ in EPAs can be used to strengthen the EU’s negotiation position on those issues in the Doha round and other bilateral negotiations. The inclusion of the WTO plus issues into EPAs forms a response to the limited progress in the Doha Round and the abandon of these issues from the WTO agenda. With an inclusion of these issues in bilateral agreements the EU has a much stronger negotiation position on investment, competition and government procurement in the Doha Round (Faber and Orbie, 2009).

3.4 Institutions: the legal context.

When we look to EPAs you can say that it is a web of all different kind of agreements. The Caribbean countries have a full EPA while others trade under the Everything But Arms (EBA) principle or light and interim EPAs. This situation is not rationally designed by EU policy makers, but can be seen as the outcome of political decision made in the second half of the 1990’s, mainly the Cotonou Agreement and the establishment of the WTO. Because the EPA is carried out within the legal framework of the WTO. WTO compatibility is very important for the EU and therefore the current situation, in which there is a need for WTO compatibility, could occur.

The Most Favoured Nation (MFN) principle of the WTO (Article I of GATT) states that when trade concession is granted from one member state to another it should be extended to all other member states. The only way to get around this rule is by establishing a free trade area. This exception is made because it serves the world economy by an increase in overall welfare. Also an EPA would be beneficial to the world economy (Karingi *et al.*, 2004). Although there is diversity, all agreements have in common that they satisfy GATT article XXIV. Article XXIV states that ‘substantially all’ trade has to be liberalised.

The Most Favoured Nation principle of the WTO states that when trade concession is granted from one member state to another it should be extended to all other member states.

¹ Issue certain members of the WTO (mainly developed countries) wanted to include in the agreement to promote transparency. These issues apply to create sustainable development, such as government procurement, intellectual property rights and trade facilitation.

The only way to get around this rule is by establishing a free trade area or by a preferential treatment based on development concerns, this is called the Generalized System of Preferences (GSP). The GSP is an enabling clause established in the 1970s. Because of its non-reciprocal nature (receiving a reduction in tariffs, while they do not have to open up their own markets) the GSP regime has been the most important opportunity for Asian and Latin American countries to export their products to the European market (Faber and Orbie, 2009). The exception of a free trade area is made because it serves the world economy by an increase in overall welfare. It is also seen as the first step towards an open world market. Also an EPA would be beneficial to the world economy, because it will create trade under a reciprocal nature (Karingi *et al.*, 2004).

It is important for the EU to have an agreement that satisfies the GATTs Article XXIV, because the Contonou agreement relies on a WTO waiver that expired at the end of 2007. Article XXIV states that ‘substantially all’ trade have to be liberalised. Important is the interpretation of this rule, what does ‘substantially all’ trade mean? The European Commission stated that 80% to 90% of the bilateral trade, in volume and tariff lines, need to be liberalised in order to be WTO compatible (Fontagné *et al.*, 2008). According to the European commission, there is evidence that opening the ACP borders for European products will increase efficiency and by this reducing the consumers prices (Mandelson, 2005). But scholars argue that the ACP countries will face much larger adjustment costs as the trade relation between the EU and ACP countries is imbalanced. This discussion is addressed more detailed in Chapter 4 and 5, here the focus is on the institutional order and their rules.

As a last note I want to draw attention to the existence of the WTO Article XXXVI which allows for a broad interpretation of the non-reciprocity. Also since the Doha-round the WTO is focussing explicit on the situation and requirements for developing countries. This is a shift in the multilateral context and leave space for an open interpretation of the WTO rules and the fitting of ACP-EU trade relations within the WTO framework. So meanwhile WTO compatibility is important for the EU, the legal context also gave room for interpretation and by this to the alternatives of EPAs as summed up in Chapter 2, namely: renewal of the waiver, abolition or ad hoc agreements with individual or different groups of countries.

3.5 Ideas: the role of regionalism.

The European Union is in favour of regional integration. This is also a central aspect of the EPAs. With the EPAs the EC tries to export its model of regional integration. The main features of the integration of the EU are liberalization of the common market, standardization of rules, economic redistribution and provision of economic, social and political rights. This recipe worked very well for the EU and European policy makers believe this package can also be beneficial for ACP countries. The EU is not standing on its own when it is provoking a discourse of a wider trade agenda in order to achieve development. From the end of the 1990’s

on the believe that market access alone is the main problem of developing countries is not dominant anymore. More and more studies in the field of development economics emphasizes on the role of institutions. Strong institutions are needed to create a stable political and economical environment (Faber and Orbie, 2009). Therefore you can say that the belief in regional integration is a causal belief. As a result of this casual belief the EU tries to address the challenge of creating a stable political and economic environment. You find this policy shift already back in the Cotonou agreement (2001), where regional integration is mentioned as one of the focal points to reduce poverty in ACP countries (Söderbaum and van Langenhove, 2005). The idea that there is a relationship between development and regional integration can also be found in the EPAs. One of the aims of EPAs is to increase governance capacities at a national and regional level, so that they can govern transaction of political and economic actors (Faber and Orbi, 2009).

3.6 summary

In this chapter, I analyzed interest, institutions and ideas. Although the economic interest of the EU in ACP countries is limited, the EU has a strong interest in EPAs because they help to create a stable WTO regime. Beside for the inclusion of WTO plus issues, EPAs can be used to strengthen the EU's negotiation position on these issues in the Doha round and other bilateral negotiations. But the WTO has also influence on the EU strategy in the trade negotiations with ACP countries. Therefore the WTO compatibility is very important for the EU. It should be mentioned that the legal framework of the WTO is quite flexible in its interpretation. Accordingly, renegotiating the waiver was an option, but the EU was the one who decided to focus on free trade area's.

Chapter 4

Economic aspects; Theories on trade and economic integration.

4.1 Introduction

In the previous chapter I argued that the EPA negotiations are a political process, that is not only driven by economic interest, but instead is largely influenced by the WTO and dominant discourses in development field. This chapter will go through economic theories that can analyze and/or clarify the economic reasons for and effects of EPAs. A frequently asked question is whether the developing countries are gaining from this ‘liberalisation project’ or whether the EPAs only bring gains for the EU countries. This question asks for an economic analysis of the trade en welfare impacts of EPAs on ACP countries. Most economic analyses of EPAs make use of a partial equilibrium model or a computable general equilibrium model. While the latter gives insight into the changes in the economy as a whole, the partial equilibrium models can give you information at a high level of product disaggregation (Morrissey and Zgou, 2007). This chapter will provide a theoretical framework that will be helpful to analyze EPAs. It will start by giving an overview of the argument for free trade in Section 4.2. Then continues with Section 4.3 which discusses forms and reasons for economic integration. In Section 4.4 the partial equilibrium analysis framework of Milner *et al.* (2005) will be explained. Finally, Section 4.5 presents a summary of this chapter.

4.2 Liberalization: arguments for and against.²

The idea that countries gain from trade is dominant in economic theory since Adam Smith. There are different theories that try to explain the origin of these gains. For example Riccardo

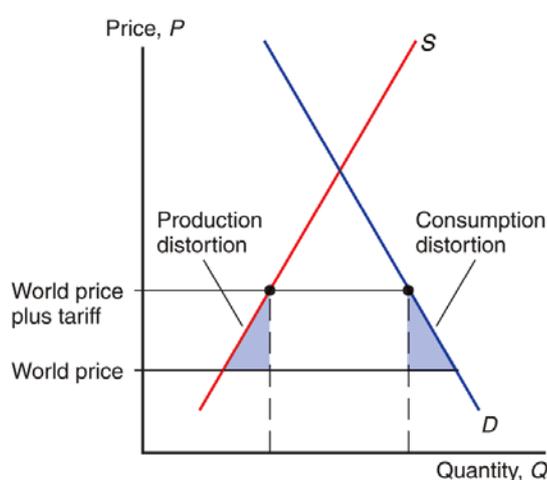


Figure 2: The efficiency case for free trade.
Source: Krugman and Obstfeld (2009)

explains the differences in comparative advantages that derives from differences in labour productivity, Heckscher and Ohlin state that differences in comparative advantages derives from differences in natural resources. In essence economic theories suggest that free trade is beneficial because there will be no costs and efficiency losses associated with protection. In Figure 2 you see a partial equilibrium model for a small country, so the country is not able to influence the foreign export price. In this case the price of a good and the quantity sold of the good is determined by supply

² This section is heavily based on Chapter 9: The Political Economy of Trade Policy. From Krugman and Obstfeld (2009)

and demand. Now assume that there is a trade barrier in this country, the domestic price of the good consumed in this country is the world market price plus a tariff. The domestic market price of the good is therefore higher than under free trade, where the domestic price will be the market price. The tariff distorts the economic incentive of both producers and consumers. According to the downward sloping demand curve, consumers will buy less of the good because of the higher price. On the other hand, producers will supply more of the good according to the upward sloping supply curve. These distortions are pictured in Figure 2 as the two blue triangles. These triangles measure the net loss to the economy, which is the production distortion plus the consumers distortion. A move to free trade will remove these distortions and therefore leads to an increase in national welfare. Another argument in favour of free trade is the economies of scale argument. When markets are protected, the world market will be fragmented and this will lead to inefficient firms. This inefficiency can exist because too many firms will enter the market. It is attractive for firms to enter when the market is protected, because the reduced competition will raise profits. The last important economic argument for free trade I want to mention here is that of innovation and creativity. As already pointed out an open market will lead to more competition. Competition provides entrepreneurs an incentive to seek for new ways to find a market for their products. As argued in Chapter 3, there are also a political arguments for free trade. This means that trade policy is driven by ideas and institutions rather than by national and economic interest.

Unfortunately the discussion is far more complex, there are also a lot of arguments against free trade. The biggest challenge for a country in a free trade situation is the income distribution, which is a consequence of resource availability. In general you can say that owners of a country's abundant factor, the factor of which there is a relatively large supply, will gain from trade. This is because countries tend to specialize in the dominant resources. This works also the other way around, so owners of a scarce factors tend to be worse off. So we can expect that developing countries tend to specialize in labour intensive products, because there is a lot of cheap labour. For developed countries we can expect a specialization in capital intensive products. Free trade will make factor prices converge along with traded good prices according to the Hecksher-Ohlin model. This argument is a theoretical argument and can not always be found back in reality. Also if the price of labour intensive goods increases, it will increase the relative wage rate as well as decreasing the relative rental rate. Another comment that is argued in the case against free trade is the benefit of setting an optimal tariff. More precisely, a large country is able to set an optimum tariff, because she can affect the price of foreign exporters. By lowering the price of imports the country will generate a terms of trade benefit, which is a benefit that derives from a decrease in the relative price of a county's import. Because of the improvement in the terms of trade of the country, she is able to maximize its welfare by setting a tariff. Other arguments against free trade have to do with the promotion of a domestic market. For example benefits associated with the

production of a good, such as a higher employment rate, positively affects a country's national welfare. A tariff can be helpful to reduce competition and thereby generate domestic social benefits. An additional argument against free trade is the infant industry argument, which is particularly used by developing countries. Infant industries have a potential comparative advantage in manufacturing. In order to get a real comparative advantage, the industry needs to develop. The argument governments use is that these industries need to be protected until they are strong enough to compete on the world market. But this is not a strategy without risk. A potential comparative advantage now, does not mean a country necessarily will have a comparative advantage in the future. Besides that the idea of supporting an industry is questioned, because industries usually get stronger by investments not by protection.

Concluding this section, it needs to be said that despite the arguments for and against free trade, most economists agree that free trade in essential is good for a country's overall national welfare. This means that even while there are losses in certain sectors and that the income distribution effects are not desirable, the overall effect for a country tends to be positive, because the victims of free trade can be compensated.

4.3 Economic integration: forms and aims.

There are different forms of regional economic integration, namely:

- Free trade area: there is free trade between the members.
- Customs union: in addition to free trade the members also have a common external tariff on trade.
- Common market: has the characteristics of a custom union, but also includes free mobility of goods, services and people.
- Economic union: includes all characteristics of a common market plus a common economic policy.

The process towards Custom Unions, Common Markets and Economic Unions are complex, because of their highly political character. The free trade area, which is almost a pure economic reform, is therefore the most 'popular' form of regional economic integration. Basically, the most important reason for economic integration is to internalize externalities, such as fragmentation of the market and economies of scale. By integrating in a regional bloc the member states become able to influence economic issues, which were previously external, with their decision making power.

When you really want to understand regional integration you have to take the economic background of countries into account. The motivation for regional economic integration differs between developed and developing countries and derives from their economic differences. While the developed countries have strong economic structures, the economic structures of Least Developed Countries are poorly developed (e.g., institutions, property rights, transportation possibilities). Developed countries are primarily involved in

economic associations because of the trade effects, so gains in the short and medium run. These are called the static effects of regional economic integration. Examples of static effects are trade effects. Developing countries are more focussed on the long run when it comes to economic integration. In the long run the economic structures can change and thereby enhancing economic growth. This is what is called the dynamic effect of regional economic integration. The main objective for developing countries is to accelerate their development, this can be done through the enlargement of the market, pooling of scarce resources and avoiding unnecessary investments. By enlarging the market economies of scale can come into being. The pooling of resources is essential for economic growth as it can give an incentive to creative entrepreneurship. Judging the results of regional integration projects in developing countries should be done in the long run, because the projects are designed to achieve development in the long run. However this is difficult, because most associations does not hold for a long period due to tension and conflict between the members. Tension and conflict can occur out of the similar individual objectives, namely acceleration in its own development at the costs of the other members (Hitris, 2003).

4.4 Partial equilibrium model: trade and welfare effects of EPAs.

In the case of the EU-SADC EPA there are three major economic players, the EU, the SADC countries and the rest of the world. We should be aware that the SADC countries are relatively small in economic terms compared to the EU and the rest of the world. So the SADC countries are not able to influence the market price. I will outline the partial equilibrium model used by Milner *et al* (2005). This model is chosen for its insight in the economic welfare effects of regional integration among small (SADC) and large (EU) countries. The model is build on the equality of supply and demand in only a subset of an economy's markets, taking variables from other markets as given. The markets are assumed to be perfectly competitive.

Figure 3 represents the perspective of a small country member country of a economic association negotiating with the EU about an EPA. Trade arises because the price differs in the absence of trade. On the horizontal axis you see the total import volume of Home. On the vertical axis you find the prices. The small country is denoted as H, which stands for Home. The line D_H is the home country's demand for import. S_p is the partners (the other members of the economic association) supply of export. There are also two outside suppliers, the EU and the Rest Of the World (*ROW*), which got elastic supply curves.

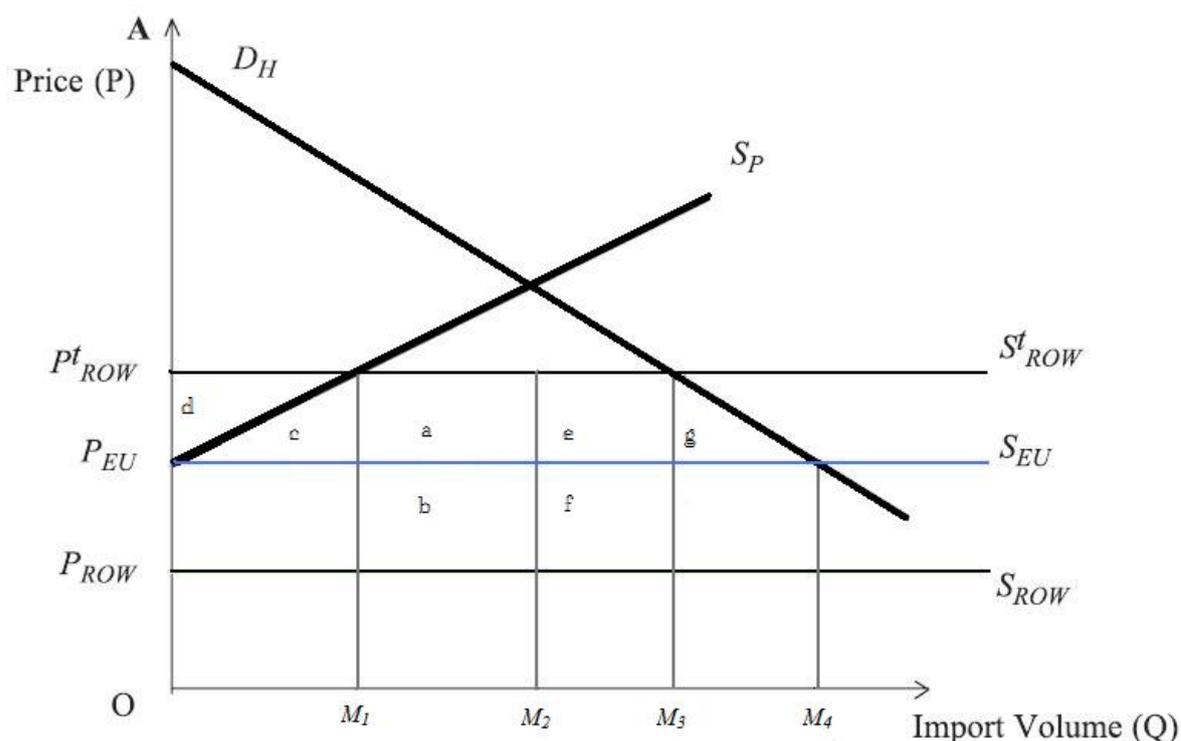


Figure 3: Effect of an EPA. Source: based on Milner *et al* (2005).

The starting point is the situation in which there is a partnership and *ad valorem* tariff (t) on extra-regional imports, where $P_{ROW}^t = P_{ROW}(1+t)$. The welfare for Home is given by the consumers surplus triangle (ABP_{ROW}^t) plus the government surplus, which is the tariff revenue on extra-regional imports ($M_3 - M_1$). The total import of Home is OM_3 . Of which OM_1 is coming from the partner country and M_1M_3 from *ROW*. The next step is the switch to EPA, which will introduce a discriminatory tariff policy towards extra-regional countries. While the EU is still imposing tariff t on imports from *ROW*, the imports from the EU in Home can enter the market duty free. So the related EU price under an EPA will be P_{EU} . Due to this change in price the total import quantity of Home will increase to OM_4 , imports will now coming entirely from the EU. There are three aspects of this trade-effect of replacing a PTA by an EPA, namely:

- Consumption expansion, area g ; an increase in quantity demanded for a good after a price fall for this good (Hitris, 2003).
- Trade creation, area $d+c$; the gains derived from shifting to an EPA. These gains are due to an improvement in efficiency by specialization and will increase a country's welfare (Pozzi *et al.*, 2005).
- Trade diversion, area $b+f$; occurs when trade with the EU simply replaces trade with non-member countries (Krugman and Obstfeld, 2009). The more efficient the EU is,

the smaller the cost of trade-diversion will be, because the gains can then run out the loses.

The total welfare effect of switching from a PTA to an EPA can be measured by $\Delta W = (c+d+g) - (b+f)$.

The conclusion that can be derived from this model is that a shift towards an EPA will imply that the gains in welfare caused by the consumption and trade creation effects are likely to be counter balanced by trade diversion effects. Therefore the level in efficiency of the EU is crucial, the more efficient the EU the less welfare losses. EPAs can reduce welfare in partner countries.

4.5 Summary

This chapter provided a theoretical framework to analyze EPAs. It started by describing the case for free trade and concluded that although there are arguments against it, free trade is in most cases desirable. The chapter continued with regional economic integration. From this section it is clear that EPAs will be a free trade agreement. The reason to promote regional integration differs between developing and developed countries. Developed countries will probably find gains in the short and medium run, while developing countries hope economic integration will foster development. In the last section an analytical framework to analyze the trade and welfare effect of EPAs was discussed. From this model it became clear that EPAs will may lead to trade diversion.

Chapter 5

Case study; EU-SADC EPA

5.1 Introduction

This Chapter will present a case study which shows the link between the political aspects of EPAs examined in Chapter 2 and 3, and the economic theories on regional integration and EPAs examined in Chapter 4. The EPA negotiations between the Southern Africa Development Community (SADC) countries is chosen for this case study, because of overlapping integration initiatives and economic diversity between the SADC countries. The SADC consists of fifteen members, of which seven were negotiating for an EPA with the EU. These seven countries, Tanzania, Mozambique, Botswana, Namibia, Lesotho, Swaziland and Angola, were negotiating under the name SADC EPA Group. But only Botswana, Lesotho, Swaziland, Mozambique and Namibia agreed an Interim region-to-region EPA with the EU (European Commission, 2009).

The first section, Section 5.2, will presents some economic characteristics of the SADC countries. Section 5.3 examines the process of regional economic integration in Southern Africa. Section 5.4 will give a summary of the main features of the EU-SADC EPA. Section 5.5 examines the trade and welfare implications of an EPA for the region. In this section the outcomes of previous studies will be analyzed. The final section of this chapter will be a summary.

5.2 Economic characteristics

5.2.1 Production structure

The study of *Keck and Piermartini (2007)* shows that the SADC countries are heterogeneous in their specialization pattern. They used data of the GTAP database, to present Figure 4 that shows the value added by merchandise sector.

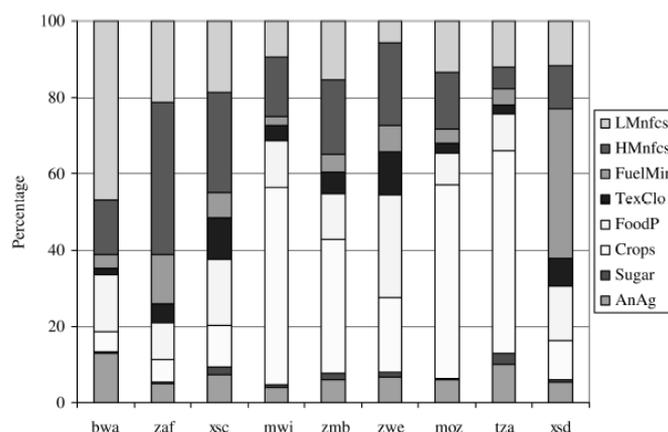


Figure 4: Value added by Merchandise sector (%). Source: Keck and Piermartini (2007)

Their study include the data of all SADC countries, and not only the data of the SADC EPA countries. Its interesting to have a look at the economic structure of the whole region, because the EPA tries to promote regional economic integration. The SADC countries are member of Southern African Custom Union (SACU), the world oldest Custom Union (European Commission Trade, 2010). Because of the economic differences between the countries it is valid to expect that EPAs have different effect across countries. Figure 4 divided the economy in the following sectors: Light manufactures (LMnfc) Heavy manufactures and metals (HMnfc) Fuels and minerals (Feulmin), Textiles and clothing (Texclo), food products (FoodP), Crops, Sugar cane and beet (Suger), Animal Agriculture (Anag). It shows that Malawi (mwi), Zimabwe (zwe), Zambia (zmb), Mozambique (moz) and Tanzania (tza) are specialized in agriculture [Food products, Crops, Sugar and Animal agriculture]. For Botswana (bwa) and the rest of SADC (xsd) industry apply as the most important sector. This data are in line with the share of the sectors in the GDP, as presented in Table 1.

	share of agriculture in GDP	share of industry in GDP	share of services in GDP
Angola	9.6	65.8	24.6
Botswana	2.3	45.8	51.9
Lesotho	7.1	34.7	58.1
Mozambique	28.7	24.5	45.9
Namibia	9.6	34.2	56.2
Swaziland	8.4	42.4	49.2
Tanzania	26.4	22.6	50.9

Table 1: procentual share of sectors in GDP. (data of Mozambique, Swaziland, Tanzania from 2009, rest of the data from 2008). Source: world factbook (2010)

5.2.2 Trade pattern

SADC exports are differentiated across the countries. The export products are mainly primary and secondary goods. The specialization in different export goods can be explained by differences in countries comparative advantages. Most exported goods are fuels and minerals, this is also true for the SADC import goods in the EU (see Figure 5).

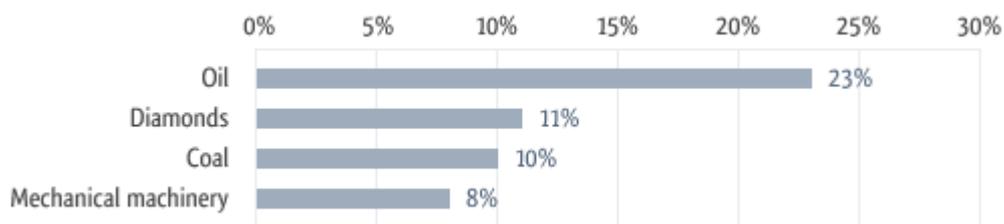


Figure 5: SADC main exports to the EU in 2008. Source: European Commission Trade (2010)

SADC imports are concentrated in the industrial sector (see Figure 6). Although food imports are significant as well in most countries. In particular, Botswana and Tanzania are net importers of processed food products.

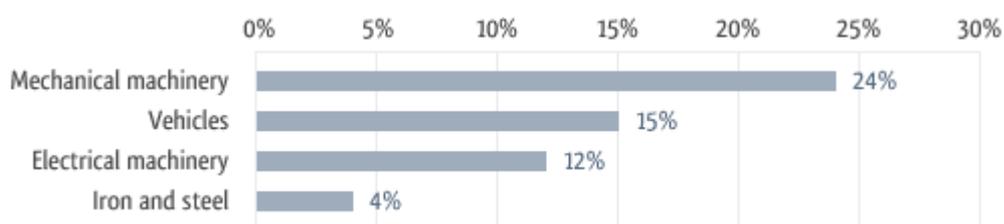


Figure 6: SADC main imports from the EU in 2008. Source: European Commission Trade (2010)

The EU is an important trading partner for SADC countries, as well for exports as for imports. Intra-regional trade is also important for SADC countries. In 1980 0.4 percent of the total trade within the SADC was inter-trade. This increases up to 9.3 percent in 2003 (Babarinde and Faber, 2009). In fact, South Africa is the most important source of imports for all SACU members. Only for the Tanzania the EU and South Africa are not the most important trading partners. So we can expect that liberalisation under an EPA is significant for all SADC countries, except Tanzania (Keck and Piermartini, 2007).

5.3 Economic integration in Southern Africa.

The SADC is founded in 1992, the aim of the members states is to enhance development in Southern Africa. The SADC decided to establish an Free Trade Area. At the moment there are no plans to integrate further and work towards an custom union or any other form of intensive political and economic integration. The process of economic integration is a slow and time-demanding practise. Although the member states developed an institutional structure, the establishment of a real free trade area is still in progress. Since a free trade area does not have a common external economic policy the members of a free trade area does not have a strong position in negotiations with external partners, such as the EU. So members of a Custom Union have an advantage in the negotiations, where they are more able to speak with one voice. So the SADC-EPA countries are in a far from optimal position in the negotiations with the EU, especially because the countries lack mandate to act collectively. The SADC can be divided into three blocks:

- The first group consists of SADC members that are as well members of SACU. These countries are: South Africa, Botswana, Lesotho, Namibia, and Swaziland. South Africa has her own trade agreement with the EU which is called the Trade and Development and Cooperation Agreement (TDCA).
- The second group are the Least Developed countries, they does not belong to another regional integration association. These countries are: Angola, Mozambique and Tanzania. According to the different development status of this group it is difficult to formulate a common economic policy for the EPA negotiations.
- The third group of members of SADC are also members of COMESA. These countries are: DR Congo, Malawi, Mauritius, Seychelles, Zambia and Zimbabwe. They join the Eastern and Southern Africa (ESA) EPA negotiations (Pozzi *et al.*, 2005).

Figure 7 illustrates this complexity of overlapping memberships.

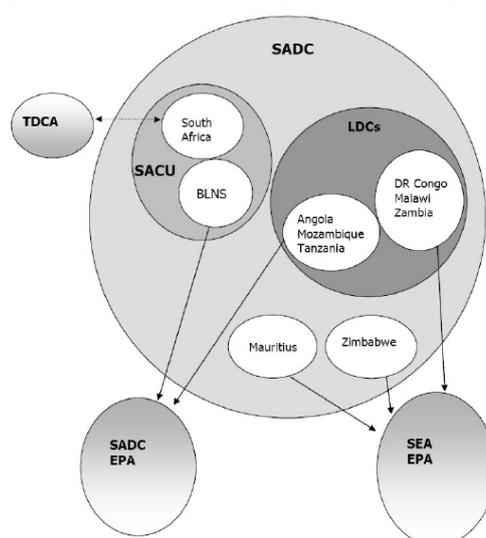


Figure 7: overlapping membership of economic associations in Southern Africa. Source: (Pozzi *et al.*, 2005)

According to the European Commission (EC) the negotiating process with SADC is rather complex, because of these overlapping memberships. The EC even states that the participation in different regional integration initiatives restrain the SADC region to make rational choices. This had and still has its influence on the EPA negotiations and makes it harder to progress towards closer regional integration. Harmonizing existing trade regimes, according to the SADC, is a goal (SADC, 2010). Also the position of South Africa makes the negotiations far more complex. South Africa is the dominant economic player in the region, but did not join the agreement. They are still participating in the full EPA negotiations, which is therefore of a great value in order to achieve effective regional integration (European Commission, 2009). It is important to keep this complexity in mind when we look to the

actual result of the negotiations, since it helps to understand the aims and objectives of the interim EU-SADC EPA.

5.4 The main features of the EU-SADC EPA.

The main features of the interim EPA with SADC is a single good market access, a commitment to continue negotiating towards a full EPA and a chapter on development cooperation (European Commission, 2009). The objective of the EPA to create a better market access actually means that SADC countries need to liberalize their markets. The EU-SADC EPA allows a transition period and the exclusion of certain products. Botswana, Lesotho, Namibia and Swaziland will liberalize 86% within 4 years, so before the end of 2012. Mozambique will liberalize 81% of its market by 2023. The goods that will be liberalised can mostly be found in the industrial sector and fishery. Excluded are mainly agricultural goods, textile and processed agricultural products (European Commission, 2009). Agriculture plays a key role in the development of SADC countries. Only 20% of the areas with economic potential are well connected to the markets. So agriculture need to become more competitive before liberalization takes place. Therefore technical assistance is included in the agreement and aims to help SADC countries to diversify their economy. I quote: “*The EPA will be a means for Europe to help the SADC region to improve and diversify its exports and build regional markets*” (Mandelson, 2005: 3). The EU will also assist producers in SADC countries in meeting the EU import standards (European Commission trade, 2010). For certain agricultural export goods of SADC countries there are still certain restrictions. With the interim EPA the EU and the SADC countries agreed on a transition period for rice and sugar. All other goods can enter the EU duty and quota free (European Commission, 2009). In most SADC countries the service sector is growing as well as the trade in services. According to Article four of the interim EPA this can be of a great value to the EPA goal of further regional integration, because transport, energy and telecommunication serve the integration process (EU/SADC, 2007). It is vital to stress that the interim EPA has a clause on the possibility for all participating countries to reintroduce duties and or quotas in order to safeguard the local economies (European Commission Trade, 2010).

EPAs is not only a trade agreement, it is also concerned with the so called WTO plus issues (Mandelson, 2005). These issues apply to creating sustainable development, such as government procurement, intellectual property rights and trade facilitation. Due to the resistance of ACP countries, trade facilitation is the only remaining pillar that is included in the interim EPA. But the EU still try to approach these WTO plus issues in informal negotiations. I quote Pascal Lamy, EU trade commissioner in 2004: “*Investment, public (government) procurement and competition are areas which we are always addressing in our bilateral free trade agreements*” (Nordeman, 2008). This is in line with the WTO strive for

transparency. The interim agreement lists all EPA related intervention which are concerned with this wider development cooperation issues, namely:

- Policy development
- Legislation and regulatory framework development
- Institutional/organisational development
- Capacity building and training. For example through the EU-SADC Investment Promotion Programme.
- Technical advisory services
- Support in the WTO agreements on sanitary and phytosanitary (SPS) measures and technical barriers to trade areas (TBT). This intervention is concerned with the protection of the health of humans and environment and is meant to strengthen and enhance technical capacity of the SADC countries on matters concerning technical trade barriers and SPS measures. This means that the EU as well as the SADC countries cooperate to facilitate trade in goods and try to progress regional integration. In order to achieve this technical regulation must be transparent. This intervention is also concerned with an international perspective by promoting the participation of SADC EPA countries in international institutions.
- Operational support including equipment, materials and related work (EU/SADC, 2007).

The European Development Fund is the EC's main financial tool to provide development in the SADC region. The fund is meant to improve infrastructure, education, human resource development and giving macroeconomic support. Besides the European Development Fund the EU-SADC Investment Promotion Programme (ESSIP) addresses the challenge to mobilize more investments to the region. They do this by building intermediaries, such as employers' federations or financial institutions. However they also organize sectoral meeting, which bring investors together (Mandelson, 2005).

The full EPA negotiations cover the interim EPA text as well as talks on services and investments (European Commission, 2009). This time also South Africa and Angola are joining the negotiations. During the interim EPA negotiations, South Africa only functioned as an observer in the EPA process. That they are actually fully joining the negotiations is important for the regional integration process, as they are the dominant economic force in Southern Africa. The negotiations also covers market access issues with South Africa(SADC, 2010). In 2008 four negotiation rounds took place. During these rounds the states were focussed on them implementation of the interim EPA.

The full EPA negotiations tries to harmonize different trade agreements. The EU-SADC EPA states are doing this by trying to streamline the Trade Development and Cooperation agreement with the EPA, so that the negotiations can be merged together and can continue as one integration process (SADC, 2010).

5.5 Trade and welfare implications.

Looking to the trade and welfare implications of an EU-SADC EPA, this section will focus on the effect for SADC countries. As the partial equilibrium model already suggested we can expect consumption, trade and welfare effects in the SADC countries. No major effects are expected for the EU given the minor share of SADC in the EU's overall trade (Keck and Piermartini, 2007).

Although the industrial sector is relatively large in most SADC countries it is interesting to analyse the agricultural sector. Due to reciprocal liberalisation under the EPA an an reallocation of resources in SADC countries can be expected. SADC countries are likely to have a comparative advantage in primary sector relatively to the EU.

In their study Fontagné *et al.* (2008) set out several scenarios regarding ACP-EU trade policies. For all these scenario's they analysed the impact on ACP countries. The third scenario they have got is the end of Cotonou followed up by successful EPA negotiations with full duty free and quota-free access for ACP countries to the EU and the liberalisation of ACP imports. Under this scenario 'substantially all trade' is liberalised, this means that sensitive products, which are merely agricultural products, are not liberalised. This scenario is in line with what the EU and SADC countries agreed on in an interim EPA. This does not mean that this will also be the outcome of the full EPA negotiation, but it is a likely scenario and makes it possible to analyze the potential trade and welfare effects of an EU-SADC EPA on the short and medium run. Appendix I shows all relevant data that are collected and modelled for this scenario.

When it comes to SADC exports it is expected to decrease for Lesotho, Mozambique and Tanzania. The other countries will stay at the same level (Angola) or will find an increase in their exports to the EU (Botswana, Namibia and Swaziland). But an increase in exports will not translate in equivalent changes in the trade balance, as imports from the EU will also be liberalised with consequent changes in their trade flows. Especially after a full EPA, which means the SADC countries are opening up their markets to an higher extend, EU imports in SADC countries will increase. Under the scenario wherein substantially all trade is liberalised and mainly agricultural products are listed as sensitive products, the import form the EU are expected to increase for all SADC countries. For Botswana this effect is quite small (1.7%), but for Mozambique (15.1%) and Tanzania (22.9%) this change in imports will be significant. But according to the agreement Mozambique will liberalize 81% of its market by 2023. So there will be a transition period wherein products from Mozambique already can enter the EU market duty free, while the country still have tariffs on most EU imports. Accordingly, a transitory gain for the trade balance of Mozambique (and the other SADC countries) is expected over the period.

The changes in total import of SADC countries are of a smaller amount than the changes in import from the EU. Since all changes are positive, this means that the EU import

is growing while the export of other countries is declining. So up to a certain level the EU trade is a substitution trade from the rest of the world. Thus there is a trade-diverting effect. As I do not have data about the changes in prices of the import goods, I can not conclude anything on trade creation as I do not know up to what level you can speak of efficiency improvement. But the study of *Keck and Piermartini* (2007) is going more into details about this. They analysed the effect of an EU-SADC EPA with a an general equilibrium model (standard GTAP model). A general equilibrium analysis takes the responses of producers or other adjustment effects into account. They found that the total trade volume and exports does not significantly changed under an EPA. According to the authors this is not a surprise because the SADC countries already had preferential market access to the EU. They also found an increase in imports from the EU is all SADC countries except Botswana. I expected this to be the consumption and trade-diverting effect discussed in Chapter 4. However the data of *Keck and Piermartini* (2007) shows that the increase of import is mainly trade creation. Only the animal agriculture and processed food sectors experience effects of trade diversion. The Latin American countries are the main victim of this trade-diversion effect. The manufactured sectors will experience the largest increase in imports. The study also shows that agriculture in SADC countries will expand under an EPA. This is what I already expected on the basis of comparative advantages theory.

The overall effect of cutting tariffs on tariff revenues depend on both the level and or products on which tariffs are reduced and the increase in imports as a result of falling import prices. In all SADC countries the tariff revenues are expected to decrease. The losses vary from -4.9% for Lesotho, up to -36.5% for Angola. These tariff revenue losses will have a significant impact on their fiscal capacity. Thus the capacity to switch from trade revenue to domestic revenue will be crucial for SADC countries (Fontagné *et al.*, 2008).

5.6 Summary

In this chapter I looked to the EU-SADC EPA negotiations and impact. The negotiations were complex due to the overlapping memberships of economic associations in Southern Africa, but they managed to agree on an interim-EPA. This agreement include liberalisation of ‘substantially all trade’, with a transition period. Due to a comparative advantage in agricultural products, we can expect a reallocation of resources towards the agricultural sector in SADC countries. Transitory gain for the trade balance of SADC countries is expected in the upcoming years, till they opened up their markets. The increase of import that SADC countries experience is mainly trade creation. Only the animal agriculture and processed food sectors experience effects of trade diversion. Finally I stated that all SADC countries expect tariff revenue losses.

Chapter 6

Summary and conclusions

6.1 Summary

This research examined the political process behind the EPA negotiations and the assumed impact these agreements have. I studied the historical context of the EPA negotiations, the EU's motive for EPAs and the context and assumed welfare impacts on SADC countries. The central question was: What drives the EU interest in EPAs and is there an economic interest for SADC countries based on the assumed impact on trade relations? To answer this question I explored political and economic theories and I did a case study to point out the complexity and effects of EPAs.

In Chapter 2 we saw that the EPAs fit in a historical tradition of trade cooperation between the EU and ACP countries, which started after the process of decolonialization. The Cotonou Agreement in 2000 paved the way for EPAs. The shift away from pure trade cooperation towards the inclusion of political and development issues can be seen in the light of the dominant development paradigm of 'good governance'. After a troubled negotiation process with internal conflicting views in the EU, the EC stuck to the hard deadline and agreed on interim EPAs with different regions.

In Chapter 3, I examined the concepts of interest, institutions and ideas and used these concepts to analyze and clarify the EU's position in the EPA negotiations. The EU has a strong interest in EPAs because they help to create a stable WTO regime. Since the EU is economically important, she has more to gain from a stable WTO system as a bloc; this is called the 'blocsized effect'. EPAs can be used to strengthen the EU's negotiation position on 'transparency' issues in the Doha round and other bilateral negotiations. The WTO has influenced the EU strategy in the trade negotiations with ACP countries. WTO compatibility is very important for the EU because she has stake in a strong WTO regime. Although the legal framework of the WTO is quite flexible in its interpretation, the EU decided not to renegotiate the waiver. Instead the EU chose for free trade areas as an internal EU compromise. EPAs provoke development through strengthening of the regional economy. The role of regionalism in the development debate grew after the successful regional integration of the EU.

In Chapter 4 I examined the case for free trade, regional economic integration and the partial equilibrium model. Free trade is in most cases desirable. EPAs will be a free trade agreement which is an economic agreement that internalize externalities. Economic associations are, for developing countries, interesting in the long run. In the long run economic structures can change and thereby foster economic development. From the partial equilibrium model we can conclude that three things are going to happen after implementing EPAs: increase in the consumption of the traded goods, an increase in trade due to efficiency

improvements, and a shift of trade with non-member countries to partner countries. The increase in consumption and trade will lead to welfare gains for the member states. However it is likely that this welfare gains will be counterbalanced by the replacement of trade with non member countries. So the more efficient the EU is, the more likely it is that she will gain from EPAs. EPAs can reduce welfare in partner countries, when these countries are not able to maintain government revenues by reforming their tax system.

In Chapter 5 the theories of Chapter 4 are used to examine the negotiations and implications for SADC countries when they implement the EU-SADC EPA. The negotiations were complex due to the overlapping memberships of economic associations in Southern Africa. The interim agreement agreed on liberalisation of ‘substantially all trade’, with a transition period. The SADC countries have a comparative advantage in agricultural products, therefore we can expect a reallocation of resources towards the agricultural sector. SADC countries will probably have transitory gains, till they liberalise their markets. Based on the scenarios from Fontagné *et al.* (2008) we expect trade creation, through the increase of import in SADC countries. Only the animal agriculture and processed food sectors experience effects of trade diversion. I stated that all SADC countries expect tariff revenue losses. The capacity to switch from trade revenue to domestic revenue will be crucial for SADC countries.

6.2 Conclusion

From the historical context and the role of the WTO in the EPA negotiations I conclude that the economic interest is of low relevance for the EU, but that there is a strong political interest. The EU has stake in a strong multilateral trade regime. Herein she wants to have a strong position. To strengthen her position, the EU goes beyond trade relations and designed an agreement that includes development issues. Although she wants to create sustainable growth trough EPAs, NGO’s and scholars questioned if this is what EPAs will bring. An important argument against EPAs is the trade diversion, the increase in trade between the EU and ACP countries simply replaces the trade from countries who are not a member of one of the parties who agreed on the EPA. Another negative effect that can be expected, based on economic theory, is tariff revenue losses in the partner countries. The capacity of those countries to switch from trade revenue to domestic revenue will be crucial. Based on a partial equilibrium model, its likely that the EU find gains in the short and medium run, but only if they are efficient in their production.

Based on theoretical studies and some empirical evidence I found results that show both the positive and negative effects on SADC countries. As positive effect I name trade creation in the agricultural sector, because this can lead to increase in the terms of trade of SADC countries. There is also the argument of efficiency, consumers will be able to buy goods for a lower price. Of course it need to be taken into account that this increase in imports from the EU maybe will drive out imports from other ACP countries. This will be the case for

animal agriculture and processed food sectors in Latin America. The total trade volume and exports do not significantly change under an EPA, because the SADC countries already had preferential market access to the EU. The overall effect of EPAs depends on the adjustment abilities of the SADC countries, will they be able to shift their tax system towards other sectors? This question shows the boundaries of my study, since I'm not able to judge their adjustment abilities. Therefore I can not give a straightforward answer to the question whether EPAs will have a positive or negative effect on SADC countries. But the SADC' interest in an EU-SADC EPA can be clarified by regionalism. The overlapping memberships in southern Africa trouble regional integration. EPAs do not solve this overlapping memberships problem, but they are a symbol for hope on regional integration and development.

Appendix I – trade effects of an EU-SADC EPA

	Angola	Botswana	Lesotho	Mozambique	Namibia	Swaziland	Tanzania
Change in exports to the EU (country level, %)	0.0 (1,0662)*	2.7 (1,716)*	-2.7 (19)*	-1.4 (723)*	14.6 (829)*	693.0 (71)*	-0.9 (711)*
Change in import from the EU (country level, %)	10.5 (1,899)*	1.7 (302)*	3.1 (57)*	15.1 (233)*	4.1 (443)*	5.5 (76)*	22.9 (457)*
Changes in total import (country level, %)	3.3 (5,747)*	0.7 (522)*	0.7 (206)*	1.9 (1,699)*	0.8 (1,743)*	0.3 (989)*	2.0 (2,568)*
Changes in domestic sale on domestic market (all products)	-1.3	-0.1	-0.1	-0.4	-0.2	-0.1	-0.1
Tariff revenue losses (all origins, %)	-36.5	-8.1	-4.9	-17.0	-11.2	-5.7	-20.5
Tariff revenue losses (millions of Euros)	73.39	2.92	0.79	17.23	9.10	2.12	28.49
Changes in trade balance (level expressed as % of 2007 total exports)	0.5	0.0	0.1	0.4	0.2	0.1	0.3

* Reference Value is the average value of 2002-2004 in Millions of Euros

Source: Fontagné *et al.* (2008)

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