

**Free Trade Areas as a Model  
for Future EU-ACP Relations**

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## 1. Introduction

In November 1996, the European Commission published a green paper containing options for the future shape of the EU-ACP co-operation. (European Commission, 1996) Two main directions could be discerned<sup>1</sup>: coverage of ACP exports by the EU's Generalized System of Preferences (GSP) or the introduction of uniform or differentiated reciprocity. The first option may be attractive for the least-developed ACP, as their preferential position remains the same, for as long as they remain least developed. However, the GSP is unilateral and the preferential margins fall as the general and sectoral competitiveness of the beneficiary countries increases. The ACP group was not in favour of the GSP solution. The group first aimed at maintaining the *status quo*, and, realising that this position would be unproductive, subsequently accepted the principle of reciprocity, embodied in Free Trade Areas (FTAs) (ECDPM, 1998).

The FTA approach to the renewal of the Lomé Convention presents a number of questions. The first is, whether FTAs between the ACP countries and the EU will produce better results than the present system. Second, even if promising on theoretical grounds, is it likely that (groups of) ACP countries will be able to conclude viable FTAs with the EU? This paper will address the former question and provides an economic analysis of the FTA approach for the future EU-ACP relations, while limited attention will be paid to the latter question. The composition of the paper is as follows. In the second section the background for the new approach is given. The third section presents the economic theory of integration in order to explain the effectiveness of the present and the new approach. The fourth section formulates the conditions that have to be met to make FTAs successful. The fifth section addresses the question whether the new approach will work in practice. Conclusions are drawn in section six.

## 2. Background of the new approach

Why is the EU so much in favour of reciprocity, and more particularly in favour of

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<sup>1</sup>The option of the *status quo* is clearly unacceptable for the EU, as will be argued below.

FTAs? For a long time, the EU has been a zealous defender of non-reciprocal preferences. In the early 1970s the EU considered itself to be an innovator of trade policies that would promote development through the granting of non-reciprocal trade preferences. The Community was the first to introduce a GSP in 1971 and the first Lomé Convention was hailed as a model for North-South co-operation in 1975. (Babarinde, 1994) The Mediterranean non-reciprocal preferences were introduced in the same period. Twenty years later there is widespread disappointment with respect to the effects of the preferences. This is mainly due to the fact that there seems to be an inverse relationship between the degree of preferential treatment and the rate of economic development. The countries in Asia and Latin America that were later indicated as Newly Industrialized, exported to the EC under the GSP - the least generous preferential system - while Sub-Saharan Africa and Mediterranean countries could export under the far more advantageous Lomé and MENA preferences. As table 1 shows, the latter two groups lagged far behind in economic growth when compared to the average growth of the low and middle income countries.

Table 1 Average annual percentage growth of Gross Domestic Product in low and middle income countries, 1980-97

Country group	1980 – 1990	1990 - 1997
Low and middle income	3.0	2.8
East Asia and Pacific	7.8	9.9
Latin Am. & Caribbean	1.8	3.3
South Asia	5.7	5.7
Middle East and Northern Africa (MENA)	0.4	2.6
Sub-Saharan Africa	1.7	2.1

Source: World Bank, World Development Report 1998/1999, Oxford 1998

Much earlier than the second half of the 1990s, many empirical studies concluded that these trade preferences would have insignificant effects on economic development.<sup>2</sup> Table 2 sheds some light on the effectiveness of the trade preferences of the EU, although we should be careful in drawing conclusions.

Table 2 Trade between the EU and developing countries as percentage of total trade 1976-1994

	1976	1980	1985	1990	1992	1994
Share of Imports from outside EU (%)						
ACP	6,7	7,2	6,7	4,7	3,7	2,8
Asia	4,2	5,9	6,5	11	13,6	13,1
Latin America	5,3	5,1	6,5	5,6	5,1	5,4
Mediterranean	6,1	6,1	8,1	6,5	6,2	6,1
All LDCs	44,8	42,4	34,7	31,2	29,9	34,2
All non EC	100	100	100	100	100	100

source: EUROSTAT (1996)

Table 2 shows that developing countries as a group - as well as the MENA countries - have not been able to increase their market share in EU imports despite substantial non-reciprocal preferences. Most dramatically, the market share of the ACP countries has declined over the years. The loss of market share is striking since these countries have received the highest level of preferences.

Why have the non-reciprocal preferences not produced the effects the EU hoped for? The first reason for this is the reduced relevance of preferences in world trade. The value of preferences is undermined by reduction of MFN tariffs under the various GATT rounds and by the FTAs that the EU has formed with more developed regions. Yeats (1994) measures the value of preferences by calculating the loss in export revenue if all OECD MFN tariffs would be reduced to zero. For SSA countries he calculates a loss of \$4 bln.; this would imply for most of these countries a loss of no more than 1 per cent of GDP. Given such low values of benefits, it is hard to expect a strong causal link

<sup>2</sup>See for reviews on empirical studies Faber (1990) and OECD (1995). For the EU see McQueen and Stevens (1989), Page and Davenport (1994); for the US see USTC (1983) and Sapir and Lindberg (1984); for OECD see Yeats (1994).

between non-reciprocal preferences and development.<sup>3</sup>

The second explanation is that domestic supply conditions have much more impact on development than the demand effects of produced by non-reciprocal preferences. Evidence from a recent research programme of the World Bank (Amjani and Yeats 1995, Ng and Yeats 1996) suggest that African countries' own policies are to blame for the failure to create the conditions to take advantage of preferences. In many developing countries supply side conditions are bad because of perverse government intervention, obscure economic decision making, failure to apply market mechanisms for allocation and lack of efficient property rights. One of the most important supply restraints in developing countries is that many of them have not gone to great efforts to liberalise their economies and reduce barriers to trade. It can be argued, that the non-reciprocal preferences enabled the preferred partners to shield their economies from international competition and to maintain inefficient structures of production, while the demand effects were insufficient to have significant effects on production as a result of low and falling preferential margins. The overall effect has been that the preferred partners have not been able to link their export structure to the changing composition of EC imports. The ACP in particular continued a heavy reliance on primary products while these products showed a falling share of EC imports (Stevens, 1999).

In addition to disappointing results from the non-reciprocal trade preferences, there is increasing resistance in the WTO against the non-reciprocal preferences for the ACP group (European Commission, 1996, p. 18). The fourth Lomé Convention received a GATT waiver for its incompatibility with the non-discrimination principle of Art. I GATT. The ongoing banana dispute, has induced the WTO to say that non-reciprocal preferences will in the future not receive a waiver any longer. Although it is questionable whether there is such a close link between the banana case and the Lomé preferences (Thomas 1997), the inconsistency between Lomé and GATT/WTO law has already been established a long time ago (Blokker et al. 1990). The main arguments are first that the Lomé preferences cannot be justified under the Enabling Clause as they discriminate among developing countries on geographical grounds; second, this preferential system cannot be presented as an FTA as it is non-reciprocal. The

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<sup>3</sup> However, Yeats analyses this in the context of net gains for developing countries because of lower MFN tariffs.

reinforcement of the supervision of Art. XXIV GATT will bring to bear more pressure on the EU to make its preferential systems GATT compatible, which means 'regionalised economic partnership agreements' that provide for the gradual establishment of free trade areas (European Commission, 1997).

### 3. The theory of FTAs

The economic theory of preferential treatment is narrowly related to the theory of economic integration, as trade preferences use reductions of trade barriers in a discriminating way as is the case in FTAs and Customs Unions (CUs). FTAs and CUs are reciprocal, while the traditional EU preferences for exports from developing countries are non-reciprocal.<sup>4</sup> The potential effects of FTAs and CUs are best shown by customs union theory (the highest form of reciprocal free trade). Viner (1950) shows that a CU affects trade in two ways. First, countries gain from preferences because of the trade creation effect. This takes place if a tariff reduction in favour of the partner country allows high-cost domestic production to be replaced by more efficient production imported from the partner country. Second, countries lose from a CU because of trade diversion, which arises if trade shifts from sources that have a comparative advantage to sources that have preferential access to markets. Two extensions of Viner's analysis are relevant. Lipsey (1960) has developed the concept of positive consumption effects that arise if a CU leads to lower prices for consumers. Another extension has been made to account for FTAs in particular. The absence of a common trade policy in an FTA can give rise to indirect trade deflection. This occurs if a member country characterised by relatively high trade barriers, shifts its imports from the world market to the partner, while the latter country - having relatively low trade barriers - enlarges its imports from the world market (Pelkmans, 1997). In practice, this means a shift of tariff income from the first to the latter country.

A country gains from participating in an FTA if the trade creation and the

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<sup>4</sup>The tradition of non-reciprocal preferences dates back to the first half of the seventies. In that period, the EC introduced the non-reciprocal GSP, the non-reciprocal Mediterranean preferences and substituted the reciprocal association agreements with former African colonies in Africa for the present - nonreciprocal - Lomé Convention (Faber, 1982).

consumption effects outweigh trade diversion and indirect trade deflection. For this to happen three conditions are important. First, FTAs must result in a substantial fall of intra-FTA trade barriers. In that case, the price reduction resulting from preferential access has large trade creation effects. Second, if trade shifts to sources that are efficient (nearly as efficient as the most efficient producers on the world market), trade diversion and indirect trade deflection do not hurt very much. Third, indirect trade deflection will be absent if the high tariff partner simultaneously lowers its tariffs (and other trade barriers) to the level of the low tariff partner. Therefore, countries that join an FTA that consists of efficient producers are likely to gain from preferential trade, particularly if they lower their trade barriers on imports from third countries at the same time.<sup>5</sup>

The trade creation, trade diversion, trade deflection and the consumption effects are static welfare effects of integration. Are these static welfare effects generally considered as being small, in the long run dynamic welfare effects are more important. First, trade may create positive production externalities in developing countries. If companies in these countries can produce more, they can create economies of scale and 'learning by doing' effects. Second, preferences will change the competitive environment in which firms operate. For instance, this will reduce X-inefficiencies because of foreign competitive pressures and it will reduce domestic market power of firms.

The economic theory of preferential trading areas gives additional underpinning for the lower than expected results from the non-reciprocal preferences, as was presented in section 2. First, the positive static and dynamic effects of preferential trade derive from falling prices and more competition in the importing country. In a situation of non-reciprocal trade preferences, the welfare improving trade creation and consumption effects will not occur in the preference-receiving countries as these countries do not reduce trade barriers, as a result of which prices of imported products would fall. On the contrary, developing countries have relatively high trade barriers and the ACP group in particular, as will be shown below. The main beneficial effects from the non-reciprocal preferences were to come from trade creation and diversion in the

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<sup>5</sup> This is likely to cause problems in the area of agricultural trade. EU producers are not well known for their efficiency.

EU, which would raise import demand for the products from the preferred partners.<sup>6</sup> This is in fact an adapted version of the Infant Industry Argument. Like that argument, the reasoning for non-reciprocal preferences may backfire as well. If countries create industries in which they do not have a comparative advantage but which are only based on preferential market access, preferences have to be kept in place indefinitely and create vested interests to keep them in place. Second, in the case of non-reciprocal preferences the dynamic effects in preference receiving countries are limited. As competition is not increased by lower trade barriers, economies of scale in export industries are the only source of potential dynamic effects. So on theoretical grounds, it was not realistic to expect very large effects on economic development, unless there were other strong factors, such as large preferential margins.

#### **4. Conditions for success**

The main reason for the less than satisfactory results of non-reciprocal preferences is that they have not been able to improve supply conditions in ACP countries. Are there reasons to believe that FTAs will perform better?

A first potential reason for FTAs to perform better is that the ACP countries will have to open up their economies for competition from the EU which will improve efficiency. This will bring direct welfare gains in the form of trade creation and consumption effects. These effects could be substantial as many of these countries have relatively high trade barriers. E.g., the average tariff of many Sub-Saharan African countries was higher than 20 per cent, while the incidence of non-tariff measures stood at 46 per cent at the end of the 1980s. (Rodrik, 1998) The dynamic welfare effects will be substantial for the same reason. It will rationalise (state) monopolies and force domestic firms to produce more efficiently.

The second potential improvement lies in the fact that increased cooperation and economic relations under an FTA may improve domestic market institutions in developing countries. This can be enhanced if the EU supplements it with deeper economic and political integration. Experience with FTAs in Central and Eastern Europe shows that FTAs in many cases include the 'export of institutions and

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<sup>6</sup> However, trade creation in the preference donor is likely to be limited. We will return to this later.



regulation'. Vogel (1995) shows that in a climate of trade liberalisation, countries will harmonise their standards towards the level of the countries with the highest standards.<sup>7</sup> If the EU takes an active stance not only in economic, but in legal (competition) and technical (standards) cooperation as well, the benefits from FTAs will be increased considerably. In addition to these arguments, it is argued that an FTA increases the credibility of governments in their structural reform policies. As a result of the long term reciprocity, liberalisation of trade in goods and services, of capital flows and the reform of institutions and regulation cannot be rescinded as easily as was the case in Structural Adjustment Programmes. (Collier and Gunning, 1995) This anchor function is considered to be an important advantage of FTAs over non-reciprocal preferences (Francois, 1997).

Ethier (1996) shows that FTAs aim at locking in the less developed partner's economic reforms and stimulate foreign direct investment. He argues that preferences and regional integration may have a dynamic effect on economic development. If reforms are successful and attract an inflow of FDI, countries gain competitiveness. However, if more countries reform simultaneously, they compete for FDIs. Trade preferences by an industrialised country to a particular developing country ensures that the FDI flows to that partner. Therefore, reciprocal preferences ensure the success of reforms and offer the incentive for other developing countries to follow.

The third potential improvement is that FTAs can have direct positive effects on the supply side of the economy by stimulating foreign direct investments from EU countries. If the stability of the relationship is enhanced by multilateral commitment, preferences are more stable and uncertainty in trade relations is reduced. This stability makes it more attractive to invest in production facilities in developing countries. Reciprocal trade liberalisation will help investment flows as well. One of the difficulties of foreign firms in developing countries is that the import of intermediate goods is expensive and prices are unpredictable due to high and erratic barriers to trade. This more stable, less risky and transparent free trade may stimulate EU firms to invest.<sup>8</sup>

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<sup>7</sup> The so called California effect. Many US states have implemented very tough Californian product standards as competitive advantage.

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However, FTAs may have disadvantages as well. The first is the economic restructuring that will follow upon the liberalisation of trade in goods, services and capital. The gains from liberalisation can only be reaped after a shrinking of inefficient lines of production. This process will be painful, the more so as employment and welfare levels are low in most ACP countries. It can reasonably be expected that production will decline in the heavily protected manufacturing and service sectors. The restructuring is less painful the quicker production and employment expand in other sectors. In theory, this could happen in those sectors where the ACP have comparative advantages and the capacity to expand production quickly: labour intensive manufactures and agricultural products. An improvement of market access to the EU for these product categories would assist short term results.

A related danger of an FTA lies in the political economy motives for conducting them. In political economy models governments are not driven by maximisation of welfare (utility) but by economic and political self-interest considerations. Most modern political economy models derive from Grossman and Helpman (1994) who argue that policy making by incumbent governments is influenced by lobby groups. Because producers are better organised than consumers, for a government the potential losses to producers from free trade are more important than the gains to consumers. Gains to producers from protection count for governments: companies have higher profits from protection, but more importantly, these gains are transferred to government in the form of political support. Grossman and Helpman (1995) show that FTA negotiations are prone to pressures that may result in significant trade diversion but will have limited trade creation effects. Domestic import competing producers will be hurt because of trade creation: prices will go down. However, trade diversion will not hurt, because the shift in the source of imports will in itself have no effect on prices. It is clear that domestic import competing producers agree with FTAs if trade creation is small (or if they can gain rents from acting as importers). If these import competing lobbies are politically powerful, governments will “swap” trade diverting arrangements and the FTA will result in a significant welfare losses through a deteriorating allocation of

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FDIs. Trade preferences by an industrialised country to a particular developing country ensures that the FDI flows to that partner. Therefore, reciprocal preferences ensure the success of reforms and offer the

resources.<sup>9</sup> Such FTAs will not pave the way for multilateral liberalisation.

The conclusion is, that there are three crucial conditions for the success of FTAs with ACP countries. First, FTAs have to improve supply conditions in the ACP countries. For this to happen, the level of protection in those countries has to come down and FDI to these countries have to increase. Second, market access for ACP exports has to be improved in order to produce quick results that lessen the restructuring pains of trade creation. Third, lobbies that lose from trade creation should be prevented from capturing the new reciprocal agreements. Parallel or previous multilateral trade liberalisation will make trade diversion and indirect trade deflection less likely.

## **5. A look in the future**

This section will shed some light on the question whether the criteria formulated at the end of the previous section are likely to be fulfilled. In its proposals for a negotiating mandate, the European Commission (1997) suggests to follow a two stages procedure. First, an overall agreement would establish the objective and framework of the ACP/EU co-operation, viz. to reach economic co-operation agreements with the three ACP regions "and name the regional sub-groups and non-LLDC ACP countries undertaking to negotiate economic co-operation or partnership agreements during the second stage of the negotiations". Negotiations with these regional subgroups take place in the second stage. The first stage would end in 2000 at the end of the present fourth Lomé Convention. The second stage - during which the existing Lomé preferences will be continued - would end in 2005 with the conclusion of regional partnership agreements, including FTAs.<sup>10</sup> A transition period of ten years would be needed to put the FTAs fully in place. As partners for its subregional partnership agreements, the Commission mentions the West African Economic and Monetary Union (UEMOA), the Customs and Economic Union of Central Africa (UDEAC), the Southern Africa Development Community (SADC), the East African Community (EAC) and the Caribbean Common

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incentive for other developing countries to follow.

<sup>9</sup> This may explain the sequencing of trade liberalisation in the MENA agreements as indicated above.

Market (CARICOM) as candidates for subregional FTA agreements. However, SSA countries have established many other Preferential Trading Areas (PTAs), such as the Community for West African States (ECOWAS), the Economic Community for Central African States (ECCAS), the Mano River Union (MRU), the Community of Eastern and Southern African States (COMESA), the Southern African Customs Union (SACU) and the African Economic Community (AEC) (Aryeetey and Oduro, 1996).

These SSA integration bodies, or some of them, will have to carry out the negotiations on FTAs with the EU and will have to implement these agreements. Furthermore, these organisations are responsible for the trade policy with respect to third countries, as most of them strive after common markets leading up to internal liberalisation of trade and payments and a common external tariff (Johnson, 1995). However, SSA regional integration shows a number of problems. Although a large number of arrangements has been signed - or perhaps because of this - they have failed in most cases "to provide tangible results - in terms of trade creation, factor mobility, or policy coordination" (IMF, 1996). Basically, many of these organisations are rather ineffective due to lapses in implementation, overlapping membership, reluctance to lose sovereignty, and conflicts about the distribution of gains and losses (Johnson, 1995). One reason for the slow process is, that the direct stimulus on economic growth from SSA PTAs is small as a result of the high concentration of SSA exports in a few products that do not correspond to import needs, and the state of transport infrastructure (Yeats, 1999).

One of the main difficulties in getting the SSA CUs operational is to reach agreement on a common external tariff. A simple rule should be agreed to. "But African countries, in light of considerations related, *inter alia* to infant industry assistance and industrial development policy, tend to opt for differential nominal tariffs and effective protection. Given the economic structure and the state of development of the various countries concerned, different schedules of tariff rates have dissimilar implications for comparative advantage of countries in the community/union" (Johnson, 1995: p. 214/15). If the countries concerned have so many problems in arriving at a common external tariff and internal free trade among themselves, is it realistic to expect them to collectively agree to FTAs with the EU which will bring about much more competition

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<sup>10</sup>This depends on a new waiver of the WTO for the second stage.

in their domestic markets than the SSA PTAs would do?

The answer is, that the EU has more to offer for participating countries, than SSA PTAs can do: a large market, financial support and political prestige of belonging to a FTA with the EU. Still it is questionable whether this will be sufficient to bring about effective SSA PTAs, that are willing to enter into FTAs with the EU. The Economic Commission for Africa (ECA) and the Organization of African Unity (OAU) have been trying to realize African PTAs since the Lagos Plan of Action was adopted in 1980. Additionally, it can be argued that many SSA countries would not suffer very much if they would lose the present trade preferences, as so much of their exports to the EU have zero tariffs anyway<sup>11</sup> (Yeats, 1994; ECDPM, 1999). This deprives the EU of part of its negotiating power. The result could well be, that FTAs are concluded first between the EU and some individual countries (e.g., Nigeria and South Africa) and that FTAs with SSA PTAs will be realized later as they have managed to agree on internal free trade and on their external trade policy. This is the procedure followed in the wake of the 1995 Barcelona Declaration. New reciprocal FTAs have been concluded between the EU and certain individual countries in the Mediterranean region while negotiations are going on with other countries in the region. In 2010, an FTA comprising the EU and all Mediterranean countries will have to be realized according to the Declaration, which in fact will create a Pan-European-Mediterranean FTA. However, the economic and political difficulties that are in the way of this FTA are not to be underestimated. (Faber, 1999) In addition, there is an important difference between the Mediterranean and the SSA case. As SSA countries generally try to establish PTAs with a common external tariff, it is not possible to merge the bilateral agreements as might be done in the Mediterranean case without giving up the goal of customs unions.

Let it be assumed that the above mentioned problems have been solved and that FTAs between the EU and subgroups of ACP countries have been agreed and are implemented. What can be said about the extent to which the conditions for success that have been formulated at the end of the last section will be fulfilled?

The first condition requires the level of protection of SSA industries to go down

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<sup>11</sup>One exception are those ACP countries that come under the protocols for particular products (bananas, beef, sugar). For some of these countries a large share of exports is possible because of these protocols.

substantially in order to increase efficiency in a static and a dynamic meaning. It is clear that WTO compatible FTAs will greatly reduce levels of protection in many ACP countries, given their present tariffs and other trade barriers. Transparency will increase as SSA has a low level of bound tariffs: only 40 per cent of imports enter these countries under bound tariffs post-Uruguay Round (Drabek and Laird, 1997). A related question is, whether the abolishment of trade barriers will give rise to lower prices in the ACP countries. For this to happen, the introduction of adequate competition policies by the SSA PTAs and multilateral liberalisation (condition three, see below) are essential. In its proposals for negotiating guidelines, the Commission proposes to improve the ACP countries' capacity to handle other trade related issues, including competition policy. In the new Mediterranean agreements, this has led to the importation by the partner countries of EU competition policy. The combination of trade liberalisation and a more effective competition policy increases the probability of falling prices after the breakdown of trade barriers against EU goods.

The second condition is better market access for ACP products on the EU market, in order to diminish the pain of industrial restructuring. This could be brought about by improving rules of origin, by refraining by the EU from using or threatening to use the escape clause and by enlarging tariff quotas for agricultural products. Generally, the EU could introduce trade stimulating measures at an early date in favour of ACP countries. Given the fact that these proposals have been made many times in the past without much result, indicates that it is at least doubtful whether such proposals will be successful this time.

In order to prevent trade diversion and indirect trade deflection, multilateral trade liberalisation by the ACP countries is necessary, according to the third condition. There is a real danger of trade diversion and deflection as many ACP countries have large import flows from non-EU countries. Pacific ACP countries bought only five per cent of their imports in the EU in 1995. For the Caribbean and SSA this figure is much higher, viz. 20 and 30 to 55 per cent respectively, but even these shares leave much room for trade diversion. However, some regional subgroups have committed themselves to broader liberalisation.

The Caribbean Common Market (CARICOM) has trade agreements with Canada and the United States, which will probably require any liberalisation towards the

EU to be generalized. In addition, CARICOM is negotiating with Colombia, Venezuela, Costa Rica, Mexico and will ultimately do so with the rest of the American continent under the Free Trade Area for the Americas (FTAA). (IDS, 1998)

In SSA, the situation is less clear. A relatively large number of SSA countries does not belong to the membership of the WTO. The 14 countries of SADC will most probably lower their trade barriers both individually and collectively. Several of these countries are engaged in Structural Adjustment Programmes that liberalise international trade. Under the Cross Border Initiative (CBI), an external tariff is anticipated with an average tariff of 15 per cent and maximum levels of 20 to 25 per cent. COMESA is preparing a common external tariff with a maximum rate of 30 per cent, which will probably be lower on the date of introduction in 2004. (Imani Development, 1998) Although tariffs and other trade barriers come down in the SADC, it can be concluded that trade barriers towards third countries will remain at levels that make trade diversion a probable phenomenon. The static net welfare effects of an FTA with the EU are generally small. However, this conclusion hides the fact that such an FTA will lower government revenue in many of the countries by three to nine per cent. (Imani Development, 1998)

Kenya, Tanzania and Uganda are re-establishing the East African Community (EAC). In 2005, internal free trade and a common external tariff will probably be in place. At the moment, these countries have maximum tariff rates of 20 to 30 per cent and surcharges in two countries of 16 and 10 per cent. Tariffs have come down over the last few years in the three countries. Quotas, import licenses and bans are not used with the exception of Uganda that has a number of import bans. In a study on the impact of an EU-EAC FTA, Credit (1998) argues that it is reasonable to assume a common external EAC tariff of seven or 15 per cent, depending on the sector concerned. This would leave room for a substantial trade diversion. It is estimated by Credit, that trade diversion may even dominate the trade effects, which would give rise to net negative static welfare effects.

In Central Africa, the Union Douanière et Economique d'Afrique Centrale (UDEAC) was successful mainly as a monetary union. In 1998, a new institution was created: the Central African Economic and Monetary Community (CEMAC). The member states use a common external tariff that varies between five and 30 per cent,

while there is a temporary surcharge set at the national level. As far as tariffs have been bound in the Uruguay Round, this is at high levels. (Planistat Belgique, 1998) Given the fragile process of integration, and the political instability in the region, a rapid lowering of trade barriers by all CEMAC members towards third countries is unrealistic. This would indicate the possibility for trade diversion. However, most imports in the region already originate in the EU.

The eight Pacific ACP countries do not have a formal regional PTA or something that resembles such an arrangement. They are members of the South Pacific Forum Insular Countries (FICs) which is part of the South Pacific Forum which is mainly political in nature and supports members in negotiations with the EU. Papua New Guinea is member of the Asian-Pacific Economic Cooperation (APEC), which strives after regional free trade on a non-discriminatory basis. The Pacific ACP states have recently lowered and simplified trade barriers. Fiji's average tariff is now 12 per cent, while the Solomon Islands have an average of 40 per cent. The Pacific ACP countries have non-reciprocal free access at the markets of Australia and New Zealand; it might well be that these two will demand MFN treatment if the EU gets free access to these ACP countries. (Netherlands Economic Institute, 1998) It is concluded that a Pacific ACP-EU FTA is still far away, as a regional organisation to conclude such an agreement is non-existent and as it is a cumbersome procedure to conclude separate FTAs with the individual countries. If an FTA will eventually be realised, multilateral liberalisation in the Pacific will have progressed. Given this and the long distance from the EU make trade diversion an unimportant factor in the discussion.

The overall conclusion with respect to the third condition is, that parallel multilateral trade liberalisation or generalisation of concessions towards the EU will probably accompany an FTA with CARICOM which will prevent trade diversion or indirect trade deflection. This does not apply for FTAs with the SADC region and the EAC which are likely to have substantial trade barriers vis-a-vis third countries at the moment the FTAs are planned to enter into force. In Central Africa and the Pacific, regional institutions that could conclude FTAs with the EU are particularly weak or non-existent respectively, while trade diversion does not represent a substantial disadvantage.



## 7. Conclusions

New initiatives are needed to increase the effectiveness of the trade policy instruments the EU uses in its policy of development cooperation with respect to the ACP countries. Merely giving non-reciprocal preferences has not worked adequately. The main reason for this failure is that non-reciprocal preferences have not improved supply conditions in developing countries. FTAs can give a new impetus to production and trade. For this strategy to succeed, the EU should avoid trade diversion and deflection and create as much trade as possible. The most important benefits from FTAs will come in the long run by creating more efficient production and competitive market conditions in developing countries and by reinforcing economic reforms.

The success or failure of the new approach depends on a number of factors that have been analysed in this paper. The institutional weaknesses of many regional ACP organisations set up to establish PTAs, mostly Customs Unions or higher forms of economic integration, is a formidable problem. It has been tried for a long time to make these organisations effective, but this has not been successful in many cases. Political instability, the wish to maintain national sovereignty, different views on development strategies and small short term economic benefits are reasons for the slow integration of ACP subgroups.

If it is assumed that the institutional problems are solved, the success of FTAs among groups of ACP countries and the EU depends on three conditions. First, in order to permit trade creation, consumption effects and dynamic spin-offs, a substantial trade liberalisation with respect to EU imports should take place in the ACP countries concerned. It was concluded that WTO compatible FTAs with the Union will greatly reduce levels of protection in many ACP countries, given their present tariffs and other trade barriers. The second condition demands improved market access for ACP countries in the EU in order to diminish the pain of economic restructuring. This is unlikely to take place, given the historical experience. The final condition prescribes a parallel multilateral liberalisation, in order to prevent trade diversion and to bring prices down. This condition is fulfilled for a CARICOM/EU FTA. For SADC and EAC this condition will probably not be met. For CEMAC and the Pacific ACP countries this condition is less relevant as trade diversion is likely to be very small.

This leads to the final conclusions. First, large institutional weaknesses will have to be overcome in order to cover a substantial part of the ACP group with FTAs. Second, the main benefits of FTAs with groups of ACP countries are to be found in dynamic economic benefits and the locking in and stimulation of economic reforms in ACP countries. Third, it is not clear for some ACP groups whether multilateral liberalisation will be sufficient to prevent trade diversion and rent seeking behaviour as a result of the FTAs concerned.

The new approach of reciprocal preferences could turn out to be a useful way of promoting economic development. However, it is not easy to apply, and much time, negotiations and investment of political capital in the EU and the ACP is required to create the right environment for these FTAs to bear fruit.

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