

# Trade, Investment and Regional Integration

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*By Oxfam*

## I. Introduction

During 2006, more than 100 developing countries were engaged in over 67 bilateral or regional trade negotiations, and signed over 60 bilateral investment treaties. More than 250 regional and bilateral trade agreements now govern more than 30 per cent of world trade, whilst an average of two bilateral investment treaties have been agreed every week over the last ten years.<sup>i</sup>

FTAs (Free Trade Agreements) pose a deep threat to multilateralism and the core values of the WTO. They directly contradict the Most Favoured Nation (MFN) principle, the cornerstone of the multilateral trading system. They create a maze of overlapping arrangements, leading to substantial trade diversion as countries discriminate against efficient, low-cost suppliers outside of the trade agreement in favour of less efficient suppliers from within the trading bloc. Costs of trade further increase as each agreement has its own rules of origin, tariff schedules, and periods of implementation.

African countries are entering new agreements in the expectation that FDI (Foreign Direct Investments) will increase as a result, but there is no evidence that this is the case. Brazil, for example, is one of the world's largest recipients of FDI but has not ratified a single bilateral investment agreement.<sup>ii</sup> African countries have between them signed over 1000 bilateral investment treaties, but receive less than four per cent of global FDI.<sup>iii</sup> Making it harder for investment to boost economic development

Flows of foreign investment entering developing countries are at an all-time high, worth \$334bn in 2005 alone.<sup>iv</sup> They are concentrated in a few industries, particularly oil and gas, telecommunications, financial services, and real estate and most FDI flows into a relatively small group of African countries.

Regional integration is a central plank of the Cotonou Agreement<sup>v</sup> and a key part of the development strategies of African countries. For Africa, regionalism can promote the pooling of resources, the expansion of markets, increased trade and investment, and greater diversification and value addition, and in turn reduce dependency on a small number of developed country markets. The EU has also recognised in its EPA negotiating mandate that 'economic and trade integration shall build on regional integration initiatives of ACP states'<sup>vi</sup> and 'shall take into account the regional integration processes within the ACP'.<sup>vii</sup> However, if regional markets are opened to EU imports before they have been consolidated, it will undermine, rather than reinforce, the regional efforts currently under way.

It is imperative that the EU uses the Comprehensive Review of the negotiation to seriously consider the proposals put forward by the African groupings, and to explore alternative arrangements. If EU-AU trade arrangements are to serve development, the least the negotiating parties should do is consider all options with proper assessment of their impacts, in order to be able to make the best choice. Member states need to give the Commission a clear message to conduct negotiations in a manner that fully respects the partnership and development objectives enshrined in the Cotonou Agreement.

## II. Regional Integration

Given the small size of most African economies and their tendency towards dependency on a few primary commodities, regional integration among groupings of developing countries can offer these countries mutually beneficial development gains. Such trade arrangements can promote the pooling of resources, expanded markets, increased intra-regional trade and investment, greater diversification and value addition. In turn they can reduce dependency on a small number of Northern markets and diminish vulnerability to a downturn in those markets. Moreover, in the longer term such regional projects could place countries in a stronger position to trade in higher value-added products on a more level playing field with major trading partners like the EU. African governments recognise these potential benefits, and currently a substantial majority of them are involved in varying forms of regional economic integration initiatives. **However, regional integration is still at an early stage in most regions, and opening to EU imports before regional markets have been consolidated could undermine rather than support the process.**

There are a number of reasons why advancing intra-regional integration within ACP blocs is a slow and complex process which needs to be allowed to go at its own internally-driven pace. For example, in most ACP sub-regions, adjacent states are largely confined to the production of the same limited basket of primary commodities for export outside the region. Market infrastructure and institutional frameworks tend to have an outward orientation, and the intra-regional enabling environments for trade tend to be weak. These realities add up to a lack of immediate complementarity of neighbouring states for intra-regional trade. Without first addressing these structural weaknesses in a way that leads to increased economies of scale and regional economic integration *within* developing-country negotiating blocs, there is little possibility of equitable economic exchange with an economic giant like the EU.

In order to ensure that sufficient regional integration and development occurs before liberalisation, the ESA (Eastern and Southern African countries) group has proposed to link the two. An essential clause in the ESA proposal is Article 19, 'Development Benchmarks and Review Clause', which proposes a five-yearly review of the EPA to assess whether it is indeed achieving its objectives: development (to be laid out in specified development benchmarks), and regional integration (building the ESA regional market). The ESA countries would be able to define when they would consider themselves to be ready for the next stages of market opening to the EU and would be able to postpone those stages if development or regional integration does not progress as expected.

The ESA group argues that to protect rural livelihoods and food security, as well as policy space for promoting development, at least 40 percent of products should be exempt from tariff liberalisation. Whereas the list of sensitive products that is to be proposed is a matter that still needs to be negotiated within the ESA group, ESA negotiators are suggesting informally that they are likely to propose around 40 per cent of sensitive products – based on criteria such as: “

- (i) Revenue contribution, for example to gross customs receipts;
- (ii) Importance of product/sector to the country's economy, e.g. contribution to employment, GDP, export earnings, food security, etc;
- (iii) Potential of the product/sector to economic development;
- (iv) Social, Health, Cultural and Religious reason;
- (v) Environment;
- (vi) Products enjoying domestic support/subsidies in the EU.”<sup>viii</sup>

### III. WTO Compatibility

The EC's interpretation of GATT Article XXIV on free trade agreements between one developed country, or regional bloc and another party is critical for the ACP to understand the negotiating parameters of EPAs. There is no definitive answer on the interpretation of Article XXIV in terms of levels of liberalisation or on implementation periods, as no WTO panel has interpreted these rules in relation to FTAs between such unequal partners as the EU and ACP. According to the Institute for Development Studies, "the EU has stated consistently in GATT/WTO committees that it believes the Article XXIV requirement that an FTA must cover 'substantially all' trade can be fulfilled if both parties reduce to zero tariffs on products that account for 90 percent on average of the current trade between them. It has also indicated that it believes this average figure can be achieved asymmetrically, with the EU liberalising on more than 90 percent and its partner on less."<sup>ix</sup> This is an extremely strict interpretation of the WTO rules that could jeopardise rural livelihoods and development.

Despite flexibilities in the WTO, the EU is insisting on its strict interpretation. The COMESA Secretariat states, that "it is expected that the divergences will emerge regarding the size of the sensitive list category, with the EC insisting that this would have to be "compatible" with the WTO rules. Although the EC is pushing developing countries very hard to open up, the EC has also indicated that it could have a sensitive list of its own, in particular, agricultural products."<sup>x</sup>

The EC has interpreted the 'reasonable length of time' to be 10 years, stating that it may be longer in exceptional cases.<sup>xi</sup> However, longer implementation periods are the norm not the exception. For example, even an FTA between developed country partners such as Australia and the US, includes up to 18-year implementation periods.<sup>xii</sup>

ACP countries need time to develop their domestic economies before opening up. The ESA draft, for example, proposes longer implementation periods than the EU has proposed: up to twenty-five years for finished goods, starting with a fifteen year implementation moratorium (Art. 14), as well as an unknown number of sensitive products to be exempt from liberalisation commitments (Art. 15)

### IV. Splintering regional groups

The EPA negotiations are splintering existing regional alignments and forcing ACP countries to choose the body through which they will negotiate with the EU. Within each EPA regional body,<sup>xiii</sup> there are problems of overlapping membership. This is particularly the case in Southern and Eastern Africa, where parties to the Southern Africa Development Community (SADC) Trade Protocol have split into three groups. Sixteen of the member states of SADC and COMESA are negotiating with the EU under the banner of the Eastern and Southern Africa (ESA) Group; the Democratic Republic of Congo is negotiating in the Central African Group; while the remaining members of SADC (Southern African Customs Union members Botswana, Lesotho, Namibia, and Swaziland, together with Angola, Mozambique, and Tanzania) are negotiating a completely separate EPA in the SADC Group. In addition, the Five East Africa Community (EAC) states (Uganda, Kenya, and Tanzania, Burundi and Rwanda) are split between the SADC and ESA groupings.

This complex realignment of regional blocs and the pace of negotiations that the EU is forcing on its former colonies will create serious difficulties for the harmonisation of liberalisation schedules. Because ACP countries have different priorities regarding the sectors they wish to protect from import competition and to preserve for the generation of tariff revenues, it is possible that each member of an EPA will select different products on which to liberalise. If regional groupings are not sufficiently harmonised before an FTA is launched, the EPAs will create new barriers to intra-regional trade.

## V. Regional partnerships under strain: inside or outside an EPA?

The presence of both LDC and non-LDC countries within EPA negotiating groups is also likely to produce difficulties for regional integration initiatives. Under the EBA arrangement, LDCs already have duty-free access to the European market for 'everything but arms', and therefore have little incentive to sign a further free trade agreement. In ECOWAS, for example, 13 of the 16 member countries are LDCs. However, if these countries choose to opt out of an EPA, but continue with the ECOWAS regional integration process, they will still feel the effects of EU imports entering their markets via their non-LDC regional neighbours.

The hidden dangers that free trade agreements with the EU pose for regionalism are illustrated by the case of the Southern African Customs Union (SACU). Although South Africa is a member of SACU, it has signed a free trade agreement with the EU — the Trade, Development and Co-operation Agreement (TDCA). While the agreement did not formally include the other members of SACU — Botswana, Lesotho, Namibia, and Swaziland — it has had a clear impact on them, effectively making them *de facto* members. Because of the SACU's common external tariff, the four countries will be forced to reduce their tariffs on imports from the EU at the rate agreed by South Africa. It is estimated that this could lead to a 21 per cent decrease in their tariff revenues, with Botswana standing to lose around 10 per cent of its total national income.<sup>xiv</sup> Similarly, the partners in any SADC EPA would effectively be accepting the import regime that South Africa has already agreed with the EU, unless they retained robust and costly border controls to filter out EU-originating goods coming into their country via South Africa.

The clustering of LDCs and non-LDCs within negotiating blocs is likely to produce even more difficulties. LDCs already have the Everything But Arms (EBA) arrangement, which allows them to benefit from market access into the EU without reciprocating. In ECOWAS, for example, 13 out of the 16 member countries are LDCs. Yet if these countries choose to opt out of an EPA, but continue with the ECOWAS regional integration process, they will still feel the effects of EU imports coming into their markets via their non-LDC regional neighbours. This presents countries with a grave dilemma and may actually increase regional tensions rather than promoting regional integration, given the wide disparities between the costs and benefits of EPAs for different countries in the same group.

## Concluding remarks and Recommendations

New investment rules in BITS (Bilateral Investment treaties) and FTAs (Free trade Agreements) prevent African governments from requiring foreign companies to transfer technology, train local workers, or source inputs locally. Under such conditions, investment fails to build national linkages, create decent employment, or increase wages, and instead exacerbates inequality. The investment chapters of free trade agreements and bilateral investment treaties allow foreign investors to sue for lost profits, including anticipated future profits, if governments change regulations, even when such reforms are in the public interest.

It is in nobody's long-term interest to have a global economy that perpetuates social, economic, and environmental injustice. In order to turn the tide and put trade and investment at the service of development, Oxfam believes that trade rules, whether multilateral, regional, or bilateral, should:

- Recognise the special and differential treatment that African countries require in order to move up the development ladder.
- Enable African countries to adopt flexible intellectual-property legislation that makes full use of safeguards to ensure the primacy of public health and agricultural livelihoods over patent rights, restricts the patenting of life forms, and protects traditional knowledge and biodiversity.

- Exclude essential public services such as education, health, water and sanitation from liberalisation commitments, and allow governments to effectively regulate the entry of foreign investors in service sectors to promote the public interest.
- Recognise the right of governments to impose capital controls on foreign investment and performance requirements that encourage joint ventures, technology transfer, and local sourcing, as well as incentives to improve labour practices.
- Include enforceable commitments by governments to protect and promote core labour standards, as set down in the ILO's Declaration on Fundamental Principles and Rights at Work, and commitments to progressively extend this to cover workers, particularly women, in precarious employment.
- Exclude agricultural tariff lines from negotiations when liberalisation threatens to undermine food security and rural livelihoods, and recognise the right of developing countries to use permanent safeguards that are triggered on the basis of both price and volume.
- Enable developing countries to use tariffs, subsidies, and other measures in support of industrial policy and to modify them as their economies develop.
- Ensure mechanisms for extensive participation of all stakeholders in the negotiating process, with full disclosure of information to the public, including the findings of independent impact assessments.

Such a shift can only come about through a change in political will and in the power imbalances, both between and within countries, that currently define trade negotiations.

The democratisation of trade policy, especially in developing countries, could transform the negotiating dynamic and the nature of the rules that result. Despite being utterly excluded from the process, civil society in many countries has effectively challenged trade and investment agreements and given voice to the needs of the disenfranchised.

Trade and investment are essential for development, and the imbalances that characterise and distort global trade and investment flows must be addressed as a matter of urgency. Unequal and exploitative trade and investment agreements, which prohibit the very policies African countries need to fight poverty, is no way to put trade and investment at the service of development, or to build a safer, fairer world.

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<sup>i</sup> UNCTAD (2006) 'World Investment Report 2006. FDI from Developing and Transition Economies – Implications for Development.'

<sup>ii</sup> M. Hallward-Driemeier (2003) 'Do Bilateral Investment Treaties Attract FDI? Only A Bit And They Could Bite', World Bank.

<sup>iii</sup> UNCTAD (2006), *op.cit.*

<sup>iv</sup> UNCTAD (2006), *op.cit.*

<sup>v</sup> The Agreement states that 'economic and trade co-operation shall build on regional integration initiatives of ACP States, bearing in mind that regional integration is a key instrument of ACP countries into the world economy' (Article 35 (2)), and that negotiations will take 'into account the regional integration process within the ACP' (Article 37 (5)).

<sup>vi</sup> EC EPAs Negotiating Guidelines, Article 35 (2), 2002.

<sup>vii</sup> *Ibid.*, Article 37 (5).

<sup>viii</sup> COMESA Secretariat, Brief on Market Access, prepared for meeting of Non-State Actors, Addis Ababa, 7-8 November 2006.

<sup>ix</sup> <http://www.ids.ac.uk/ids/global/pdfs/CSEPAHandbook2005.pdf>

<sup>x</sup> COMESA Secretariat, Brief on Market Access, prepared for meeting of Non-State Actors, Addis Ababa, 7-8 November 2006.

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xi European Commission (2005) 'Economic Partnership Agreements — Putting a Rigorous Priority on Development', memo, 20 January 2005. Brussels: European Commission. [www.europa-eu-un.org/articles/en/article\\_4245\\_en.htm](http://www.europa-eu-un.org/articles/en/article_4245_en.htm).

xii Bilal and Rampa, *Alternative (to) EPAs: Possible Scenarios for the Future ACP Trade Relations with the EU*, p. 26.

<sup>xiii</sup> The regional EPA negotiating bodies of the sub-Saharan Africa countries are the Economic Community of West African States (ECOWAS), the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), and the Central African Economic and Monetary Community (CEMAC). The Caribbean Forum (CARIFORUM) is the regional integration body for the Caribbean states, while the Pacific ACP Group represents countries in the Pacific region.

<sup>xiv</sup> C. Grant (2006) 'Southern Africa and the European Union: The TDCA and SADC EPA', TRALAC Trade Brief, No. 1/2006.