Institute for International Integration Studies

IIIS Discussion Paper

No.224 / June 2007

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Abstract

The European Union is currently concluding negotiations for Economic Partnership Agreements with 77 developing countries in the African, Caribbean and Pacific (ACP) regions. The dilemma at the heart of those negotiations is how to reconcile the goal of poverty reduction and development with the substantial trade liberalisation involved. ACP counties have become marginalised in world trade over the past three decades while at the same time they have adopted outward–oriented trade policies and their economies have become increasingly open. Therefore, further trade liberalisation is unlikely to contribute much to development in any major way. Instead ACP countries should focus on domestic growth strategies. Each ACP region should identify its own priority growth sectors and adapt its own specific growth

JEL: F13, F15, O19

Key words:

development, trade liberalisation, regional integration.

Acknowledgements

An earlier version of this paper was presented at a seminar at the Institute for International Integration Studies in March 2007. The views expressed in this paper are the personal views of the author and do not represent the position of the United Nations or the Board of Trinity College.

The EU-ACP Economic Partnership Agreements What impact on development?

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The European Union (EU) is currently in the final stage of negotiating Economic Partnership Agreements (EPAs) with 77 developing countries in the African, Caribbean and Pacific (ACP) regions. What those geographically dispersed countries have in common is that they are all former colonies of Europe and are still, today, among the poorest and most vulnerable countries in the world. From a total population of 692 million people, more than half live in extreme poverty while the rest are on the verge of lapsing into a similar situation. Sub-Saharan Africa (SSA) is by far the largest group with a population of 660 million. Since Ghana led the way to de-colonisation fifty years ago, optimism about Africa's economic development has not been realised. Quite the contrary. According to a recent World Bank study Africa's share of total world exports has declined from 7 per cent in 1948 to 1.5 per cent in 2004 (Broadman, 2006).

The EPAs have been hailed by the EU as modern trade and aid agreements that are part of the wider framework of the Millennium Development Goals (MDGS).[1] Therefore, EU statements have repeatedly emphasised that EPAs are first and foremost about poverty reduction, about fostering economic development and integrating the ACP countries into the global economy. Commissioner Mandelson (2005) has stated that development must be the over-riding priority and trade liberalisation will be 'at the service of development'. The Commission has further emphasised that 'the mindset with which Europe is carrying forward the EPA discussions is fundamentally different from traditional hard nosed trade negotiations'.

How will the goal of poverty reduction be achieved? Through regional trade agreements (RTAs) that are 'in full conformity with the provisions of the World Trade Organisation'. And there's the rub. For development and WTO compatibility do not sit comfortably together. Trade liberalisation will be based on reciprocity and the scope of the agreements will be sufficiently wide to include liberalisation of trade in goods and services as well as a long list of trade – related areas. The new trade issues, better known as the 'Singapore issues' of investment, competition and public procurement, that have been rejected at the multilateral level, will also be included.[2]

[1] The EPAs are the trade pillar of the Cotonou Agreement signed in 2000. Article 1 of Cotonou says 'The partnership shall be centered on the objective of reducing and eventually eradicating poverty'. Goal one of the MDGs is to halve extreme poverty in the world by 2015. Goal eight aims to develop further an open, rule-based, predictable and non-discriminatory trading and financial system, and to address the special needs of least developed countries, landlocked countries and small island states.

[2] This agenda is based on the mandate for negotiations of the Commission which was agreed by the European Council in June 2002. It is expected that the Commission will follow this mandate as long as there is no general agreement among member states to change it, although some individual member states have expressed their criticism.

Reciprocal market opening between such 'unequal partners' as the richest economic block in the North and the poorest group of countries in the South has provoked a strong political backlash from civil society groups.[3] Non-governmental organisations (NGOs), like Oxfam (2006), claim that EPAs make grossly unfair demands on ACP countries and run counter to any notion of 'trade justice'. Government fiscal revenue, which is highly dependent on income from tariffs, will be substantially reduced from the proposed trade liberalisation which will threaten those countries' ability to achieve the MDGs.

The objective of this paper is to assess the current state of play of EPA negotiations and to explore how they may impact on development. The EPA negotiations are set to conclude by the end of 2007. At the time of writing (June 2007) we do not yet know what the contents of the agreements will be and, as history has shown, some of the most important breakthroughs can occur at the eleventh hour of trade negotiations. Nevertheless, there are a number of pointers as to what the endgame will be.

The paper is organised as follows. First, I discuss the new academic thinking on trade and development. Next, I analyse the trade policy and performance of ACP countries that has led up to the EPAs. Then I discuss the relationship between EPAs and the multilateral trade system. Aid for trade is discussed in the following section. Concluding thoughts on the development impact are presented in the final section.

I. New Academic Thinking about Trade and Development

Since the late 1990s, there has been quite a lot of new thinking in academic circles about the linkage between trade and development.[4] This debate was triggered by such questions as how do we explain the glaring 'development gap' between Sub Saharan Africa, for example, and East Asia? What is our current state of knowledge on development theory? How good is our ability to design successful development policies for countries at different stages of development?

The debate was fuelled by interesting insights gleaned from the study of two golden ages in the history of development – the first during the latter half of the nineteenth century and the second during the latter half of the twentieth century.[5] From the long term historical perspective, development was shown to be a broad process involving sustainable economic growth, significant transformation of production patterns and, of major importance, the

[3] Thirty civil society groups across Africa and Europe, including Third World Network-Africa, Oxfam International, Christian Aid *inter alia*, have called for an end to negotiations and launched a 'Stop EPA campaign.

[4] Joseph Stiglitz presented two landmark papers in 1998, one at the United Nations University, WIDER, the other was the Raoul Prebisch lecture at UNCTAD.

[5] See Adelman and Morris (1988) for a comparative historical study and Adelman and Morris (1997) for a critical review of the implications of development history for development theory.

development of economic and political institutions. History also throws light on contrasting theories of development.

- *Contrasting theories of development*

The neo-classical approach to development places primary importance on trade liberalisation as the engine of economic growth and development. In summary this approach argues that '*trade is enough'*. Trade liberalisation will extend the size of the market and substitute for low domestic demand that stunts growth in poor countries. Governments should free up trade by removing trade barriers and then, comparative advantage will do the rest. This approach was gradually extended to behind the border areas.

State interventionism in the domestic economy of developing countries is the major impediment to the smooth reallocation of resources that is a necessary part of the development process. Deregulation and privatisation of state-owned enterprises is the necessary complement to international liberalisation. This is an essential part of 'getting the prices rights' and combined with trade liberalisation will lead to sustained economic growth. Macroeconomic stabilisation is essential for sound money and exchange rates. Thus the three staples of the neo-liberal development policy are 'stabilisation, liberalisation and privatisation'.

But modern development theorists argue that '*trade is not enough'*. In other words, trade is necessary but not sufficient for development. Terms of trade pessimism regarding commodities markets was a first counter-argument put forward. In addition, non price factors prevent the smooth reallocation of resources essential for structural adjustment in developing economies. Market imperfections such as incomplete markets, externalities and imperfect information, which are rampant in developing countries, may get the economy caught in a low income equilibrium trap. Given the conjunction of those factors, free trade alone will not be sufficient to initiate the process of development. Thus, there is a need for activist government policy to ensure co-ordination of investment in key sectors of the economy and to provide essential public goods such as infrastructure, health and education.

History is not on the side of the neo-liberal development paradigm that has been dominant since the 1980s. The so-called 'Washington Consensus' has provided the guiding principles of development advice doled out to developing countries by the International Monetary Fund and the World Bank. A central tenet of its accepted conventional wisdom was that countries with lower trade barriers experienced faster economic growth. Thus the link between openness, defined in terms of lower tariffs and non-tariff barriers, and economic growth was established. The positive causal relationship was supported by a number of influential empirical studies published in the 1990s. [6]

[6] The best known studies include Dollar (1992), Den-David (1993), Sachs and Warner (1995) and Edwards (1998).

However, in his study of Sub-Saharan African countries, Rodrik (1997) concluded that trade policy was not the main cause of their poor economic and trade performance. The real reason was their low economic growth rates. Therefore, they should concentrate their efforts on the ‘fundamentals of long term economic growth’ which he identified as human resources, physical infrastructure, macroeconomic stability and the rule of law. Moreover, he argued that further trade liberalisation would have little influence on their future economic growth. Expanding on this study and using wider cross national evidence, Rodrik and Rodriguez (1999) questioned the robustness of the methodology underlying the relationship between trade liberalisation and economic growth.[7] This opened up a whole new debate about the perceived paradox of development.

Some developing countries, like those in SSA, have become marginalised in world trade and suffered serious economic decline, while developing countries in other regions of the world are making great economic strides. While that is obvious, it is puzzling that those countries with poor performance have followed the ‘orthodox’ policies prescribed by the multilateral institutions, while the more successful developing countries had followed a rather more unorthodox path.

The most successful cases of post-war development have been in East Asia from which lessons may be drawn. They have all used domestic industrial policy to build a competitive manufacturing sector. Each country has mixed its own special blend of development policy with a heterodox trade policy that included high levels of tariffs and non-tariff barriers, government ownership of major sectors in the economy, export subsidies, local content requirements, patent and copyright infringements, selective restrictions on foreign direct investment and portfolio capital. Success was based on diversity of domestic policy arrangements coupled with a wide range of trade policy instruments. High economic growth typically took place in the domestic economy before opening up to trade (Rodrik, 2004).

There is still general academic agreement on *what* developing countries need to do to grow out of poverty and to become better integrated into the world economy. Trade plays a vitally important role and no country has ever developed behind closed borders. But on *how* exactly trade contributes to economic growth and development, there is much less agreement. The linkage between trade liberalisation and development is more complex than was previously thought. The confident assertions of the ‘Washington Consensus’ have been increasingly challenged. Compared to a decade ago, there is much less certainty now about how to design successful development policy and what ‘getting the trade rules right’ might mean (Rodrik, 2006).

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[7] Their critical study covered the four major papers cited in the previous footnote and also includes analysis of Frankel and Romer (1999).

- *Policy space for development*

So, what are the policy implications for developing countries today? To achieve sustained economic development, they should continue trade reform – reduce high levels of trade restrictions, remove export restrictions and deregulate domestic monopolies etc. But they should give up their hazardous obsession with increasing market access in industrial countries in WTO trade negotiations, as this only leads to an upward spiral of trade liberalisation. Instead, they should aim to re-orient trade rules towards allowing them more latitude to carve out the needed 'policy space' to pursue their own domestic development strategies (Rodrik, 2001). This is of utmost importance as trade liberalisation, *per se*, does not lead to economic growth and too much trade openness may even undermine domestic development.

Under WTO rules today developing countries do not have access to the same amount of policy space and range of policy instruments for economic development as did the Asian countries in the 1960s and '70s. Moreover, those same policy instruments were even more freely available to industrial countries themselves when they were experiencing their own industrial revolutions. WTO restrictions, for example on trade related investment measures (TRIMs) and trade related intellectual property measures (TRIPs) have limited the ability of developing countries to regulate key sectors in the economy. Those policies have been characterised as the North using the old strategy of 'kicking away the ladder' to prevent the South from moving up towards higher levels of industrialisation and economic growth that will lift their populations out of poverty (Chang, 2005).

Can regional integration create a new policy space for developing countries? Can it effectively act as a stepping stone to gradual integration into the global economy? The 'new regionalism' of the 1990s has spread especially in the South where regional integration is considered as a strategy for development. It is also viewed as a means to harness globalisation to the needs of development and foster intra-regional trade (Gavin and Van Langenhove, 2003).

Commissioner Mandelson (2005) has underlined that '*regional integration …if implemented properly will build markets where economies of scale, return on investment, and enhanced domestic competition become really meaningful and stimulate economic growth and employment. Growing regional markets are particularly important to landlocked countries and to the small and vulnerable islands of the Caribbean and the pacific'*. This is indeed classic European regionalism but what are the implications for development?

All of the ACP regions are already actively involved in their own regional integration schemes, with different degrees of progress. The Caribbean is most advanced, in Sub-Saharan Africa there is a situation of variable geometry resulting from borders that, still today, reflect colonial times, while in the Pacific it is still at an embryonic stage. What does the EU expect by the end of the negotiations for EPAs? '*A single trade regime at the regional level, with common and modern customs procedures, that give sufficient protection to larger markets enabling them to expand as trade grows. To attain this, what matters is the political will of EPA regions to cooperate internally and respect their own intra-regional treaties'* (Mandelson, 2005).

The achievement of complete customs unions in all six regions by the end of 2007 goes far beyond what is required by the Enabling Clause of the WTO.[8] As such, it implies a further restriction of policy space for development. ACP countries will lose the type of flexibility that regional groups in other regions enjoy. Even more important is the emergence of North-South regional trade agreements, such as EPAs, which pose new threats in this context. If the weight of trade liberalisation is placed asymmetrically on developing countries, because their real negotiating leverage is limited, this will not provide a positive enabling environment for development.

II. Trade Policy and Performance of ACP countries

The poor trade performance of ACP countries over the past thirty years has been repeatedly cited as the rationale for EPAs. So it is worth going over the factors that have contributed to the marginalisation of ACP countries in the world economy. In particular, it is important to see the relative importance of trade policy in contributing to their severe economic decline. How we answer those questions will have major implications for how we think about the new EPA regime.

- Non-reciprocal trade preferences

Since 1975, ACP trade relations have been based on unilateral preferences to the EU market without having to reciprocate by opening up to European exports.[9] Those preferences have been augmented to total duty and quota free entry for 'everything but arms' from the least developed countries (LDCs) since 2002.Lomé preferences, it was believed, would foster a virtuous circle of trade and development for ACP countries: enhanced market access would lead to increased exports, which would lead to increased economic growth, which would lead to development. But this has not happened and the question is why.

The standard narrative of the Lomé regime usually runs like this. Despite preferential access for up to 99 per cent of all products, the ACP share of EU trade dwindled from nearly 8 per cent in 1975 to 2.8 per cent in 2000. The export price stabilisation mechanisms of the commodity protocols have not led to diversification and 50 per cent of total ACP exports to the EU are still

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[8] Under the Enabling Clause of 1979, developing countries may enter into regional trade agreements among themselves for mutual reduction of tariffs on goods. While they are not required to undertake comprehensive liberalisation, they must not raise trade barriers in the process of forming an RTA.

[9] Non-reciprocal preferences were introduce into the GATT in 1971 under the 'Generalized System of Preferences' which was accepted as a form of 'positive discrimination' for developing countries and thereby exempted from the most favoured national clause. But the preferences granted to ACP were deeper than to non-ACP countries which required a special waiver.

concentrated in just eight products. By contrast, non – ACP countries that did not benefit from trade preferences have performed better and increased their EU market share (Bilal, 2006).

For neo-liberal economists, dependence on primary commodities and the failure to diversify into processing and manufacturing is a consequence of rent-seeking that leads to financial transfers from rich to poor countries. Preferences induce rents for exporters and so create incentives to continue existing specialisation and deter diversification. Preferences have sheltered countries from competition and have undermined comparative advantage to the detriment of development. Moreover, they have generated political frictions with those countries that have been excluded from preferences (Hoekman, 2005).

Furthermore, preferences have compounded the Dutch disease problems associated with commodities trade. Africa's rich natural resources have become a 'resource curse'[10] that has had a perverse effect on development (Auty, 1994). But export of primary commodities has been a stepping stone to successful development in other countries – without preferences. In Latin America, Chile is cited as the shining example, while South East Asian countries like Thailand, Malaysia and Indonesia have also crossed the bridge. The root of the problem in Africa, in this view, is trade protectionism.

Development has been made dependent on exporting commodities that benefit from preferential market access while manufacturing has been protected by import substitution policies. Inward looking trade policies have stunted industrialisation with the result that the vast majority of the labour force are still left in the agricultural sector. Governments have not wisely invested profits during commodity booms, then borrowed from abroad and ran up large debts. Surplus rents have been captured by vested interests leading to very unequal income distribution which have created serious problems for trade reform.

This analysis views Lomé through the neo-liberal lenses of the Washington Consensus. The central criticism is that non-reciprocal preferences have contributed to high levels of protectionism in ACP countries. Preferences in the European market provide a measure of protection which depends on the margin of preference. The absence of reciprocity gave the ACP countries a free ride with regard to their own domestic protectionism. Although most ACP countries have joined the WTO, they have been able to maintain relatively high bound tariffs. When this diagnosis of the ills of Lomé is accepted at face value, the obvious solution is a large dose of trade liberalisation. In the next section we lift the veil on Lomé in order to see the real market access that was available to ACP countries as well as the numerous other factors that affected their trade performance.

[10] The resource curse refers to the paradox that countries with rich natural resources tend to have lower economic growth rates than countries without those resources. There are many reasons for this including a decline in competitiveness in manufacturing due to exchange rate appreciation, volatility of export revenues from natural resources, windfall profits and government mismanagement.

- Real market access

The importance of preferential access under Lomé has been greatly exaggerated. Many primary commodities of major interest to ACP exporting countries do not receive preferential treatment in the EU market as those products are MFN duty-free. In fact, only 25 per cent of EU imports from the least developed ACP countries are dutiable products as 75 per cent of imports from LDCs into the EU are duty free on an MFN basis, as shown in Table 1. Among the least developed ACP countries, only fourteen have benefited from EU preferences in real market access terms – shown in Table 2. In agricultural commodities, ACP products that benefited most from EU preferences were limited to only nine tariff lines.

In practice there was very low utilisation of Lomé preferences. The exploitation of preferences presupposes that developing countries have the capacity to develop and divert production into preference granting channels. That was not the case in ACP countries where supply side constraints were sufficiently serious to prevent them from utilising the preferences. Weakness of supply capacity was the major factor contributing to under-utilisation, but restrictive rules of origin (Roo) and the legal insecurity over the continuity of preferences, also prevented utilisation.[11] The highest utilisation of EU preferences is in agriculture where Roo are easier to comply with than for non-agricultural products. The EBA experience is revealing in this context. Although the EBA initiative was more generous than the Cotonou preferences, the vast majority of imports from the LDCs continue to enter the EU market under the Cotonou treatment. The reason is the more complicated rules of origin under EBA (UNCTAD, 2005)

Preferential access to European markets has not been mirrored by relatively closed trade policies at home. Many ACP states, especially African countries, were obliged to adopt rapid trade liberalisation in the 1990s as part of wide-ranging economic reforms under the structural adjustment programmes of the IMF. Unilateral liberalisation of tariffs and non-tariff barriers has resulted in many countries, including the LDCs, having very liberal trade regimes today. Openness of LDCs estimated by UNCTAD (2004) for the period 1999-2001 showed that the amount of trade in goods and services represented 51 per cent of GDP. This was higher than the figure for OECD countries which was 43 per cent.

Rodrik (1997) showed that African counties' trade ratios were not low by cross national standards. On average, they trade as much as expected when individual characteristics (income levels, geography and size) are taken into account. Moreover, that openness has been achieved at comparatively high speed. The rapid rate of trade liberalisation by the LDCs in the 1990s was much

[11] The implementation of preferences has been frequently criticised for non-transparency, unpredictable arrangements based on changing conditionality, as well as complex regulations, which is another reason for their lack of effectiveness.

faster than what East Asian countries experienced in the 1960s and ‘70s, or what Chile experienced in the 1970s and ‘80s.

- Commodity market cycles

Rapid opening to trade has made ACP countries extremely vulnerable to external factors. The life of Lomé coincided with a period of long term decline in commodity prices following the market boom of the early seventies. During that period UNCTAD calculated that there was an average fall of 50 per cent in the commodity price index for both mineral and agricultural primary commodities. Swaray (2005) showed a strong link between high levels of indebtedness and unfavourable terms of trade among commodity dependent countries. Furthermore, the degree of openness of LDC economies also has a significant influence on its external debt level.

Even countries that succeeded in increasing their exports did not experience increased economic growth. The case of agricultural commodities, which are most important for ACP countries, show this clearly. Between 1980 and 2000, sugar prices declined by 75 per cent, cocoa by 70 per cent, coffee by 60 per cent and cotton by 50 per cent, according to the Food and Agricultural Organisation (FAO, 2004). Despite the fact that some coffee producing countries were able to increase their exports by 26 per cent in the 1990s, they still had an income reduction of 33 per cent (countries dependent on coffee for more than 20 per cent of export earnings). A similar trend occurred in cotton producing countries that increased their exports by 40 per cent but their revenues fell by four per cent. The fall in real prices since 1980 for the ten most important agricultural commodities (in terms of export revenue) exported by developing countries was estimated to cost them some US$ 112 billion in 2002 figures. This was more than twice the level of total development aid distributed world-wide (FAO, 2004).

Commodity price cycles are frequently related to industrial cycles in industrial countries. As Lomé began, *les trentes glorieuses’* of the post war period were coming to an end in Europe. Intra-industry trade was fuelling North-North trade which was now growing faster than North-South trade. Scientific progress fostered the use of synthetic materials as substitutes for the natural materials from the South. In the emerging post-industrial economy the importance of manufacturing was declining relative to services - now becoming the largest sector of employment.

Table 1: Main Primary commodities of interest to LDCs not receiving preferential treatment (MFN duty-free)

Commodities	Exporting countries
Aluminium ore	Guinea, Mozambique
Animal skins	Burkina Faso, Djibouti
Cobalt ore	Democratic Republic of Congo, Zambia
Cocoa beans	Equatorial Guinea, Haiti, Sao Tome and Principe
Coffee (unroasted)	Angola, Burundi Central African Republic, Dem. Republic of Congo, Ethiopia, Malawi, Rwanda, United Republic of Tanzania, Uganda.
Copper	Dem. Republic of Congo, Zambia
Copra	Kiribati
Cotton seeds	Benin, Burkina Faso, Central African Republic, Chad, Guinea Bissau, Mali, Sudan, Togo, Uganda
Diamonds	Chad, Guinea Bissau, Mali, Sudan, Togo Uganda, Angola, Central African Republic, Dem Republic of Congo, Guinea, Sierra Leone
Gold	Dem. Republic of Congo, Ethiopia, Mali, Sudan.
Gum arabic	Chad, Sudan
Iron ore	Mauritania, Togo
Petroleum oil	Angola, Dem. Republic of Congo, Equatorial guinea, Sudan, Yemen
Pharmaceutical plants	Sudan, Vanuatu
Phosphates	Togo
Natural rubber	Liberia
Sesame seeds	Burkina Faso, Ethiopia, Sudan, Tanzania
Tea	Burundi, Malawi, Rwanda, Uganda
Wood (non-coniferous or tropical)	Cambodia, Central African Republic, Equatorial Guinea, Guinea Bissau, Liberia, Solomon Islands, Vanuatu

Source: UNCTAD, 2005.

Table 2: LDCs in ACP Group benefiting most from market access in the EU

Countries	Relevant Products
Angola	Crude petroleum oil and preparations therefor; cuttlefish, squid
Madagascar	Frozen shrimps and prawns; vanilla; cloves; preserved tuna; garments
Senegal	Fresh and frozen fish and fish fillets; cuttlefish and squid; octopus; crude groundnut oil; preserved tuna; leather footwear.
Dem. Republic of Congo	Crude petroleum oil and preparations thereof;
Mozambique	Frozen shrimps and prawns
Mauritania	Fresh and frozen fish; cuttlefish and squid; octopus
Malawi	Tobacco
Tanzania	Fresh and frozen fish fillets; octopus; fresh cut flowers; tobacco; preparations of petroleum oil
Uganda	Fresh and frozen fish fillets; fresh cut flowers; tobacco
Sudan	Crude groundnut oil
Equatorial Guinea	Crude petroleum oil
Solomon islands	Preserved tuna
Zambia	Fresh cut flowers
Guinea	Fresh fish

Source: UNCTAD 2005

Commodity price stabilisation schemes fell into disfavour in the eighties as, in the words of Margaret Thatcher, ‘you cannot buck the market’.[12] Developing countries were obliged to de-regulate commodity trade arrangements and privatise state marketing boards as part of their structural adjustment programmes. An important justification for dismantling those commodity stabilisation mechanisms was ‘getting the prices right’.

- *Protectionism in the WTO*

The same pressure was not brought to bear on the EU and other industrialised countries to liberalise their agricultural protection that discriminated against developing countries. WTO Director-General Pascal Lamy (2006) has recently acknowledged the structural imbalance that still exists today “…*while the political decolonization took place more than 50 years ago, we have not yet completed the economic decolonization. It is therefore one of the purposes of the current multilateral negotiations to continue the rebalancing of our rules in favour of developing countries.”*

The Uruguay Round initiated the move towards more market-oriented agricultural trade but the actual level of agricultural protection was left largely unchanged (Gavin, 1994). Agricultural tariffs still remain high today with the average bound tariff in countries of the Organisation for Economic Co-operation and Development (OECD) at 60 per cent, compared to five per cent for manufactures (FAO, 2004). And this average tariff does not reflect the tariff peaks in OECD countries, which are highest on imports from developing countries.[13] Tariff peaks on agricultural commodities include 350 per cent for tobacco, 277 per cent for chocolate, 171 per cent for oilseeds and 134 per cent for poultry.[14]

Tariff escalation, which discourages investment in commodity processing, is pervasive. An FAO study found that out of sixteen global commodity chains analysed in 2004, twelve of them practiced tariff escalation. It was particularly strong in those commodities of special interest to developing countries including sugar, coffee, cocoa, fruit, hides and skins. Tariff escalation is highest in food processing which concerns 20 per cent of agricultural export earnings for LDCs, but 57 per cent for non-LDCs. Reducing tariff escalation has been identified as one of the most important issues for market access in the WTO negotiations on agriculture.

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[12] International commodity agreements attempted to stabilise price fluctuations and incomes of producers by creating buffer stocks, to be increased at times of low prices, thereby limiting their fall, and decreased at times of high prices, thereby limiting their rise. As surpluses built up – especially in agricultural commodities – from the eighties on, those mechanisms were no longer considered necessary.

[13] We can speak of a tariff peak when a tariff rate exceeds 15 per cent *ad valorem* any other tariff in the same category. Using this definition there are more than 1,000 tariff peaks in the schedules of the Quad countries. The EU tends to have significantly more tariff peak on agricultural than on industrial products.

[14] Those rates have been calculated by the World Trade Organisation and cited in the FAO report, op.cit, 2004.

Export subsidies and the dumping of export surpluses has undermined the many small family farms which are typical of ACP countries. Price depression has been further exacerbated by the emergence of vertically integrated global commodity chains with sufficient global buying power to close out weak developing countries. This constitutes a major new problem that goes beyond WTO competence. '*The increasing disconnection between the prices paid by final consumers and those received by producers may reflect the growing market power of intermediaries in the marketing chain and emphasises the importance of competition rules to discipline the abuse of their market power*' (Matthews, 2005: 16).

- *The new positive commodity cycle*

EPA negotiations have been overtaken by unexpected events in the global economy that have contributed to a new positive commodity price cycle. An important development in the global economy over the past five years has been the revitalisation of commodity markets through growing demand fuelled by South-South trade.

Between 2000-05, African exports grew at a rate of 20 per cent, while exports to China increased by 48 per cent, compared to 14 per cent to India. Asia is now the third largest export destination. The EU is still the largest trading partner taking 32 per cent of African exports, followed by the United States which takes 29 per cent. But Asia has climbed up and now comes close taking 27 per cent of African exports. However, 85 per cent of all African exports to Asia are primary commodities and its share in total Asian trade is still tiny, only 1.6 per cent (Broadman, 2006).

On the whole, African countries are now experiencing growth rates that are above the three per cent needed just to keep up with population growth (UNCTAD, 2006). The oil exporting countries, which represent 27 per cent of African countries, are in a special category with above average growth. But the oil have-nots are also gaining from the present commodities boom. Recent figures from the World Bank show that 34 per cent of African countries have growth rates of 4.5 per cent or higher, 19 per cent of countries have growth rates of 3- 4.5 per cent, while 20 per cent of countries have growth rates of less than 3 per cent (Broadman, 2006).

The current external situation is more favourable than at any time over the last thirty years. How should this be exploited to achieve sustained economic growth and development? What are the implications for trade policy? The current commodities boom is generating significant wealth from extractive industry based on non-renewable natural resources. But the extractive industry will not produce sustained economic growth. It will not provide large-scale employment over a long period of time and, moreover, it will lead to further environmental degradation.

Therefore, African countries need to adopt suitable economic policies to transform the present boom into the development of a solid industrial base. They should invest the surpluses to add value to their natural resources and follow the successful Asian countries in processing their minerals by creating downstream industries. India provides a good example for its successful development of iron and steel industries (Subramaniam, 2005). But in crossing the bridge from primary commodity processing to industrialisation, African countries face many difficulties.[15] Designing a successful development policy will require a new balance between domestic industrial policy and trade rules. Capacity building will also be important in this field (Bonaglia and Fukasaku, 2007).

III. EPAs and multilateral trade rules

The choice of EPAs as the new trade policy framework must be understood within the framework of the multilateral trade system. The evolution away from the old, looser, GATT system to the tighter, rules-based, WTO has played a major role in shaping the EPA policy option. The transition from non-reciprocal trade preferences into a WTO-compatible regional trade agreement, is depicted in the matrix below. It provides an analytical device for showing how institutional constraints play a major role in determining the different levels of trade integration.

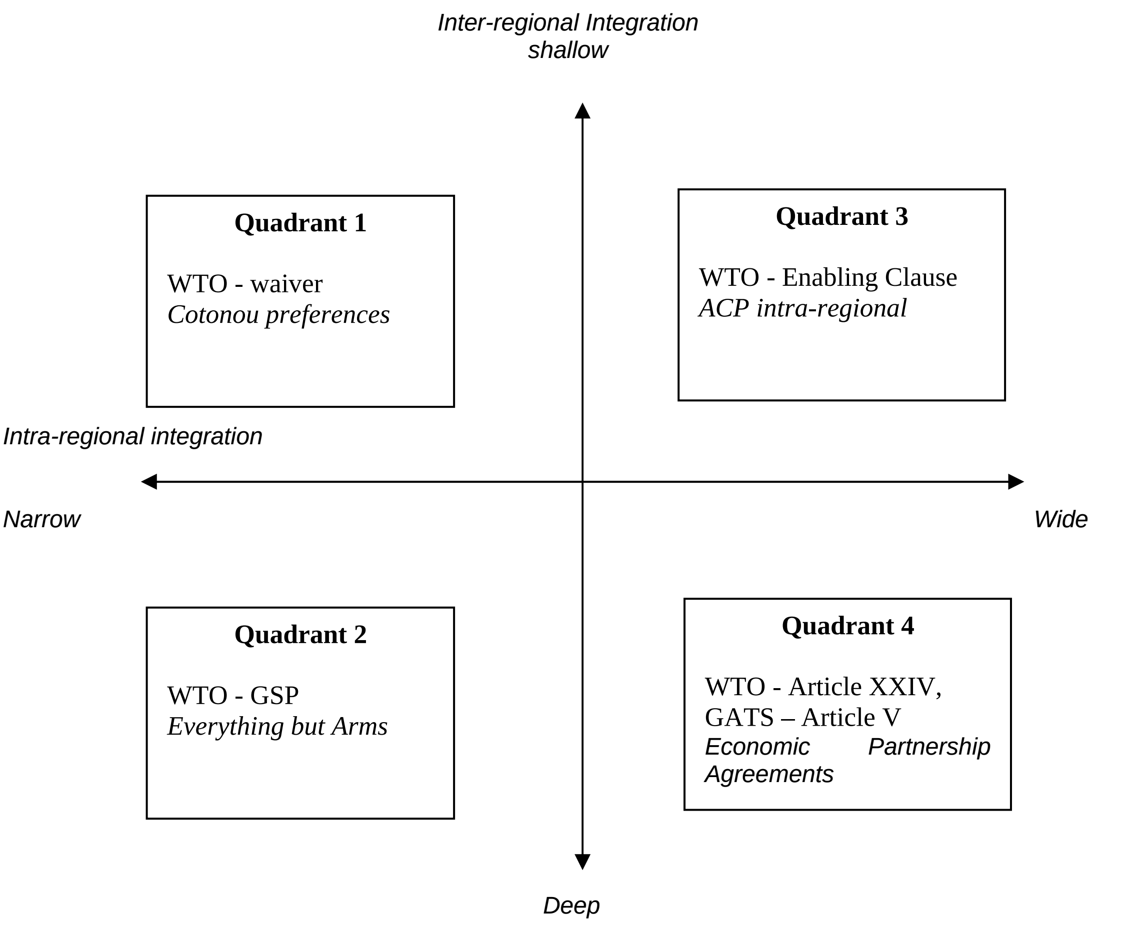
Quadrant 1 shows the current situation of non-reciprocal preferences for ACP countries to the EU market that are valid until the end of 2007. Rolled over from the Lomé regime, those special preferences have required a waiver from the WTO principle of non-discrimination. Since the EU is not prepared to pay the 'hefty price' (Mandelson, 2006) of a new waiver, this model of preferences has become unsustainable as it is threatened by increasing legal challenges in the WTO. The history of the waiver has shown that it does not provide adequate legal security for ACP trade policy. The WTO ruling against the banana protocol of Lomé was not based on development considerations. More recently, the WTO ruling against the EC sugar regime, although not targeted directly at development preferences, has adverse effects on ACP countries. The possibility of future legal challenges makes this an insecure basis for future ACP trade policy.

Quadrant 2 shows the deeper EU preferences under the 'Everything but arms' (EBA) initiative, which are available to all LDCs – both ACP and non-ACP countries alike. It is therefore consistent with the universalist principle of the WTO. It would not be possible for the EU to extend EBA treatment to all ACP countries under WTO rules. However, it would be possible to extend EBA market access provisions to all ACP countries within the framework of a

[15] Cramer (2003) analyses the special internal markets and international markets faced by African countries and as their market structure is very different from Asian countries, they can not simply imitate their policies.

regional trade agreement. This has been an implicit goal of the EU since the beginning of the negotiations but it has just recently made it explicit. It solves the problem of differential treatment embodied in the Cotonou agreement in a positive way by upscaling market access for non-LDCs (Hinkle and Schiff, 2004).

Figure 1: EPAs and WTO Compatibility



Quadrant three shows the process of South-South integration that is currently taking place in all of the ACP sub-regions under the Enabling Clause of the WTO. The latter provides for regional integration among developing countries but with less stringent conditions that allow a certain flexibility in the name of development. As North-South agreements, EPAs call for further liberalisation than would otherwise be required, thereby stepping up the pace and scope of the ACP's infant integration schemes. This is necessary to achieve the end goal of EPAs, which is full regional integration between the six ACP regions and the EU, under Article XXIV of the WTO. A key question here is the extent to which the ACP countries will be able to complete their own internal regional markets before opening up to the EU.

The transition from non-reciprocal preferences to a WTO-compatible RTA will involve a radical restructuring of ACP trade policies. The EU has always argued that EPAs represent the best possible option for ACP countries to become integrated into the world economy on a sound WTO legal basis. But, the fundamental dilemma still remains unresolved. The goal of EPAs is to foster development and reduce poverty while at the same time they must be WTO-compatible. Will compatibility compromise the objective of development?.

- *What compatibility entails*

Regional trade agreements are negotiated outside of the multilateral system but they must be WTO compatible. Because they are departures from the principle of MFN, they must be notified to the WTO and assessed for conformity with the rules. The Committee on Regional Trade Agreements (CRTA), established in 1996, was given the mandate to monitor and assess the conformity of RTAs with WTO rules. But even if an RTA has been judged to be compatible in the CRTA, it can be challenged by any WTO member at a later date. So there are good reasons to believe that the EU will adhere strictly to WTO rules.

WTO compatibility entails compliance with Article XXIV concerning trade in goods and Article V of GATS concerning trade in services. Unlike other WTO rules, Article XXIV has no ‘special and differential’ provisions for North-South RTAs.[16] The ACP countries have made a submission in the Doha round requesting that special and differential (S&D) provisions be included to Article XXIV (Onguglo and Ito, 2005) However, submissions from other members go in exactly the opposite direction, that is, existing flexibilities and loopholes should be tightened up.

The EU has endorsed the argument of the ACP group that there should be more coherence between the different categories of WTO rules relating to development. There is no *a priori* reason why S& D provisions should not be incorporated into Article XXIV. But the EU also calls for differentiation of rules governing large countries like China and India, and small countries like the ACP countries, which is a politically sensitive issue in the WTO. Given existing divergences, getting a consensus between WTO members on reform of the present rules will be difficult. Therefore, ACP countries cannot rely on reform of Article XXIV in the foreseeable future (South Centre, 2005).

[16] The Doha declaration called for a review of S & D measures in order to make them more effective and operational but very little real progress has been made so far in the negotiations.

- Trade in goods

The essential requirement of Article XXIV is the elimination of all 'duties and other restrictive regulations of commerce…with respect to substantially all trade' between RTA members. But in the absence of a clear legal definition, there is no agreement among WTO members on what a generally acceptable benchmark should be. EU practice to date has used a quantitative benchmark based on 'a percentage of trade' approach which generally covers 90 per cent of total trade existing at the time of the agreement. For EPAs, the EU proposes to liberalise 100 per cent of its own trade while requiring the ACP countries to liberalise 80 per cent of their trade. Averaging out to 90 per cent, this would allow ACP countries to exclude 20 per cent of their imports and to protect their most sensitive products.

The implications of this method as a tool for development needs to be thought through. Focusing trade liberalisation on actual trade flows may not be optimal for developing countries in the long run. The static nature of this approach locks out trade that currently does not exist, for example, agricultural trade that has been crowded out by protectionism, but that developing countries may legitimately expect to exist in the future. The situation is similar regarding trade in processed products that has been crowded out by high effective protection of tariff escalation. Furthermore, trade liberalisation is front-loaded so it restricts flexibility in the present and limits the options for opening up future potential trade that will emerge from evolving comparative advantage.

A solution would be to use a hybrid method combining a quantitative and qualitative benchmark. The latter, which has already been proposed by Australia in the WTO, would consist of 95 per cent liberalisation of all tariff lines under the harmonised system, at six digit level used in multilateral trade negotiations. From a range of some five thousand tariff lines, this benchmark would allow ACP countries larger exclusion lists and focus more liberalisation in the future than in the present. A combination of the two approaches would allow developing counties to achieve greater flexibility that what is currently offered under the EU approach.

- Trade in services

In the case of services, the General Agreement on Trade in Services (GATS) also provides for regional economic integration based on guidelines similar to that for trade in goods. GATS Article V agreements are required to provide for 'substantial sectoral coverage' and may not 'a priori' exclude any of the four modes of supply.[17] However, there is a development dimension in the GATS

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pertaining to agreements between developed and developing countries requiring less stringency on the part of the latter.

The GATS positive approach allows a country to commit to liberalise only those sectors that are specified in the agreement, as opposed to a negative approach which commits a country to open up all sectors unless specified in the Agreement. Developing countries have insisted on the positive approach to services liberalisation as it allows them greater flexibility in deciding when and what to commit to. There is still great uncertainty surrounding liberalisation of service sectors in the context of developing countries which calls for caution in undertaking the irreversible liberalisation that GATS lead to.

How much liberalisation of services will be entailed in the EPA? The EU has said that it will adopt a WTO consistent approach but in the absence of movement in the Doha round, there is growing uncertainty. African governments have underscored their need to establish strong regulatory frameworks before commiting to liberalisation and have urged the EU not to push for widespread opening (Van der Stichele, 2006). As one of the world's most competitive providers of services, the EU would make major inroads into the extremely weak service sectors of ACP countries if substantial liberalisation is pushed through. But on Mode 4, which is of special importance to ACP countries, liberalisation for greater mobility of temporary migration to allow guest workers into the EU is unlikely given hardening national attitudes to immigration and the lack of a common EU policy.

- Transition periods

The transition period for implementation of EPAs is of major importance for the adjustment process and its impact on development. Article XXIV lacks precision on transition periods, saying that the liberalisation should be completed within a 'reasonable length of time'. This has been somewhat clarified to say that it should not exceed ten years only in 'exceptional cases'. While the EU has proposed the ten year benchmark, sensitivity to development concerns would dictate that ACP countries qualify for exceptional circumstances, and they should be given a longer transition period. A reasonable time frame would be within a range of twelve years as a minimum and twenty years as a maximum for ACP countries. On the EU side, it is offering market access for trade in goods from the very beginning, but that simply reflects the fact that EPAs imply only minimal change for Europe. In services however, the ten year period has

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The four modes of supply are as follows.
Mode 1: Cross-border supply - Service delivered within the territory of the Member, from the territory of another Member
Mode 2: Consumption abroad - Service delivered outside the territory of the Member, in the territory of another Member, to a service consumer of the Member
Mode 3: Commercial presence - Service delivered within the territory of the Member, through the commercial presence of the supplier
Mode 4: Presence of a natural person - Service delivered within the territory of the Member, with supplier present as a natural person

been specified by the EU thus diminishing any development advantage for ACP service exporters.

- The new trade issues

The EU is determined to include the new issues of investment, competition and public procurement in EPAs, although they have been rejected by developing countries in the WTO. They have rejected investment in the multilateral arena because it would limit their ability to regulate the conditions of foreign inward investment. RTAs are now ignoring the international agreement accepted in the WTO and are regularly including investment. There is a real risk that investment standards are being imposed by powerful industrial countries regarding such matters as entry requirements, equity requirements, local content requirements, regulation of capital transfers, investment incentives, and most controversial of all, dispute settlement procedures.

It is worth recalling here that it was European countries who pioneered bilateral investment treaties (BITs) with developing countries in the 1960s. They have since been readily accepted by Asia countries, who have been most successful in attracting FDI. Host country governments were obliged to protect the private property of European investors but were not obliged to accept large scale liberalisation. They reserved their rights to selectively regulate foreign investment in the interest of promoting their own development.[18] Regarding competition, the first step towards international competition rules for the EU is that all countries should adopt domestic competition rules. Given their extremely scarce resources, ACP countries have to select absolute priorities. While the introduction of competition policies may be desirable in the long run, they are not essential for development right now and, moreover their introduction and implementation would impose significant costs on ACP countries.

IV. Aid for Trade

Development assistance is not a substitute for pro-development trade rules and neither will it make development happen. A healthy scepticism towards development assistance may be justified in the light of experience over the past fifty years. (Easterly, 2006). Notwithstanding how development aid has been used – and abused - by both donor and recipient countries in the past, there is an emerging international consensus that aid for trade is essential to balance the realisation of potential benefits from trade liberalisation and the adjustment costs (Page, 2005). The need for greater coherence between trade liberalisation and financial assistance has been recognised at the multilateral level in the context of the Doha round of trade negotiations.[19]

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[18] The European model of BITs is discussed in 'Trade and Investment', in Gavin (2001).

[19] Following the Monterrrez Consensus and the Gleneagles G-8 summit, the IMF and the World Bank were requested to prepare a report on the topic of aid for trade. They presented the report in September 2005.

EPAs are expected to induce considerable adjustment costs during the period of transition. Those costs will be borne by the private sector and will also have a major impact on the public sector through loss of tariff revenue. While debate about how the actual amount of costs continues, one authoritative study has placed them quite high (Milner, 2005).

The European Commission recognises the problem of adjustment but has argued that EPA negotiations as foreseen in the Cotonou Agreement are about trade negotiations only. They say that development assistance to ACP countries is channelled through the European Development Fund which has been allocated the sum of € 22.7 billion for the period 2008-2013. In response to growing criticism, the General Affairs and External Relations Council (GAERC) of member States agreed to provide an additional €2 billion to be explicitly used for support of the EPAs (Bilal, 2006). Critics have questioned the additionality of those funds describing the exercise as a rearrangement of existing categories, just robbing Peter to pay Paul.

The refusal to link trade liberalisation with adjustment assistance sounds disingenuous on the part of the EU given its own internal practice. Equitable development in the EU has not happened automatically but was achieved with a great deal of help from the Commission’s own internal development aid - better known as the ‘structural funds’. Since 1989, the structural funds to aid the development of the poorest countries and regions has become a key policy and the amount of funds has been significantly increased. Structural funds currently account for 4 percent of GDP in the poorest EU countries and that figure is expected to double over the next five years.

The challenges of adjustment facing ACP countries are far more serious for a number of reasons. They are starting from higher levels of tariffs and therefore, the required adjustment will be greater. Their economies are less diversified, with lower opportunities to expand into other sectors, so that the relative impacts will be greater. Capital markets are less efficient and, therefore less well able to cope with the financial implications of adjustment. National governments do not have the capacity to put the necessary adjustment policies in place such as safety nets and retraining of workers. Many ACP countries are small open economies, therefore very dependent on imports for their development.

Adjustment costs will include loss of fiscal revenue from tariff elimination, closure of domestic factories, and unemployment. Loss of fiscal revenue will be serious for many countries as import tariff revenue makes a considerable contribution and their overall tax systems are at a rudimentary stage of development. Furthermore, many ACP countries are net food importing countries, so that opening to EU trade could bring a surge of imports and higher prices for agricultural products threatening their food security.

ACP countries have expressed their concern about the present arrangements. Legally binding commitments in trade are matched by non-binding commitments in aid that are delivered through separate channels. Experience has shown that many aid promises in the past were not kept. Therefore, they have proposed two changes that they consider to be essential. There is need to increase existing resources and they want to establish a direct linkage between development aid and the EPA agreements.

Concluding thoughts on the development impact

The central question addressed in this paper is how the trade liberalisation programme envisaged under EPAs will impact on the development of ACP countries. A definitive answer to that question will, of course, only be possible after an ex-post impact assessment. So what can academic analysis provide today? What analytical tools are available to guide policy makers towards a more pro-development outcome, which is the stated aim of the EU. *'We have no mercantilist objectives in these talks and we should reassure the ACP on this count'* (Mandelson, 2006).

ACP countries have been marginalised in world trade and have suffered declining economic growth over the past three decades. At the same time they have undertaken significant economic reforms and trade liberalisation through the structural adjustment programmes of the international financial institutions and the multilateral trade negotiations in the WTO. So ACP countries have adopted outward-oriented trade policies and their economies are open to trade according to the internationally accepted standards of openness.

They should continue those trade policy reforms which minimise the taxation of imports and exports and make a significant contribution to economic growth. Furthermore, trade reforms should be continually and credibly implemented to enhance the stability of trade performance. But the main problem facing them is how to achieve sustained economic growth which is essential for poverty reduction. There are limits to what trade liberalisation can contribute to economic growth and more trade liberalisation may be even counterproductive

The inflated claims of EU trade officials about the benefits of trade liberalisation for poverty reduction show they are still thinking within the conceptual framework of the Washington Consensus. Addressing the ACP-EU Joint Parliamentary Assembly, Mandelson (2005) quoted directly from the World Bank to advocate a 'comprehensive' approach to liberalisation. *'If the EPAs provide enhanced market access to the EU, tear down external and intra-regional trade barriers in the regional EPA groupings, and reduce institutional frictions to trade, the development gains could be great'*. The IMF too continues to prescribe comprehensive trade liberalisation for Africa to promote a favourable environment for development (Gupta and Yang, 2006).

The fact is, however, that the vast majority of ACP countries, especially those countries in SSA experienced two decades of economic reform without growth in the eighties and nineties under the structural adjustment policies of the international financial institutions. As a result of that African countries have now significantly opened up to trade. The balance in practically all countries has shifted towards outward oriented, pro-trade policies. Still, despite the radical reforms in some countries like Ghana and Uganda, they are still struggling to recover their development levels of the 1970s. By contrast, countries, like Botswana and Mauritius, which have followed the more unorthodox trade policies have been far better growth performers.

Are Africa’s development problems today really problems of market access? The growth of African exports in recent years provide ample evidence that there is significant market access available in the world economy. The fact that the Doha round of multilateral trade negotiations has stalled has not prevented African countries from expanding into new markets – especially in Asia. Furthermore, African countries are diversifying away from primary commodities, like coffee, tea and cocoa, and are exporting fresh vegetables, processed food and horticulture. Kenya has become the second largest supplier of fresh roses in Europe after Holland. South Africa and Nigeria have started to export low to medium technology products. Exports of services are increasing, for example in tourism (Broadman, 2006).

And, despite the absence of a multilateral agreement on investment, African countries are attracting increased amounts of foreign investment, especially from China. Most of this investment has been in the extractive industries, but Chinese investors are now diversifying into other sectors such as clothing, agro-processing, electricity power generation, road construction, telecommunications and tourism (Broadman, 2006).

The real risk of EPAs is that the EU will use its economic leverage to impose comprehensive trade and investment liberalisation. Further openness would create an enabling environment for European companies but is unlikely to contribute to development in any major way. What ACP countries need to focus on is growth strategies. They need to be selective and to identify priority growth sectors, rather than to adopt a comprehensive programme of trade lberalisation. Each ACP and region will have to determine its own priorities and adopt its own specific growth strategies.

ACP countries now find themselves between a rock and a hard place as they strive to conclude EPA negotiations. The Doha round of negotiations has so far failed to make any satisfactory progress on development. In the absence of new pro-development rules, what is actually happening is a process of ‘competitive liberalisation’ though RTAs. This is reflected in the EPA negotiations. The signs point towards pressure for comprehensive, across-the board liberalisation in goods, services and investment. ACP countries should reject such an outcome and fight for policy space that would allow them to promote alternative growth strategies.

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