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Economic Partnership Agreement (EPA) is the last nail in the coffin for Industrialization and development of low-income countries

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The Economic Partnership Agreement (EPA) which is negotiated between EU and ACP countries can have more devastating impact on industrialization and development of low-income countries than the 5 percent rules imposed on colonies during the colonial era. It will lock the Least Developed and other low-income countries; particularly least developed ones (LDCs) in production and exports of mainly primary commodities and at best in some labour intensive industries and assembly operations.

LDCs have severe production supply problems for manufactured products. While market access to other countries is necessary for supplying their export product, a reciprocal free trade agreement destroys their potential for expansion of supply capabilities of their manufacturing sector. Their industrial base is small and weak to compete with products of established foreign industrial firms (mostly large TNCs, a 1000 of which account for about 80 percent of world industrial output) in the internal and external markets.
The importance of supply capabilities is indicated in the lack of the ability of the majority of LDCs to benefit from the GSP (General System of Preferences) scheme, which provides generous preferential market access for their exports to developed countries. As evident in the following table only nine LDCs, out of about 50, accounted for between 96 to 99 percent of exports of LDCs to main developed countries under the GSP scheme. Further, 5 countries, out of 9, were the main exporters.

Albeit EPA offers better Rules of Origin (ROO) for a single transformation unlike under the Everything But Arms (EBA) arrangement, the component of a reciprocal free trade agreement between unequal partners. These are countries with no or little industrial base and European countries which are already industrialized would create imbalance in the gains that would accrue from the FTA. Likewise, EPA would restrict the policy space in case of a need for emergency safeguards (for only two years) and other necessary government interventions. Nevertheless, EU seems to threaten that if the ACP countries do not ratify the agreement, their preferential access to European markets will be withdrawn. And if they do ratify EPA, their preferential market access will be lost in 5 to 10 years anyhow, while non-LDCs try to preserve their preferential market access.

Table 1: Share of the top five preference receiving LDCs in total GSP exports from LDCs to the main developed country markets in early years of the decade, 2000-2010

Receiving country/group	Five countries	Share of 2 main countries		Other countries	
USA	99	Angola	87	Equatorial Guinea, Yemen, Bangladesh	8
		Congo	4		
		Total	91		
EU	98	Bangladesh	81	Nepal, Lao PDR, Yemen	9
		Cambodia	8		
		Total	89		
Japan	89	Cambodia	25	Mauritania, Myanmar, Zambia	40
		Bangladesh	24		
		Total	49		
Canada	96	Bangladesh	47	Haiti, Maldives, Malawi	24
		Nepal	25		
		Total	72		
Total countries		5		9	

Source: Based on Puri, 2005

As far as policy space is concerned, according to the EU proposal, zero tariffs would be applied to 80 percent of tariff lines of LDCs in 15 years. The remaining 20 percent covers “sensitive products” which include mostly agricultural items. Thus the industrial goods will be subject to free trade after 15 years. As far as agricultural goods are concerned, although some tariffs are allowed, imports of heavily subsidized agricultural goods from EU (through Common Agricultural Policies-CAP) and the USA to LDCs will undermine development of agriculture in LDC countries. In 1998, the total amount of support provided to OECD agriculture (which accounts only for about 4 percent of their GDP in the same year), amounted to US$ 362 billion, which was about 14 times higher than the total exports, including petroleum, of LDCs in the same year. Over time the amount of subsidies paid to the agricultural products of OECD, particularly exports have increased (Shafaeddin 2005a: 183). For example, according to the 2008 Farm bill of the USA the amount of subsidies paid to exports of agricultural products of the country was to be nearly US$57 billion per annum which amounts to over 69 percent of the value of the exports of agricultural exports of the country in 2005 and yet higher than the allocation of about US$50billion in 2002 (Shafaeddin 2010. 181).

The case of the Chicken industry in Ghana is a clear example of the negative impact, on the domestic production, of the combination of removal of import tariffs by the country and imports of subsidized chicken from EU. After the removal of the tariffs, the price of imported subsidized chicken was below the cost of production in the domestic market. As a result, the share of the domestically produced chicken in Ghana’s consumption of the product fell from 95 percent to 11 percent (TWN).

This policy brief is an extraction of the paper “Prospects for and obstacles to industrialisation and development in Least Developed Countries” presented at the International workshop on the “Economic Perspectives of Least Developed Countries” held at EPRC Conference Centre, Kampala-Uganda on May 24-26, 2011. The workshop was organized by Economic Policy Research Centre, Makerere Business School and HTW Berlin – University of Applied Sciences.

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No flexibility is allowed by EU for the policy space of the partners. For example, ACP's tariff lines are supposed to be bound not only for 15 years but also afterwards when 80 percent of their tariff lines will be fixed at zero rates. Yet more, the agreement also contains a standstill clause on tariffs. In other words, no new custom duty can be introduced except for some items in the sensitive list. Although for the first 15 years temporary infant industry protection will be allowed, it cannot be used ex-anti, as a tool of industrial policy. It will be allowed "ex-post" as a safe-guard measure. In other words, if there is a serious injury, or threat of injury, to an industry, the importing country may under certain conditions apply protective measures for two years. Nevertheless, even then the country will not have autonomy to do so because it has to consult the EU beforehand, implying that the approval of EU would be required! It is interesting to note that by contrast, EU has the right to increase its tariff beyond the bound rate in case the import price of some products of interest to the member countries declines! Talk of double standards!

The tariff structure to be imposed on ACP would lead to the loss of their policy space. The experience of both developed and developing countries indicates that consolidation of an industrial sector will take far longer than 15 years. Further, during the course of industrialization a country needs a flexible and dynamic tariff structure to alter individual tariff rates applied to different categories of industries, that is, consumer goods, intermediate goods and capital equipment (Shafaeddin 2005b).

The experience of developing countries during the colonial era as well as more recent decades indicates that pre-mature trade liberalization leads to de-industrialization (Shafaeddin 2005a, 2006 and 2011a). In the particular case of LDCs, there is evidence indicating that the pre-mature and across-the-board trade liberalization of recent years has led to de-industrialization (Shafaeddin, 2009). Table 2 provides some evidence in this respect.

Table 2: MVA/GDP ratios of LDCs (1990-2008)

Year	All	Africa	Asia	Islands
1990	10.5	9.7	12.0	6.6
2000	10.2	7.7	12.6	7.2
2008	9.8	7.6	13.9	5.9

Source: Based on UNCTAD, LDC Report, various issues

If the EPA is ratified, the loss of policy space and policy autonomy will not stop at import tariffs. First, export taxes cannot be increased either. Again to impose new taxes on new items should be negotiated with the EU authorities. Thus the loss of export taxes together with import duties (which together account for more than 76 percent government revenues in some LDCs) would lead to the loss of important sources of government revenues necessary for financing economic development but also limiting of local industrial processing and development.

Second, the proposed EPA, includes a number of "WTO plus" conditions and so-called Singapore issues such as liberalization of capital flows, financial and other services and government procurement (an important source of demand for domestic firms) as well as competition policy. For example, in procurements by the government, no preference should be given to local firms despite the fact that they are in unfavourable competitive position vis-à-vis TNCs. Yet, EU firms will have free hands in investment. Therefore capacity building of infant local firms will be undermined. Further, any preference given to other countries by a LDC country (for example, through regional agreements) is to be given to EU through the MFN (Most Favoured Nation) clause.

Even if a country (say A) does not sign EPA, it will suffer from its negative impact because of the inflow of EU products through its regional borders with countries which are involved in regional FTAs with country A and sign EPA. As there will be no control on imports, the rule of origin will not apply in this case.

In short, the countries which ratify EPA will lose policy space for their long-run industrialization and development. They will be locked in the production and exports of primary commodities and at best in assembly operation of some light manufacturing products. Moreover, they will also be exposed to more external shocks and global business cycles and competitive pressure of TNCs. The result will be further de-industrialization, human misery and tragedy.

To avoid such an outcome, and to develop production capacity in the industrial sector, at least in the case of medium and large size countries which have some potential for industrialization, LDCs should formulate their own industrial strategy (see also Shafaeddin 2011b) LDCs. And to be able to implement it they should resist further loss of their policy space through EPA and/or NAMA, international financial institutions and bilateral trade agreements. As far as EPA is concerned, they should push for an agreement which allows a dynamic industrial policy and step-by-step trade liberalization as the LDCs develop. If this does not become feasible they should walk-out of the negotiation as no agreement is better than a bad agreement which will not be conducive to their industrialization and development. All-in-all, According to the South Centre, the benefits of no-EPA scenario will be greater than its cost (South Centre 2011). Of course; there is also a need for changes in practices of donors, international financial institutions which are under the control of developed countries.

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