

Chapter 1: Brief Introduction to the Mozambican Economy

1.1. *Introduction*

This Chapter looks at the main trends and characteristics of the Mozambican economy that are relevant for this study. The Chapter has two main purposes. On the one hand, it aims at providing a platform for a better understanding of the possible impacts of an EPA on the Mozambican economy. On the other hand, it also aims at providing a basis upon which to build a strategy to guide the negotiation process and the identification of the sensitive issues that should be dealt with while negotiating an EPA. Thus, the purpose of this Chapter is not to analyse the whole of the Mozambican economy but, fundamentally, to extract the relevant issues for such an analysis for the study.

Along this report, there are aspects of the Mozambican economy that are developed in more detail (for example, in the sections concerned with the fiscal analysis; or when the discussion is focused on specific sectors, such as, for example, services). Thus, this Chapter is only a basic and brief overall introduction to the Mozambican economy.

1.2. *Official Macroeconomic Trends*¹

Over the last decade, the Mozambican real GDP has been growing at an annual average of 8 per cent, and real GDP per capita has grown at an annual average of 3.9 per cent.

The rate of inflation has slow down considerably from 57 per cent in 1995 to less than 10 per cent in 2003, but remains very unstable. However, during the same period lending interest rates of commercial banks have increased by almost 50 per cent, and the spread between deposit and lending rates has been maintained at around 16 percentage points. Real lending interest rates fell from 22 per cent to 12 per cent between 1998 and 2001, but increased again to about 26 per cent in 2002 and 2003.

Between 1997 and 2002, global state budget deficit as percentage of GDP has increased by 50 per cent (before grants) and doubled (after grants) because total expenditure has increased significantly more than public revenue and grants. Import duties and consumer taxes on imported goods and services add to significantly more than 50 per cent of fiscal revenue.

The current account deficit has more than doubled between 1997 and 2003, when it was well over US\$1 billion. The trade balance deficit reached almost US\$600 million

¹ Unless otherwise stated, the sources of data for this section are the National Directorate of Planning and Budgeting (Ministry of Planning and Finance) and the central Bank (Banco de Moçambique),

(equivalent to one year of exports of goods) despite the rapid increase in exports due to mega projects (aluminium). Outside exports of the mega aluminium smelter, Mozal, the level of exports has remained stagnant for the last five years. The current account deficit has been compensated by a huge surplus in the capital balance due to debt forgiveness (80 per cent of the surplus in 2002), balance of payment support grants and foreign direct investment.

Data on employment and unemployment is scarce and very unreliable. However, different surveys of the manufacturing industry and other sectors show that sectors that traditionally are large employers are collapsing (for example, the textile and clothing industry) or making significant downward adjustments in their work force (for example, the port and railway sectors). New industries are mostly capital intensive (for example, the large aluminium smelter Mozal produces 25 per cent of manufacturing value added and employs only 3 per cent of formal labour in manufacturing). The only significant exception is the sugar industry, which is expanding and is a very large employer. New investment in cotton, tobacco and cashew may create job opportunities. However, jobs created in the new, labour intensive cashew industry represent less than 10 per cent of the jobs lost with the closure of the old, large scale cashew industry. Given the low level of processing currently involved, cotton and tobacco create most of their jobs in the agricultural activity, through the organization of the small holding production under concessions – thus, prices and work are highly sensitive to small changes in the world market. On the whole, a significant number of jobs has been lost and employment opportunities for unskilled and semi-skilled labour have declined.²

A recent Government report, based upon data collected by two surveys of household expenditure (IAF 1996 and IAF 2003), argues that the percentage of the population under the national poverty line declined from 69 per cent to 54 per cent of total population, according to expenditure calculations. However, these surveys have little or no information about the causes and dynamics of poverty reduction or, more accurately, increase in household expenditure.³

Thus, in negotiating an EPA, particular attention has to be taken to three issues: balance of payment sustainability, fiscal constraints and employment generation. This means that an EPA could be useful if it emphasises a development component over simple trade liberalisation, and if it helps to change the patterns of investment, production and trade, as discussed in the following sections.

1.3. Dynamics of Growth, Investment and Trade

Over the past decade, growth and investment trends in the Mozambican economy have become narrower and more concentrated. Gross Domestic Product (GDP) and Manufacturing Value Added (MVA) have been growing in real terms, but the sources

² See, for example, Biggs *et al* 1999 and Nasir *et al* 2003.

³ Inquérito aos Agregados Familiares (IAF) 1996 and 2003.

of growth are increasingly fewer. Private investment has been very unstable on a yearly basis, but has reached significant levels over the last 13 years or so. It has also been narrowly focused. These, and other issues, are discussed in this section.

1.3.1. Dynamics of growth and exports

The major sources of growth of GDP have been services (mostly trade, finance, transports & communications, tourism and construction), and mega and large projects in industry, energy, minerals and agriculture (aluminium, natural gas, heavy or mineral sands, energy, cement, beverages (particularly beer), sugar and cereal milling).

With the exception of tourism, all the other service sectors are heavily concentrated in Maputo: about 70% of trade and transport & communications, and 75% of financial services and construction activity take place in Maputo. Furthermore, almost 80% of investment in transports takes place around the big corridors (Maputo, Beira and Nacala), with emphasis on the Maputo Corridor that links Mozambique and South Africa. Construction is concentrated around industrial mega projects, road programs with emphasis on the Maputo-Witbank toll road, and luxury housing around Maputo and Matola. Trade is fundamentally urban and retail and rural trade networks are weak and very slow to develop. Finance is either speculative or related to large projects linked with international capital. Thus, services are developing around and helping to create economic dynamics that are narrowly based and that operate against the broadening of the development basis.⁴

Production and exports of goods have similar trends to services, as it would be expected. Although cereals for household consumption are estimated to be the dominant agricultural production, dominant agro-industrial activities are sugar (for the domestic market, but also a very important export good), tobacco, wood and cotton (all for export). These four agro-industrial products account for less than 15% of total industrial output, but represent more than 80% of agro-industrial output. Manufacturing output is heavily concentrated around aluminium, beer, cereal milling and soft drinks, which represent more than 70% of total output. Aluminium, alone, represents some 48% of total manufacturing output.⁵

In 2002, exports of goods represented almost 70% of export revenue, because of the exports of aluminium. Since Mozal, the large BHP-Billiton aluminium smelter, started operation, Mozambique's exports of goods more than trebled. Aluminium represents approximately 75% of manufacturing exports, 66% of exports of goods and 42% of total export revenue of Mozambique.⁶ Put together, exports of goods from fishing, agriculture and all other industries (except aluminium) add to no more than two thirds of total aluminium exports.

⁴ INE (various issues of the statistics yearbook); Banco de Moçambique (various annual reports); KPMG 1999.; Castel-Branco 2003 and 2002a.

⁵ INE (various issues of the statistics yearbook) and Castel-Branco 2003, 2002a and 2002b.

⁶ INE (various issues of the statistics yearbook); Castel-Branco 2003; and Castel-Branco and Goldin 2003.

Outside the dynamics of mega and large projects, particularly of Mozal, industrial output and exports are mostly stagnant. There are firms in metal-engineering, cashew and some other industries that are growing dynamically, but they are only a few and still with little impact on the overall economic activity.⁷

1.3.2. Dynamics of private investment

Private investment, which has represented about 60% of gross capital formation in Mozambique between 1990 and 2003, is concentrated in a few mega and large projects, with skewed regional distribution, dependent on inflows of external capital. Between 1990 and 2003, such projects or industries,⁸ comprising not more than 20 firms, have accounted for about 75% of all Foreign Direct Investment (FDI) accruing to Mozambique; 40% of National Direct Investment (NDI); and two thirds of all private investment. Natural gas and heavy/mineral sands (controlled by 4 large multinationals, two of which South Africans), absorb almost 90% of all investment in minerals. Aluminum and energy, sugar, beer, soft drinks, cereal milling and cement (some 16 firms, all of which are foreign owned, including 8 multinationals), absorb 94% of FDI, 50% of NDI and 73% of all private investment in manufacturing.⁹

Investment estimates, based on an analysis of 1,800 investment projects approved and implemented (or under implementation) during 1990-2003,¹⁰ also show that South African (SA) corporations are leading determinants of flows and patterns of investment in Mozambique. Directly, they are involved in 18% of all investment projects of the set of 1,800, and are responsible for about 40% of FDI and 15% of total private investment in Mozambique during the period. However, the total (direct and indirect) impact of SA corporations on private investment in Mozambique is much more significant than the direct impact: as a whole, the projects in which SA corporations are directly involved have absorbed 85% of all FDI accruing to Mozambique, 35% of NDI and 75% of total private investment. Additionally, 73% of all directly productive, financial loans (from commercial, multilateral or other sources) are associated with these projects.

SA investment is mainly associated with the minerals-energy complex (MEC) of SA: aluminium and energy, natural gas, heavy and mineral sands. Investment around MEC is heavily supported by the small number of very large SA multinational corporations (SA MNEs, such as BHP-Billiton), large minerals and energy capital from around the world (Australia, the UK, Ireland, Japan), SA public enterprises (such as ESKOM and SASOL), investment and development agencies (IDC, IFC, EIB and others).¹¹

⁷ Castel-Branco 2003; Castel-Branco and Goldin 2003.

⁸ Aluminium and energy, heavy/mineral sands, natural gas, sugar, beer, cereal milling, soft drinks and cement.

⁹ Castel-Branco 2004, 2003 and 2002a.

¹⁰ Data base kindly provided by the investment promotion centre (CPI), and checked through contacts with provincial directorates for the respective sector.

¹¹ Industrial development corporation (IDC), a SA parastatal; international financial corporation (IFC), a member of the World Bank group; European Investment Bank (EIB). For sources: Lutchman and

In addition, SA investment has expanded quickly into areas of oligopolistic or quasi monopolistic competition, in a bid to globalize by using the region as a trampoline for world markets, or simply as an expansion of the domestic market. Mains areas of investment are: sugar (Illovo and Tongat Hullet control 3 out of 4 sugar estates, and IDC helped a Mauritian consortium to control the fourth); beer (SAB control all three breweries); soft drinks (SABCO has control, through a local branch, Coca-Cola, of all bottling plants), cereal milling (Namib Management controls or is involved with the largest cereal milling complexes, except one), mega tourism projects (Limpopo and Libombos), and mega infrastructures (management of major ports, major toll roads, communication systems and industrial parks developed around anchor projects associated with the MEC). Tourism and infrastructures are developed around the concept of spatial development initiatives (SDI), a SA public policy to expand the SA economy into the region.¹²

Associated with the MEC and oligopolistic expansion, SA investment has also moved into dependent industry and industrial services.¹³ On the one hand, MEC, SDI and other large projects represent demand for certain industrial activities and maintenance and engineering services, resulting in quick expansion of linkages between supplier SA firms, based in SA, and mega and large projects in Mozambique. Social, economic and political pressures to increase linkage effects led to the development of specific strategies, by large firms, to link with firms established in Mozambique. Most of such links with domestic firms have been established with SA firms that have relocated or opened branches in and around Maputo, or with joint ventures of Mozambican and South African firms. When investment costs of relocation are low, SA firms open their own branches (warehouses or specialised trading companies). When investment costs are high, such as in the cases of metal-engineering and industrial maintenance, SA firms have rented capacities of Mozambican firms and undertake very little investment. Only in highly specialised services of continuous demand (such as specialised industrial waste removal and transport of aluminium) have SA or other international firms developed an entire business structure. Outside this general framework, links with domestic firms have been developed in services, mostly in construction and maintenance of buildings, gardening, catering, and non specialised transport.¹⁴ On the whole, if better structured

Naidu 2004; Rumney 2004, Fine and Rustomjee 1996; Shoeman 2003; Daniel, Naidoo and Naidu 2003; Games 2003; Castel-Branco 2004, 2003, 2002a and 2002b.

¹² Lutchman and Naidu 2004; Rumney 2004, Fine and Rustomjee 1996; Shoeman 2003; Daniel, Naidoo and Naidu 2003; Games 2003; Castel-Branco 2004, 2003, 2002a and 2002b, Roberts 2000. It should be noted, however, that European investment is become more significant in tourism, particularly of Portuguese and Italian origin. This should not be confused with small investment in tourist facilities undertaken by families originated from the Portuguese community in South Africa.

¹³ The concept of dependent industrialization is linked to the following characteristics: import dependency; dependency with respect to exogenous dynamics of industrialization (including access, to markets, technology and capital, product design, investment decisions, etc.); dependent partnerships (such as in the case of integration with oligopolistic, international product and value chains); lack of dynamic backward and forward linkages within the economy outside the mega and large projects that have initiated the process. This pattern of industrialization cannot be identified as import substitution (even when firms produce only or mostly for the domestic market), as it does not substitute, but rather creates, import pressures. True import substitution would involve backward and forward linkages that this pattern of industrialization does not, usually, develop outside economic enclaves.

¹⁴ According to Castel-Branco and Goldin (2003), some of the core industrial capacities and services developed around Mozal are as follows: *Engineering/manufacturing industry firms*: Cometal-Mometal

and utilised, these links could become important components of strategies to develop domestic productive capacities, and to reduce marginal costs of making investment in Mozambique (because of the industrial service and engineering basis of most of the links). The main question, though, is how to diversify the poles of demand and supply such that the links are continuous and lead to industrial innovation and upgrading, rather than ephemeral.

On the other hand, dependent business dynamics have developed around product chains controlled by SA or other MNE large corporations: this is happening in export of fruits (citrus) and some basic agro-industrial products (honey, cassava products, animal food), some areas of metal engineering in which SA firms provide reputation and access to markets, tourism related activities, and others. On the whole, a very large proportion of existing and relatively successful (or at least not unsuccessful) small and medium firms have developed linkages with SA firms, some of which within the “black economic empowerment” (BEE) scheme pursued by the SA Government.¹⁵

SA capital has long been a driving force in the Mozambican financial market. The literature on finance in Mozambique usually emphasizes that the Mozambican financial system is controlled by Portuguese financial interests. This is only partially true when one looks at the domestic financial system and abstracts from its international interactions. Worse still, this argument only holds if one abstracts from the relationship between finance, investment and production.

In other words, Portuguese banks own most of the banks in Mozambique, and the larger banks from the point of view of domestic banking operations. However, the domestic banking system is responsible for less than 20% of financing of investment and production in Mozambique, and a significant share of their activity is limited to being an agency to channel international capital flows. Most of the private capital invested in Mozambique over the last decade or so comes from SA and international financial institutions that also operate through SA banks. Thus, SA banks are far more important than Portuguese ones, but they used to operate mostly through direct relationships with mega and large projects and firms rather than through direct, physical presence of the banks in Mozambique. Hence, more recently, the SA banking system has started to expand, physically, into the Mozambican economy in line with the dynamics of FDI in Mozambique: one new commercial bank was created and two commercial banks were bought by SA banks over the last two years. Given their

(pots, chimneys and pipes); Tubex (tools and spares); Kempe/Metech (maintenance of pot lines); Forjadora (containers); Kanes (spares, metal structures and maintenance); Agro-Alfa (repair of start up equipment); MC Engineering (repair of start up equipment). *Construction firms*: Marcleusa (electricity substation in the plant and acoustic barrier in the port of Matola); Construções Chemane (maintenance, water drains, removal of temporary buildings); SORADIO (electric installations and wiring, and repairs); and Wade Adams (housing construction and maintenance of buildings). *Industrial services*: TDM (phone and phone data base network); EDM (shareholder and represented in Motraco); Strang Rennies Mozambique Consortium, SRMC (export of aluminium); Diesel Eléctrica (suppliers and maintenance of hydraulic equipment); Interwaste (industrial waste removal); and Transaustral (employee transport). *Other services*: Eurest Support Services (catering); Gray Security (manned security, reception, and armed response); Thsala Mozambique (catering and cleaning); Cinderella (laundry and uniform management); and Flor Real (landscaping earthworks).

¹⁵ Lutchman and Naidu 2004; Rumney 2004; Shoeman 2003; Daniel, Naidoo and Naidu 2003; Games 2003; Castel-Branco 2004.

experience in financing productive activities and their superior financial linkages and muscle, SA banks may be in a better position to expand their domination of the Mozambican financial system and, therefore, strengthen the dominance of the key investment dynamics in SA that are influential in Mozambique: MEC, oligoplistic competition, SDI and associated, dependent industrialization.

From the analysis of growth and investment dynamics, it seems that public policies and corporate strategies of SA firms (MEC, oligoplistic globalization, SDI and BEE) are the main determinants of levels and patterns of capital inflows to Mozambique, and of the magnitude and patterns of economic growth and trade. This has, of course, strong implications for the determination of how Mozambican businesses and productive capacities can be developed, and in what direction, and how future trade arrangements are likely to affect the Mozambican economy.

On the one hand, the Mozambican economy is highly sensitive to what happens with investment, trade and production patterns in South Africa, irrespectively of the formal trade and customs arrangements that exists between the two economies. Thus, it might be on the best interest of the Mozambican economy to diversify the sources of economic dynamics away from the heavy dependence upon South Africa.

On the other hand, it seems that most FDI accruing to Mozambique, including non SA FDI, is related to SA corporate strategies – this is, Mozambique has little independent capacity to attract large amounts of diversified FDI. It seems, therefore, that Mozambique has to target very specific areas of development to attract FDI from different sources and to start diversifying the patterns of investment, trade and growth (some of these issues are discussed at later stages). However, the evidence so far seems to be that FDI is generally more interested in, and comfortable with, SA corporate strategies than the Mozambican economy *per se*. This cannot be changed by providing more and generalised traditional fiscal incentives (which, in turn, have high social costs). Specific targeting strategies have to be developed around selective investment and industrial strategies and policies. The conditions are set for investment polarisation following an EPA (combined with trade agreements between SA and EU, and trade agreements in the region). The question is if Mozambique can use an EPA to change that.

Furthermore, without changing the patterns of investment, production and trade, Mozambique will not be able to take significant advantages of the EU market. If this happens, then an EPA will tend to increase fiscal and balance of payment pressures. This argument can be used to emphasise the development component of an EPA – this is, the creation of productive and institutional capabilities that allow the Mozambican economy to benefit from an EPA. Some of these issues are further discussed later.

1.3.3. Macroeconomic impact of current dynamics of growth, investment and trade

Macroeconomic, productive and trade conditions in Mozambique are closely and dynamically related. On the one hand, productive and trade dynamics affect macroeconomic balances: employment, fiscal deficit, balance of trade and balance of payments deficits, savings, investment and growth. On the other hand,

macroeconomic limits also constraint growth and investment dynamics. Finally, macroeconomic policy, aimed at providing monetary balances through monetarist approaches, contributes to shape the patterns of investment and growth.

Thus, any approach to developing business and productive capacities, and negotiate trade arrangements, has to take into account the dynamic relationship between macroeconomic, productive and trade conditions, including macroeconomic policy. To do so, it should look at: (a) the impact of current patterns of growth, trade and investment on macroeconomic conditions; and (b) how macroeconomic policies affect macroeconomic, productive and trade dynamics. Given that macroeconomic policies are unlikely to be part of the negotiating package with the EU, we do not address this issue in this report.

The macroeconomic-production/investment-trade *nexus* in Mozambique involves three main characteristics. First, the productive base of the economy is heavily import-dependent, such that imports of investment goods are highly and proportionally sensitive to investment. Second, the export basis is highly concentrated and narrow, established around primary products and up to 2001 was not elastic with respect to investment. Thus, investment and economic expansion have always been associated with chronic and increasing trade balance deficits. This is, every time the economy expands, the trade balance deficit increases, sometimes reaching the point of crisis. Third, investment is highly dependent upon inflows of foreign capital. Thus, when investment and the economy expand, the capital balance becomes highly positive. In the short run, the capital balance surplus may offset the trade deficit generated by economic expansion. In the long run, if foreign inflows of capital are not continuous, capital repatriation and interests (and other investment services) payment will contribute to exacerbate the overall balance of payment deficit. This is, the trade deficit is chronic, while the capital balance surplus is short to medium term. Thus, the lasting effect of fast growth, under current circumstances, is balance of payment imbalances.¹⁶

This general trend has been slightly modified recently because exports have become more elastic with respect to investment. This is only due to the export impact of Mozal (aluminium), and the forthcoming export impact of SASOL (natural gas). As mentioned earlier, the other sectors have had a very small impact on increase of exports.

Mozal's net trade gains in 2004 are expected to be around US\$ 350 million, which will reduce Mozambique's trade deficit by more than one third. However, Mozal's impact on trade is not the only impact of Mozal on the balance of payments. Mozal also affects the capital balance and the balance of services through capital inflows (investment), payment of investment services, profit and wage repatriation, services and royalties, and so on. When the overall impact of Mozal on the balance of payments (BoP) is accounted for, net BoP gains are only about 30% of net trade gains. Furthermore, if one considers weak wage linkages (due to high capital intensity) and weak fiscal linkages (due to low wage linkages and high fiscal incentives) between

¹⁶ Castel-Branco 2003, 2002a and 2002b.

Mozal and the rest of the economy, very little of Mozal's net financial gains are retained by the Mozambican economy.¹⁷

Additionally, there is the problem of export concentration: a 10% variation of world aluminium price will immediately change export revenue by more than US\$ 80 million, which is more than the overall exports of the manufacturing sector (excluding Mozal). At the same time, the trade deficit will change by about US\$ 40 million. Between 2000 and 2002, the world aluminium price fell by 15%, such that only in 2004 is Mozal expecting positive net trade gains. If BHP-Billiton adjusts output to a longer than expected fall in aluminium prices, export revenue loss will be even larger.¹⁸

Thus, leaving the solution of the macroeconomic-production/investment-trade *nexus* to mega projects seem to be not only unwise but dangerous. First of all, multiplier effects of such MEC projects are limited, unless they, mega projects, continue to expand (which is unlikely), or the rest of the economy starts developing fast (which is desirable but is not happening at the required pace). Second, the import substitution effect of such projects is also very limited. For example, Mozal could reduce production related imports by one sixth at best, provided that the Mozambican economy can supply everything that is not electricity and alumina (which is unlikely to happen during the lifetime of Mozal's project). Third, the overall balance of payments, wage and fiscal linkages emerging from such projects are very limited: a cereal milling or beverage firm producing 10% of Mozal's output pay more taxes than Mozal.¹⁹ Fourth, the economy becomes more volatile as exports become more narrowly based. In periods of boom, the economy tends to suffer from "Dutch disease", such that the exchange rate and the non-MEC productive basis become uncompetitive, domestic prices may go up and external trade trends may actually become more chronically imbalanced. When prices fall, the economy may loose at least the equivalent to the exports of the entire manufacturing sector (MEC projects excluded). Fifth, policy and institutions will tend to develop around the dominant interests of the MEC and oligoplistic expansion, thus failing to systematically address the issues related to broadening the basis for growth, investment, trade and development.²⁰

In the short run, mega projects can increase the elasticity of exports with respect to investment and have a huge impact on net trade gains, provided that prices are stable

¹⁷ Castel-Branco and Goldin 2003.

¹⁸ Ibid.

¹⁹ It can be argued that mega projects usually implement larger social projects than other firms. Together, Mozal and SASOL, for example, spend a total of about US\$ 10 million per year in social programs. However, this is less than half of what a 1% increase in turnover taxes of these projects would contribute to the state budget (these projects benefit from the largest tax holidays available in Mozambique due to their status as free industrial zones). Additionally, these mega projects' social programs tend to be focused on infrastructure building: schools, health centers, roads, housing complexes, and so on. The management and operation of such infrastructures is, however, assumed by the government and translated into pressures upon current expenditure. Thus, capital expenditure in social programs by individual projects may well crowd out the ability of the state to sustain such programs or to develop other social programs. Therefore, social programs would be better served if such projects pay more taxes.

²⁰ Castel-Branco 2002a and Castel-Branco and Goldin 2003.

and productive and pecuniary linkages are developed with the rest of the economy. However, a strategy that is **solely** focused on mega projects to promote equilibrium, stability and dynamic economic linkages is bound to fail if the issues related to promoting a broader basis for development are not seriously addressed.

What this discussion shows is that macroeconomic stability is fundamentally related with the patterns of investment, production, growth and trade, rather than solely, or mostly, with monetary variables *per se*. This calls attention: (a) to the macroeconomic limits of an EPA, in particular of trade liberalisation; and (b) to the importance of addressing fundamental issues, if a useful EPA is to be negotiated, related to investment, productive and institutional capacities.

1.4. Issues for a Negotiation Strategy

The above discussion raises a series of crucial issues for the negotiation of an EPA. First, there are limits with respect to the fiscal sustainability of blank trade liberalisation, as it will later be discussed in the section about the fiscal impact of an EPA. These limits have a static dimension (fiscal revenue loss from reduced import duties and other taxes on imports). But they also have a dynamic dimension, much more difficult to quantify without detailed sectoral studies – the fiscal impact arising from the impact of universal trade liberalisation on the displacement of domestic productive capacity and jobs. Thus, although it is quite possible to identify instances in which selective liberalisation of imports, particularly of investment goods and services, may help to develop domestic capacities, it is also possible to identify many cases in which trade liberalisation may well displace existing capacities, or prevent such capacities from developing, without much of a compensating gain for the economy as a whole.

The argument that consumers' surplus would increase due to cheaper imports is flawed because without jobs such consumers cannot afford to pay for any imports, cheaper or not. So far, there is no evidence that jobs lost are reallocated to more efficient sectors. In the recent years, the trend in Mozambique is that jobs lost are rarely recovered; and that demand for labour tends to be higher for the small pool of skilled workers. Thus, the fiscal sustainability of trade policies is important also because of the sustainability of public financing of massive education and training schemes.

Second, there are also limits with respect to sustaining higher levels of external trade, if this means simply, or mostly, higher levels of imports, due to balance of payment constraints. The current level of exports is only equivalent to half of the current account deficit, and slightly less than the trade deficit. The compensating effect of the capital balance is short lived: the direct impact of debt forgiveness will disappear, inflows of aid tend to decline, and costs associated with serving investment will tend to increase. When SASOL's natural gas project starts to export, exports will increase fast, but this will also mean that aluminium and gas will represent between 75 per cent and 80 per cent of total exports, leaving the economy extremely vulnerable. Thus, the Mozambican economy has to pay very serious attention to its trade balance.

Third, these two issues raise fundamental doubts about mainstream calculations of trade flows (diversion and creation) that result from an EPA. These calculations are often derived from simple models dependent upon import elasticities, quantities and the rate of change in prices. Quite apart from the fact that there are no known elasticities calculated for Mozambican imports, and that such models are often based on simplistic assumptions regarding product homogeneity, dominance of market transactions over intra and inter-firm trade, inexistence of local or regional trade arrangements and negligible transport and transaction costs, calculations of trade flows have to take into consideration the macroeconomic conditions – in particular, the fiscal and balance of payment sustainability of trade policies.

Fourth, the three previous points show that to benefit from an EPA, Mozambique has to make sure that three necessary conditions are met: (a) the EPA helps to increase and diversify investment, production, trade and institutional capacities and diversification; (b) the EPA helps exports to increase significantly faster than imports and to diversify; and (c) the EPA helps to substitute imports through development of effective and efficient backward and forward linkages.

This means that the EPA has to be understood as much more than a trade arrangement that introduces reciprocity with respect to access to markets. For Mozambique, the EPA must also to represent an opportunity for development. Thus, Mozambique needs not only access to hypothetical markets, or removal of red-tape. In order to effectively benefit from new trade opportunities, Mozambique needs access to finance, foreign inflows of capital and cheap and high quality industrial and productive services (consultancy, training, information, certification, quality and standards, enterprise development support, product development, engineering and maintenance services, environmental services, and so on); partnerships in production, innovation and technological development; and to create the institutional capacities to formulate, develop and implement investment and productive strategies and policies and coordinate the development of core capacities and mobilisation of core resources in the strategic priority areas.

As mentioned in many of the interviews undertaken during this study, the biggest question is not whether Mozambique liberalises its trade regime or not; but what is done through public policy and industrial and firms' strategies and partnerships to develop the domestic productive capacities, to export, to substitute imports effectively, to innovate and to compete in the world arena.

Without specific and detailed sectoral studies, it is difficult to identify the sectors and industries/services that should receive more attention. However, it is possible to risk a few criteria for definition of priority and sensitive sectors and activities. Such criteria would include: export opportunities of high added value content (or equivalent net foreign currency earners such as in exports of services like tourism, for example) in dynamic markets and products of high income elasticity of demand; effective import substitution through backward and forward linkages; employment and wage linkages; fiscal linkages; technological linkages; services that facilitate transactions and linkages, services that help to develop quality and standards, reputation, training and skills, innovation, information and other services related to productive and technological capacities. These issues are discussed in more detail later in this study.

Chapter 2: Evaluation of Trade Agreements - The case of EBA and AGOA

2.1. *Evaluation of EBA*

On the basis of methodology presented in the annex 1 the so called “Everything but Arms” has been evaluated and a detailed analysis can be found in the annex. Here only the principal results will be presented.

1. The EBA²¹ is characterised by a complete elimination of the tariffs on the remaining 919 tariff lines not included in the standard GSP with a ‘nearly 100%’ degree of coverage even if important products are excluded and under a transitory regime (see annex for more details). Therefore at a first level it can be said that the EBA appear to be extremely generous in terms of coverage and tariff structure
2. The analysis of NTBs, in which we include the ‘rules of origins’ (ROOs), the sanitary and phytosanitary measures (SPSMs), shows a less favourable picture. Indeed these appear to be a barrier for LDCs. Apart from specific ROOs that appear to be more restrictive under the EBA than under Cotonou²² like for instance in the case of rules for fishing vessels (see annex) there are two major problems with the ROOs under EBA. Firstly, the cumulation is only ‘diagonal’ and not ‘total’ in the sense that the only inputs that can be used should come, under the EBA, from countries in the same regional bloc and only for certain blocs (ASEAN, SAARC, CACM, Andean Community) and not for all ACP countries. Secondly, the ‘degree of tolerance’ for the non-conforming the ROOs inputs is lower in the EBA²³. In the end it looks that ROOs appear to dangerously reduce the opportunities opened by the EBA and undermine the liberalisation emerging from the tariff structure and coverage
3. SPS barriers are another NTBs that appear to be important in undermining the value of the market access given by low tariffs. However for the case of crustaceans the problems have been solved thanks to the support of the EU and Japan in upgrading the testing laboratories and setting up a system that conforms with the more stringent requirements. However this is not the case for all the other agricultural products: groundnuts face major problems and problems can be foreseen also for horticulture and other fresh produce that is today a sector with growing potential in Mozambique²⁴

²¹ The EBA is indeed a GSP-plus for LDCs

²² An important issue to be noticed is that the EBA being an extension of the GSP is based on the same ROOs than GSP, notoriously more restrictive than the special regimes traditionally granted to ACP under Lome before and Cotonou presently.

²³ See annex for more details

²⁴ Technoserve

4. The other major ‘negative finding’ when analysing the EBA impact on market access is the safeguards rules and, linked to this, the degree of uncertainty of the trade concessions. The EBA introduce new provisions for ‘safeguards’ in particular if imports from LDC face a massive increase from usual levels. Further special safeguard provisions for the sensitive products (i.e. rice, sugar, bananas) are in place. All these weaken the certainty of the EBA’s trade concessions and may reduce incentive to investors. Further being the EBA unilateral and concessionary its concessions could be withdrawn at any time
5. Analysing the effective impact of the EBA on Mozambican exports following the methodology above proposed it can be noticed that this is a very small impact. Among the Mozambican exports to the EU only citrus and sugar are included in the EBA list, but sugar remains under a special regime and not immediately open. Therefore an effective transfer from the EU revenues to the Mozambican private sector is only happening for citrus exports which totalled \$123,000 US in 2001²⁵.
6. Potentially other 3 products presently not exported to EU could benefit from the EBA: oil cakes, maize, brans and sharps and other residues. However these products are being presently exported to the SADC region and it is unclear if Mozambique would be a competitive exporter of these products to the EU besides the high transport costs and high transport costs-to value ratio for these products.

Table 1: Rules of Origins

The ROOs are literally the criteria used to ascertain the provenience of a product, their importance is enormous because these are an essential device to implement preferential trade agreements.

Another objective that ROOs can have is to promote the development of vertically integrated industrial systems in developing countries.

Finally ROOs can have a third objective linked to the attempt to modify the traditional trade flows.

However ROOs have increasingly emerged as one of the most sensitive tools for trade policy in an era of expanding importance of PTAs from one side and the expansion of multinationals with the production of goods in multiple stages using parts produced in different locations around the world.

Various analysis point towards the ROOs as potentially protectionist tools that need to be understood and taken into account. The main critical remarks about rules of origins are the following:

1. In reality ROOs often act as non tariff barriers because:
 - These are often more complex than if the only objective was to avoid ‘trade deflection’
 - These are inconsistent whenever they use different ‘qualifying’ tests for different products without any apparent efficiency or fairness reason. Sometimes it is even necessary to fulfil various ‘qualifying tests’ simultaneously
 - Existing data show that ACP countries have normally preferred to export under Cotonou than under EBA despite EBA having lower tariffs. The principal reason appear to be often related to the ROOs
2. ROO can impede a developing country from participating in ‘global value chains’ because they may preclude the access to inputs from certain regions/countries
3. The ROOs can achieve perverse results, in principle against the increase in market access offered by the PTAs, at least in two ways:
 - The beneficiary countries can be obliged to use inputs from less efficient sources with a negative

²⁵ Assuming the citrus exported to EU were exported under MFN this would imply an implicit transfer of maximum \$20,000 US for 2001 (assuming the citrus exported were paying the maximum tariff of 16%).

impact on their final competitiveness (i.e. textile)
 - The ROOs can de facto create a barrier to access the markets because they impose 'entry costs' (i.e. shifting suppliers of inputs and raw materials) which may well exceed the tariff margin gains.

2.2. Evaluation of AGOA

Following the same type of analysis we also look at another important preferential agreement of which Mozambique is beneficiary: AGOA. As for the EBA a more detailed analysis is reported in the annex (box 6) and here we reports the principal findings

1. As for the EBA the AGOA presents a very wide coverage, expanding the previous 4,650 GSP products with 1,835 new products that can enter US with zero tariff
2. Similarly to what was found in the analysis of the EBA, also in the case of AGOA the principal problems with realising the 'promised' market access are linked to ROOs, SPS, safeguards rules
 - a. With regards to ROOs the problems appear to be particularly big for the textile sector but LDCs have been granted a 'special waiver' and therefore don't have to comply with the stricter general rules (need to use inputs from other African countries or US)
 - b. SPS are very restrictive and in particular the process of approval for certain products may be very lengthy
 - c. Various safeguards are introduced in the AGOA, in particular a system of conditions for 'eligibility' is in place and it is submitted to a yearly review. This may actually increases the risks of the measures been unilaterally withdrawn and therefore reduces the degree of certainty attached to the trade benefits of this agreement.
3. In calculating the effective 'added' benefits from AGOA these appear to be very limited as with respect to the 25 principal Mozambican exports to the US in 2001 20.4% was free of duty on an MFN basis and 74.8% was already benefiting of its inclusion in the GSP. Textile exports that actually benefited from AGOA in 2001 are equal to 2.5% of Mozambican exports to US, which implies a net transfer of about 34,000 USD from US tariff revenues to Mozambican private sector (textile producers)²⁶

Conclusions

This chapter applied a simple methodology for analysing the trade agreements on the basis of various dimension. The importance of this analysis with respect to the EBA and AGOA can be summarised in the following:

- a. Tariffs are only one of the element to be taken into account, other important elements must be carefully evaluated. In particulare we focussed

²⁶ For more details see box 9 in appendix

our attention to the RoOs and safeguards close, but other important areas like SPS should be also considered.

- b. It is crucial to link trade benefits with other type of strictly “non-trade” benefits and this could be one of the reason of the reduced impact for LDCs of the two agreements analysed
- c. Simple statistical analysis can illustrate the ‘real monetary gains’ of the tariffs preferences and could be used during the EPA negotiations.

Chapter 3: Why EPAs?

The Cotonou Agreement replaced a series of so-called Lomé Conventions – trade and development assistance agreements between the African Caribbean and Pacific (ACP) countries and European Union (EU) which have been successively renewed since the first Lomé Convention of 1975. These agreements were characterised on the trade side by preferential arrangements for the ACP States which gave them better access to the EU markets than other groups of developing countries.

The feature of the Cotonou Agreement that is strikingly different from the preferential arrangements of the earlier Conventions is that preferences will be no longer one way – the ACP countries will have to offer some reciprocity in the form tariff-free access to their own markets under the so-called Economic Partnership Agreements (EPAs). Other characteristics of the EPAs will include agreement on certain trade-related disciplines including competition policy, policy on inward investments, labour market standards and protection of the environment. though the full range of such requirements will only become clear through the negotiating process.

But Cotonou makes clear throughout that the EPAs are not to be considered as primarily free trade agreements (FTAs). The development dimension and poverty elimination – the link between the two is left vague – are important ingredients, though given less prominence than the ACP negotiators wanted. Financial support and technical assistance are given more pages than are the trade arrangements but details of how much will be available are not spelt out. The total sum euro 13.5 billion under the 9th EDF has been set for the quinquennium but how it will be disbursed – between countries or between regions – has not. In addition to what extent additional funds might be available from the European Investment Bank or the Commission’s own budget is still unclear. In addition there is a large amount of unspent EDF funds from earlier commitments which could be reallocated.

This chapter seeks to shed some light on the EU’s rationale for introducing these radically different agreements in place of the Lomé Conventions. Various possible explanations have been offered by the EU itself, including the failure of the Lomé Conventions to yield the anticipated growth in ACP exports – development and poverty reduction dividends – and the alleged inconsistency of the one-way nature of preferences with the WTO rules on regional trade agreements. Other possible, less ventilated, explanations might include the goal of exporting the EU’s own principles of “good governance” or simply the mercantilist aim of prising open better access for its own suppliers of goods and services in the ACP countries. These will also be examined. However, as is typically the case with any significant reorientation of

national (or coalition) policy, the agendas of different groups who contribute to the reformulation are different while the argument that all parties will benefit – that the switch represents a positive-sum game – has a powerful and appealing, if more wishful than real, resonance.

This chapter does not put forward the counter arguments – it simply analyses the stated (market integration effects, efficiency and accountability in development finance, WTO compatibility) and unstated justifications (the political agenda, mercantilist goals) of the EU to push for EPAs. The rest of the report will at various points look at the counter arguments and alternatives – particularly in the context of Mozambique. It is always important, though, to start with an attempt to understand the other party's motivations behind a process which it is attempting to persuade one to join.

3.1 The Failure of Lomé

In some early reflections on the policy switch the EU Commission noted that despite the succession of Lomé Conventions, ACP countries' share of the EU market declined from 6.7 per cent in 1976 to 3 per cent in 1998 with 60 per cent of total exports concentrated in only 10 products. The performance of sub-Saharan Africa is particularly disappointing with the per capita gross domestic product (GDP) growing by an average of only 0.4 per cent per year as contrasted with a 2.3 per cent growth for developing countries as a whole.²⁷ The EU Trade Commissioner Pascal Lamy cites other data to indicate the narrow spread of benefits: in 1999 10 African countries represented 61 per cent of total ACP exports while 9 products represented 57 per cent of total ACP exports.²⁸ Lamy explains the failure of Lomé with three arguments: First, ACP-EU trade co-operation has been entirely centred on 'promoting trade between the ACP States and the Union', thereby neglecting the potential offered by national, regional and international markets. Secondly, ACP-EU trade co-operation has been too limited in its scope – ignoring the importance of non-tariff barriers, such as standards, SPS rules and measures to protect the environment. Thirdly, ACP-EU trade co-operation has been largely perceived as an end in itself rather than as a means to sustainable development and the eradication of poverty in the ACP countries.

However it must be noted that the so-called failure of Lomé depends to a large extent on how the data are selected. McQueen has demonstrated sizeable benefits for those ACP countries that did not have strong anti-export policies and traded in products that had a significant preference-margin over third countries.²⁹ Also whereas overall SADC exports to the EU in volume terms have declined by 5.4 per cent, in those areas where margins of preference over GSP beneficiaries were greater than 3 per cent

²⁷ See, for example, European Commission (EC) (2002a), *Economic Partnership Agreements – start of the negotiations: a new approach towards ACP-EU trade cooperation*, October 2002, available on http://europa.eu.int/comm/trade/issues/bilateral/regions/acp/docs/brocheuacp_en.pdf

²⁸ Interview with Pascal Lamy in *The Courier*, EU Commission, Brussels, July-August 2002

²⁹ McQueen, Mathew (1998), "Lomé Versus Free Trade Agreements: The Dilemma Facing the ACP Countries", *World Economy*, Vol. 21, No. 4, 1998

exports to the EU have increased by 83.6 per cent.³⁰ Also export performance data ignore the impact of standards and SPS rules which have become stricter over time and raised more problems for ACP exports. The Commission's selective use of data in its speeches and documents does not contribute to confidence in its analysis or its proposals.

Thus the degree to which Lomé has contributed to the development of and poverty reduction in the ACP countries still remains a question for research. Clearly the answer will depend on the country involved, probably also the time period in question and the particular instruments in question. It would seem a priori likely that the impacts of preferential access to the EU markets, of quotas for protocol goods (sugar, bananas, rum and rice) and of financial assistance have been very different. There might be an argument to be made that successive Lomé conventions have helped protocol beneficiaries disproportionately. In general there is no reason to believe that the benefits of financial assistance under Lomé has been significantly different to those which derive from other multilateral or individual country aid programmes, though the relative shares between grants and loans, and the extent to which loans have been made on concessional terms, are clearly important. However these issues remain speculative pending serious research – which would have been a useful precursor to the new arrangements under Cotonou. The same is true for the impact of Lomé on individual ACP countries, including Mozambique.

3.2 Concern for political dialogue and good governance

Negotiations on the Cotonou Agreement started in September 1998 in the midst of a very violent decade in many African countries. It is tempting to see the emphasis on political dialogue as a attempt to check civil wars and armed cross-border incursions and, perhaps, herald and legitimise a more activist role for the EU in African politics. However civil strife continued in a number of countries and there was no apparent follow up by the EU. Still, in the Cotonou Agreement the emphasis on political dialogue is both stronger and backed by new sanctions – used for the first time in early 2002 in the freezing of assets belonging to members of the Zimbabwe government.

Article 8 of the Cotonou Agreement states that dialogue between the Parties shall cover 'all questions of common, general, regional or sub-regional interest' and that 'through dialogue, the Parties shall contribute to peace, security and stability and promote a stable and democratic political environment.' It specifies cooperation strategies as including the environment, gender, migration and questions relating to the cultural heritage, and issues of mutual concern including the arms trade, excessive military expenditure, drugs and organised crime and ethnic, religious or racial discrimination. All areas of cooperation between the parties will incorporate such 'cross-cutting' themes as gender equality, environmental sustainability, institutional development and capacity-building. Article 8 emphasises human rights 'be they civil and political, or economic, social and cultural', democratic principles and the rule of law. After much negotiation it was agreed that failure to observe these basic principles,

³⁰ Author unknown (n.d.), *Issues in future EU-Africa trade relations: the problems which need to be addressed under any moves towards free trade with the EU*

and specifically, serious cases of corruption may lead sanctions, such as the withdrawal of aid or even suspension from the Agreement (Articles 95 and 96). Indeed sanctions have already been adopted against several African countries, not for corruption but on human rights issues, for example, Zimbabwe in December 2001. However it is worth noting that the concept of conditionality is nowhere spelt out.

Linked with this set of objectives, the Cotonou Agreement differed from the earlier Lomé Conventions in a stress on the role for representatives of civil society and other non-state actors. Indeed the Cotonou Agreement even allows for funding to private institutions – including local government, civil society organisations, trade unions and private sector groups – directly from the EU without the consent of the government of the country involved.

Avafia and Hansohm draw attention to the increasingly ‘explicit inclusion in the number of “political considerations” from Lomé to Cotonou and now with the ongoing EPA negotiations’.³¹ Cotonou has substituting the Lomé emphasis on one-way trade preferences, development support and respect for sovereignty by an emphasis on dialogue and governance. Of course the extent to which the EPAs will go further than Cotonou in pushing for democratic principles and other aspects of good governance remains to be seen. Still the circumstantial evidence supports the view that political considerations are at least one factor behind the successive moves from Lomé to Cotonou to the EPAs. Moreover, while it is not argued in so many words, there is at least a strong suggestion in the Cotonou Agreement – and often more explicitly in related EU texts – that good governance would increase government accountability and improve economic performance.

3.3 *Belief in economic integration*

The domestic markets of all ACP countries are small and thus unable to benefit from specialisation in production and the economies of scale and additional efficiencies that integration brings and through which is itself reinforced. Arguably the ACP countries are in fact too specialised, usually in particular agricultural goods, but these do not benefit to the same degree from the productivity gains associated with specialisation as manufactures. By encouraging regional groups of ACP States to open their markets to each other and by opening its own markets to the ACP States the EU believes that significant productivity gains can be realised and the ACP countries in general will be able to participate more fully in international trade. For this of course investment in export sectors is required and most of this investment will have to come from outside. However the opening of new markets³², supported by various ‘flanking’ policies such as national treatment for foreign direct investment (see below), the EU argues, will in itself generate these investment flows.

However, in practice such flows would not materialise if differences in skills, productive and scientific infra-structures, factor productivity and quality, and

³¹ Avafia and Hansohm (2004), p. 4

³² It must be noticed that for LDC that already benefit of the EBA the market openings from tariff reduction will not a very important element

transport and transaction costs erode openness incentives.³³ These difficulties could be augmented by the EU producers' free access to regional markets through third parties in the region, leading to investment concentration in the most developed countries of each region at the expense of the others – depending also on other issues, such as the size of the market, competitive conditions, etc.

The EU also argues that EPA negotiations will give a new impetus to regional integration. The Commission cites the fact that the Economic Community of West African States (ECOWAS) accelerated its integration plans in line with the EPA timetable, and agreed to put in place a customs union in 2007, just before the entry into force of an EPA with the EU.³⁴ The various regional initiatives often lack the economic, legal and institutional depth to exploit the advantages of wider markets: in the Commission's view the EPAs will furnish that depth and accelerate the integration process.³⁵

Of course, the above assumptions abstract from strong economic differentiation between countries in each region, leading to conflicting interests between them and very different economic and institutional capacities to influence and take advantage of the process of integration. South African's persistence in negotiating trade FTA with other countries and regions in the world without consulting her partners in SADC and SACU are just an example of such problems.

Besides the argument about WTO compatibility – which we come to next – the reciprocal opening of ACP markets to EU goods will mean that 'the regional commitments will be locked into EPAs which will increase their impact, enhance their credibility and give confidence to investors.'³⁶ To sum up South-South integration with an extra North-South backbone will result in³⁷

- the exploitation of economies of scale;
- the development of increased specialisation;
- increased competitiveness;
- attractiveness to foreign investment;
- increased intra-regional trade flows;
- increased trade with the EU;
- increased trade with the rest of the world;

and all this will ultimately promote more sustainable forms of economic and social development in ACP countries. Lamy also argues that while the EU 'will be prepared to further open up its market for ACP products and to tackle all other trade barriers, the ACP States must be prepared to implement appropriate policies to strengthen their supply capacity and to reduce transaction costs.'³⁸ These include anti-competitive

³³ See Robert Lucas (Nobel laureate in economics) 1990.

³⁴ European Commission (2003), *Economic Partnership Agreements: Mean and Objectives*, available in <http://trade-info.ec.eu.int>, Dec. 2003

³⁵ Szepisi, p. 12

³⁶ *ibid*, p. 3

³⁷ These are all quoted by Lamy and other EU officials

³⁸ *op.cit.*

behaviour of undertakings such as price fixing or the abuse of dominant positions, an inadequate level of protection on intellectual property rights and an unpredictable or discriminatory investment regime.³⁹

One related argument – rarely spelt out as such but clearly important to those with fundamental attachments to market resolutions – is that of ‘the cold shower of competition’. In other words ACP producers will either benefit from competition from other regional or EU suppliers or they will not survive. To stay in business they will have to raise their productivity levels, employ modern cost-saving techniques, train their workers, reduce their transactions costs and so on. The reaction of most ACP commentators is one of disbelief – the shortfalls in productivity, the shortage of trained personnel, the inadequacy of the economic infrastructure are such that the increases in productivity are simply implausible without large-scale investment and the wholesale transfer of modern technology and skills. Additionally, in the ACP LDCs a huge proportion of the labour force is unskilled and even illiterate. To benefit from trade openness, these countries would have either to engage in absolutely massive and efficient education and training programs; or be able to promote unskilled, low-paid massive employment that would enrich international companies in very few products, more than they would do to reduce poverty and promote development.

3.4 Development finance

The EU clearly believes that reform of the Lomé regime of financial cooperation is required. Under Cotonou there will be greater emphasis on dialogue with the individual countries, focussing on their particular needs, on efficiency, flexibility and, as we have seen above, accountability. The allocation of funds will no longer be as determined by the individual government’s wish-list. Follow-up funds will not be automatically made available but will depend on performance in meeting the agreed social and economic goals of each programme. In this way the inefficiencies, waste and corruption associated with development finance under the Lomé Conventions are to be significantly reduced. We consider that the intention seems appropriate but clearly could involve more time and bureaucratic processes.

Secondly the system of development finance is *supposed* put much greater weight on the role of the private sector in both the ACP and EU countries. A private sector forum *should* promote dialogue, cooperation and partnership between businesses at the regional and EU-ACP level. An Investment Facility to be run by EIB in the form of a revolving fund will replace the Lomé interest rate subsidy system. It is *meant to* facilitate business finance in the ACP countries – often a key problem for the private sector in developing countries – with direct access for the private sector and, in due course, public enterprises. It is also intended that funds be made available for such programmes as public-private sector cooperation, entrepreneurial skills development,

³⁹ In this brief section we put forward the arguments of the Commission pressing for EPAs in order to set the stage for the rationale behind the negotiations – still the authors in this section do not intend to evaluate each of these arguments as it would be difficult in the space and time allowed but intend to put forward the reasons why EC put so much emphasis on the EPAs

privatisation and enterprise reform, and the development and modernisation of mediation and arbitration systems⁴⁰.

3.5 WTO compatibility

In the late 1990s the EU become involved in a number of disputes, both as petitioner and defendant at the WTO. In the latter role the long-running dispute over the EU's preferences for ACP bananas, that was first condemned by a GATT panel in 1993, was not finally resolved until an Arbitration Panel judgment against the EU in December 2000. But the EU has also taken a number of countries' trade policies to the disputes settlement system, including in recent years the US over hormone-fed meat exports and the discriminatory taxation of foreign earnings. The potential value of the WTO disputes mechanism, newly-empowered in the Uruguay Round, slowly dawned on EU governments. With that came the realisation that issues of relatively limited importance in trade relations should be resolved *ex ante* in the interests of avoiding WTO scrutiny and only in the event of a major threat to EU trade interests would the EU accept the role of defendant.⁴¹ This simply meant that the EU would not allow the preferential treatment of ACP exports to be the subject of a WTO dispute *even to the extent of abandoning in advance the possibility of obtaining a further WTO waiver for Lomé-style preferences after the current waiver expires in 2008*. It is true that certain countries such as Thailand strongly opposed the current waiver until the details of the Cotonou Agreement – in particular the reciprocity arrangements – were agreed. But ten years earlier the threat of being turned down would not have deterred the EU from assuming a second waiver could be achieved or alternative arrangements agreed while the dispute was in progress. Needless to say the justification for insisting on reciprocity was put in terms of the best interests of the ACP countries.

But Cotonou and, even more subsequent documents such as the EU's negotiating brief, have stressed the importance of flexibility and special and differential treatment (SDT) in the reciprocal opening of ACP markets to EU exports. This flexibility can come through either allowing the ACP States a list of goods on which tariff protection will be maintained for the indefinite future plus longer timetables ('backloading') for dismantling tariffs in the other sectors. At one stage the objections of the ACP negotiators to the apparent inconsistency between the importance attached by the EU to strict WTO compatibility and at the same time promises of flexibility led to an amendment to the EU negotiating mandate. As the ERO puts it, '[t]he [original] EU mandate makes repeated reference to ensuring conformity with the provisions of the WTO. In a text containing ten clauses no less than 13 references are made to ensuring "conformity", "consistency", "accordance" or "compatibility" with WTO rules and provisions. In discussions on the negotiations European Commission officials have repeatedly rejected the need for any modification of WTO rules in order to allow the "flexibility" required for the negotiation of reciprocal preferential trade

⁴⁰ The authors here intend to what is supposed to happen according to the Commission.

⁴¹ In 2001 the ACP (less South Africa) accounted for 3.1 per cent of EU exports and 2.8 per cent of EU imports, in both cases considerably less than half that of Switzerland. See http://europa.eu.int/comm/trade/issues/bilateral/regions/acp/docs/econo_acp-excl-s-afr.xls.

arrangements between developed and developing economies.⁴² However the ACP negotiators won the argument and the mandate was revised to include a commitment to EU-ACP cooperation in the WTO discussions on the rules on Regional Trade Agreements. The EU has declared itself ready to help the ACP countries seek areas of consensus so that WTO rules better address development issues.⁴³ This means that EU will cooperate with the ACP to get the Article XXIV changed in an “appropriate” way. This is discussed more in detail below.

3.6 The mercantilist incentive

Of the possible motivations behind the EU’s espousal of EPAs this is the most difficult to get a grip on. In simple terms EU companies – and to some extent public sector enterprises – have a clear interest in increasing their exports of goods, and perhaps even more so, of services to the ACP States. To some extent this is mainly a question of preferential access to the ACP country’s markets. But with trade in services increasingly important and with the need for establishment to supply those services, interest in investment is becoming increasingly important. The question is to what extent the potential benefit to EU firms is a major impetus behind the EU’s insistence on reciprocal tariff dismantling, on a competition policy to prevent price-fixing or other such behaviour from inhibiting the activities of EU enterprises, on an investment policy that does not discriminate between domestic and foreign companies – indeed offers ‘national treatment’ across the board – and on a strict WTO-plus interpretation of the TRIPS agreement to protect the intellectual property of EU firms.

The Commission is responsible for preparing and conducting international trade negotiations but, even then, it does need a mandate from the General Affairs Council –consisting of the Member States’ foreign ministers who may have different ‘agendas’. However the Commission’s mandate only stretches to trade in goods – service trade and to some extent the new trade-related issues are still to some extent in the competence of the Member States. In any event business groups probably do lobby for easier access for the supply of goods and services to particular ACPs. How effective they are it is difficult to say. Szepisi describes what happens in Brussels prior to trade negotiations as follows:

“As a negotiation partner to external parties, the Commission is clearly the EU’s key actor in preparing and conducting international trade negotiations. However, the Commission does need a mandate from the General Affairs Council –consisting of the Member States’ foreign ministers. In the past, when solely trade in goods was negotiated, exclusive competence for the negotiations used to be assured for the Commission once the mandate was given by the Council. New issues such as services, intellectual property rights and investment have blurred the Commission’s competence however, introducing areas of mixed competence where more national involvement is warranted. This broadened agenda requires all Member States plus the Commission itself to ratify trade agreements, which makes the process more cumbersome.

In the preparatory process, the Commission formulates proposals addressing the initiation and content of trade negotiations. Here, DG Trade is the natural leading institution, but it has to work in close cooperation with other DGs, primarily Development and Agriculture. The overlapping reach of trade

⁴² European Research Office, *The ACP Guidelines and the EU Negotiating Mandate: a Comparison*, September 2002

⁴³ Kenneth Karl, Economic Partnership Agreements – hopes, fears and challenges, *The Courier*, EU Commission, Brussels, November-December 2002

*agreements can invoke turf wars between the different DGs. In view of ACP-EU relations this has been observed as well, with DG Development usually at the losing end.*⁴⁴

To the extent that EU commercial interests are represented, it is likely to be through other DGs in the Commission rather than directly through the Council of Ministers or member state delegations in Brussels. For example DG Agriculture can be a vociferous defender of EU farmers interests and DG Industry of industrial interests. Individual commissioners may also be active in supporting particular sectoral interests in their own member states though how important this is in the final outcome is difficult to evaluate. Ministries in the member states tend to play a minor role – even those concerned with development policy. The same is broadly true of lobby groups, both those active in EU commercial affairs and those whose interests are in development. Perhaps most serious from the ACP States viewpoint is the sidelining of DG Development. According to Szepesi

“In response to the Commission’s Green Paper proposing EPAs to replace the non-reciprocal Lomé-regime, in mid-1997 DG Development proposed more vague Regional Economic Cooperation Agreements that would not require ACP reciprocity, arguably because they were to be more development-oriented. The proposal was rejected by DG Trade for being WTO-incompatible. Apparent conflict of interest also existed between DG Development and DG Agriculture, again with Development losing out against its ‘weightier’ adversary. The former would have liked to offer the ACP increased market access in a post-Lomé agreement, but the latter insisted that market access improvements for non-tropical agricultural products (the only sector de facto excluded under Lomé) was not a bargaining option.”

Of course how the Commission approached the Cotonou negotiations is a limited guide to negotiations on the EPAs themselves. We only note that to the extent that the trade concerns of the EU Member States have played a role in the push for EPAs, such self-serving interests can be made consistent with the interests of the ACP States through the doctrine of the Positive-Sum Game.

3.7 Positive-Sum Game

Since Ricardo, some economic schools have taught that trade is a win-win game. The fact that the EU will benefit from EPAs is no reason to discredit the EU’s motives or the EPAs themselves. If integration leads to increased market size and this encourages investment and leads to the transfer of technical know-how and skills, the exploitation of economies of scale, improved competitiveness and a better allocation of resources, the EU will benefit marginally – for many years the ACP countries taken as a whole will play a minor role in EU trade – but individual ACP countries could gain substantially in exports, GDP growth and poverty reduction.⁴⁵ Of course, the assumption is that the linkages mentioned above will actually occur at zero or very low costs; and that there is no interim period between opening up and the occurrence of the linkages, such that no one loses. Whether linkages result from trade openness, trade openness results from such linkages developing, or trade openness, alone, prevents linkages from developing, is still a matter for serious debate amongst academic economists and practitioners alike.

⁴⁴ Szepesi, see especially Annex 5.

⁴⁵ To put EU-ACP trade in perspective see footnote 10 above. It is also worth noting that in 2000 the ACP States, excluding South Africa, accounted for 1.5 per cent of the EU’s outward investment flows and 1.4 per cent of the STOCK of EU outward investment (same source).

Furthermore, in a world of increasing internationalisation of capital and trade, and where trade agreements become more cumbersome and multidirectional, old trade models that are based on two-product two-country analysis are highly inadequate. For example, Mozambique is part of SADC, which is dominated by the SA economy, which has a trade agreement with the EU. In this context, why would a trade agreement between Mozambique and the EU necessarily result in development linkages in Mozambique, instead of investment polarisation – this is, all, or most of, investment and development linkages go to SA and Mozambique is left to with capacity to import resulting from aid flows and services?

The concern of the EU as regards the trade-related issues is similarly win-win. If competition policy improves the investment climate it will encourage inward investment, *assuming that investors are looking for a more transparent competitive environment and nothing more*. The same is said to hold true of disciplines over intellectual property and improvements in border procedures – although mainstream economics cannot convincingly explain the rational about investors needing a competitive environment and innovation needing a protective environment (not to speak of the facts that more often than not large investors and innovators are the same entity). On the financial side if the new regime for development assistance – the emphasis on dialogue and the participation of private sector and civil society – leads to an improvement in the efficiency with which it is used, this will be reflected in economic performance. Why this system of assistance requires trade openness, and whether local private sector and civil society are in favour of trade openness, to what degree and under which conditions, these are all issues not discussed.

But that does not imply that the ACP countries do not have to be alert to policy changes pressed upon them by the EU which may not necessarily be in their best interests. On investment policy, national treatment for foreign investors should arguably be the norm in many sectors but at the same time individual ACP States should be able to reserve – through a positive list system (see Chapter 9 below) – sectors for their own public or private suppliers on the grounds that their development priorities dictate that they build capacity, expertise and international competitiveness in particular key goods or services sectors. These might include particular agricultural and fishery products, certain manufactures, telecommunications, air transport, banking or whatever. Transparency in government procurement is one demand that, in the interests of efficient use of public resources including development finance funds from abroad, is difficult to object to. But when it comes to opening tenders across the board to foreign providers, the positive-sum game argument is more difficult to defend. In many cases, if ACP countries were required to open their public tenders to EU providers, their own providers would have little chance of success. And there is small prospect of ACP enterprises winning major public procurement contracts in the EU.

Another factor that needs careful consideration is the cost versus the benefits of adopting policies. In particular trade facilitation schemes, institutions to police and prosecute infringements of competition policy or of intellectual property rights, schemes to protect the environment or legislation to protect certain labour rights may all impose heavy costs on tight government budgets. Some of them may impose even greater costs on entrepreneurs and employees.

3.8 Summary

The arguments stressed by the EU in support of the planned EPAs are on the one hand based largely on the gains from regional economic integration and the larger markets this affords. This regional integration, reinforced by the EPAs and the participation of the EU, coupled with cheaper (i.e. tariff-free) imported inputs and a better business climate will encourage inward investment in export sectors. The improved climate for investment will also gain from the trade-related policies – on competition, national treatment for inward investment, better protection of intellectual property, more efficient border processes and so on. The gains in exports will finance the extra imports drawn in by tariff reductions as well as generating higher economic growth and making possible a more rapid reduction in poverty.

On the other hand the arguments for EPAs are related to the new and improved dialogue with the individual ACP States – among private sector and civil society representatives as well as public officials – and the stress on good governance (and the rather downplayed sanctions that are available to make this work). The improved dialogue will mean that the flexibility associated with market opening is efficiently exploited in the economic interests of each country or region, while at the same time ensuring a less corrupt and more efficient allocation and better-managed use of the funds made available through the development finance instruments.

This chapter has argued that the EU may have another agenda, in particular a more activist role for the EU in African politics. Apart from the recently imposed – and very limited – sanctions on the Mugabe regime in Zimbabwe, the EU has not followed through with this agenda, or, rather, it has not publicly used the Cotonou Agreement to advance the cause of dispute-resolution within and among ACP States. Another consideration was that of the business interests of EU companies in exporting to and investing in the ACP States and the national gains that could materialise from this. Given the multiplicity of partners involved on the EU side, commercial interests and their lobbies, the development lobbies, the member states and their various ministries largely with differing objectives, the Commission itself with its own contradictory objectives it is difficult to assess the significance of any of these on any particular point. But while business groups may have lobbied for improved access to particular countries, this seems unlikely to have been a major factor in the development of the EPA concept. In general the importance in assuaging the EU's sense of responsibility to the ACP is likely to far outweigh the mercantilist gains

One point – often raised in the context of trade negotiations – is that, if the benefits to one of the parties are so clear and could largely be achieved by unilateral liberalisation, why get involved in market access negotiations and risk being committed to additional measures that are less welcome. In the context of the EPAs, the ACP countries have generally embarked on regional integration schemes – often strongly supported by the EU – which ultimately aim at Free Trade Areas (FTAs) if not fully-fledged customs unions (CUs). The climate for investment could be improved by, for example, unilaterally adopting policies for the nondiscriminatory treatment of foreign investment and laws against price-fixing. However the Commission has made the point that having the EU fully participate in the FTA, besides widening it and extending the area of preferential treatment for its members, also introduces a certain solidity and predictability to the process of integration. In the

past regional moves by groups of ACP countries have often been thrown off track by economic or political hiccups, while individual countries have extended their lists of 'sensitive' products so that the coverage is severely impaired. Such delays and erosions are much less likely in the event of an EPA. Finally the 'political economy' value of EPAs should be mentioned. The governments of a number of ACP States might welcome the chance of justifying certain policy initiatives, which they would like to have taken unilaterally but would have been strongly opposed by particular domestic interests, on the grounds that they were required by the EPA which is of overriding importance.

Chapter 4: Parallel processes of trade negotiation

This chapter will discuss the role of Mozambique in parallel trade negotiations and the extent to which these overlap negotiations with the EU over an EPA. In particular it will examine the extent to which Mozambique has to meet other trade obligations whilst negotiating an EPA with the EU. These parallel negotiations are underway:

- within the World Trade Organisation, where the progress of the Doha Round had been set back by the failure of the ministerial meeting in Cancun, but, as of February 2004, are again beginning to show an accelerating engagement on the part of a number of countries. The renegotiations of Article 24 of the GATT will be given particular attention;
- in SADC with respect to the Trade Protocol. The members of SADC have signed an agreement leading to an FTA by 2015 with varying speeds of tariff liberalisation of intra-group trade. But besides the abolition of tariffs the aim is the gradual dismantling of all barriers to trade with SADC – export duties and non-tariff barriers, including the relevant domestic regulations, as well as tariffs;
- and in the EU over its Common Agricultural Policy (CAP). Mozambique is clearly not directly involved in the Community's reform of the CAP. However, agriculture plays a major role in the economy of Mozambique through its contribution to the PIB and economic growth, source of employment, income and food security, and an import source of exports, and the reform of the CAP will have a major impact on future exports, production and thus employment and earnings.

In this chapter we seek to examine the threats and challenges for Mozambique that lie ahead in these negotiating fora. But there is one problem raised by all parallel trade negotiations. These have implications for Mozambique – and all ACP countries - in terms of the capacity to service a number of different sets of negotiations simultaneously while, at the same time, maintaining a consistent and constructive position throughout.

4.1 WTO

At present the members of the WTO are negotiating a new round of multilateral trade liberalisation. This is important to all ACP countries faced with negotiations with the EU over an EPA. These include

- the fact that the background to and starting point for the EPA negotiations is the current situation as regards market access. Preferential treatment, whether for the ACP States or for the LDCs, must be relative to the alternative which are MFN tariffs and these are set in WTO negotiations;
- developments at the multinational level could even have a significant impact on whether Mozambique wanted to pursue the option of an EPA, if MFN trade liberalisation – particularly in agriculture – were such as to undermine the value of EPA and even EBA preferences;
- for trade-related disciplines, such as competition policy and the treatment of foreign investment, the background will again be set in Geneva. The EU has already made clear its intention of achieving, with the EPAs, “WTO plus” conditions – that is, more, more stringent and far-reaching rules than those that are envisaged in the WTO negotiating process. It should be noted that the ACP countries have agreed that, following the EU’s refusal to discuss these issues at the all-ACP level they would not entertain any negotiations on them until the WTO has reached agreement on the issue in question. This clearly introduces a very explicit link between the two sets of negotiations. These issues will be discussed at some length in Chapter 9 below. Thus the decision by SADC to engage in negotiations in ‘trade facilitation’ may appear to contravene decisions at the all-ACP level which could set a bad precedent for the all-ACP group.
- given the EU’s emphasis on the importance of WTO compatibility in the EPAs, another important linkage arises through the Doha-mandated ‘clarification’ of Article 24 which defines the conditions that preferential trade arrangements must satisfy. Until now the EU has made its own rules as regards the key concept of ‘substantially all trade’. The present negotiations in Geneva – in which it behoves the ACP States to get fully involved – could redefine the rules to take the interests of developing countries – particularly of LDCs – into account more fully.

This section will look at the challenges and problems that are created for the ACP States – and in particular Mozambique – in these two sets of parallel negotiations. At the end of the chapter we will draw some conclusions with respect to these, as well as the related processes of SADC integration and CAP reform.

The breakdown of the Ministerial Meeting at Cancun has been attributed to a North-South confrontation of the meaning of a ‘development round’.⁴⁶ The developing

⁴⁶ See, for example, the report of Parliamentary Group of the Party of European Socialists, *Cancun: How it failed, why it failed*, at http://www.erylmcnallymep.org.uk/world_trade.htm

countries were organised in new alliances, the Group of 20 and the Group of 90 – a re-embodiment of the Group of 77 with a wider membership. The former included many of the larger developing countries, including Brazil, China, India and South Africa.⁴⁷ The latter was an alliance of African Union, ACP and LDC countries. Both groups sought to secure major reforms by industrialised countries, particularly in agriculture, not least to correct what they saw as the injustices created in 1994 by the Uruguay Round agreements, whereas the developed countries saw the talks as based on the give and take and last minute concessions of traditional trade negotiations.⁴⁸

The Doha Ministerial Declaration, which launched the current trade round, focussed negotiations on a substantial liberalisation of agricultural markets in developed economies: on market access, on reductions in, and ultimately the phasing out of, all forms of export subsidies, and on substantial cuts in trade-distorting domestic support. In return both the EU and the US united to call for the opening of developing country markets, including that of agriculture, rather than demanding changes in one another's farm policies as in earlier rounds. Separately, without US support, the EU (along with Japan and Korea) sought agreement to open negotiations on the Singapore Issues. Despite a broad but ill-formulated willingness on the part of the G20 countries to discuss some liberalisation of their markets, and a last minute climb-down on the part of the EU who agreed to unbundle the Singapore Issues and postpone discussion of investment and competition policy, the concessions were too little and too late. That, together with the refusal of the developed countries to show any radical flexibility over agriculture, meant that the meeting was closed, in hindsight prematurely, before serious negotiations had made much progress.⁴⁹

The breakdown of negotiations in Cancun probably implies that the outlines of a multilateral agreement on trade liberalisation will not be clear before negotiations on an EPA get under way between the EU and a Southern African regional grouping including Mozambique – or indeed Mozambique alone, were it to decide to opt for a single country EPA with the EU.

This has several implications. If the Doha Round timetable had been followed and agreement reached before the beginning of 2005, detailed EPA negotiations would have started from a different, more liberal, situation. As it is, the EPA negotiations on market access start from the status quo as regards MFN tariffs. While improvements in preferential rates for ACP countries and the reciprocal opening of their domestic markets are being negotiated with the EU, both sides will simultaneously be negotiating multilateral liberalisation under the WTO umbrella. Multilateral liberalisation of course implies the erosion of the same preferences.

⁴⁷ Since joined by Egypt, Indonesia and Nigeria.

⁴⁸ Other demands included strengthening and 'mainstreaming' S and D treatment, including emergency safeguard measures, action on Mode 4 of the GATS, improvements in the provision and quality of trade-related technical assistance, the reduction of tariff peaks and tariff escalation and progress on the concept of 'special products' for which the developing countries could maintain special import regimes to cope with food security, rural development, poverty alleviation and product diversification issues.

⁴⁹ See South African Institute for International Affairs, Faizel Ismail, *An Insider's Insight, in Africa After Cancun: Trade Negotiations in Uncertain Times*, November 2003, available at <http://www.wits.ac.za/saiia/TradePolicyBrief/TR2Cancun.pdf>.

Secondly, there will be less incentive for the EU to abide by its commitment to significantly improve its GSP at the beginning of 2005. If Cancun had accelerated the WTO negotiations leading to significantly lower MFN tariffs across the board before the new GSP had been finalised, the GSP terms of access would have had to have been improved in order to give the beneficiary countries significantly better access than MFN suppliers. Thus there is less pressure for an improvement to standard GSP preferences and the rules of origin (on both standard GSP and EBA imports) This means that the attraction for an ACP State of opting out of an EPA in favour of GSP treatment will be less than it might have been. On the other hand an improved EU GSP for non-LDC developing countries would also contribute to the erosion of ACP preference margins. However an improvement in EBA rules of origin – which are different from and significantly more severe than the rules under Cotonou – would be an additional incentive for ACP LDCs to decline to negotiate with the EU. Again, this is less likely than it would have been had the Doha Round made more progress.

Thirdly, the absence of an extension to the peace clause may result in many more disputes over agricultural policies coming to the WTO. Already there are complaints about US cotton exports and the EU sugar regime. On balance the success of such complaints will probably reduce the dumping of agricultural surpluses by the developed countries, but individual programmes which are important to particular ACP States, e.g. meat and sugar, may be dismantled.

Thus in preparing negotiating stances for the EPA, the ACP countries are facing less clarity as to the likely structure of a multilateral agreement than would have been the case were the Cancun discussion to have led to a firming of the chances for a multilateral agreement over the coming years.

The failure at Cancun also has implications for Mozambique as far as its programme of trade negotiations over the coming years is concerned, both in terms of the call on human and financial resources as well as in terms of the logical coherence of positions adopted in different negotiating fora. A period of negotiations in Geneva –probably lasting two years or more – will precede the next Ministerial meeting. These will aim to ascertain the extent to which each group is prepared to go on the major issues in dispute – in particular agriculture and the trade-related issues. But clearly there is a limit to the extent to which Mozambique can be actively involved in Geneva over and above the SADC EPA negotiations and possible discussions over entry into SACU. Nevertheless it is important that the Mozambican authorities monitor the WTO negotiations in preparation for and alongside the EPA negotiations, particularly in order to inform the choice as to whether Mozambique should enter any negotiations with the EU or should opt for an EPA on its own or with other Southern African countries. In these decisions prospects for the liberalisation of agricultural markets in the developed world and the phasing out of export subsidies are critical in determining whether and, if so, what agricultural exports other than sugar should be central to government planning.

The lack of success in the EU's efforts to have negotiations started as regards the Singapore issues – trade and competition policy, trade and investment, transparency in government procurement and trade facilitation – reinforces the likelihood that the EU will insist that these topics feature in an EPA. But even if multilateral agreements on these issues were agreed before the EPA negotiations are concluded, the EU might still demand that the EPAs take these issues even further than the multilateral

agreements. The EU has been stressing that the EPAs must be WTO-plus, that is that they improve market access and further other trade-related disciplines beyond that likely to be imposed by a WTO agreement.

As for trade-related disciplines, it is argued in Chapter 9 below that in the area of trade and competition there may be gains to developing countries from a multinational agreement – or a plurilateral agreement to which most of the large developed economies subscribed. There is much less to be gained from agreements on investment or public procurement. An agreement on trade facilitation, preferably outside the WTO aegis, could be helpful if improvements to border facilities were facilitated by additional technical assistance and finance. One of the issues then is whether Mozambique would benefit from any WTO-plus commitments on the Singapore issues, which might be a required component of an EPA.

As for developing country negotiating groups, it is important to remember that the Group of 20 has only three African members, Egypt, Nigeria and South Africa, The Group of 90 is arguably too large and divergent in interests to form an effective pressure group within the WTO. The African Union could serve as such. It represents the smaller, poorer countries that share many common interests. Most of its members are ACP States. It would be sensible for Mozambique to put its weight behind building up the authority and expertise of the African Union.⁵⁰

Of course the issue of the erosion of preferences through multilateral liberalisation under the Doha (and future?) rounds – referred to earlier – is of concern to the developing countries and will arise in the EPA negotiations. The same problem arises in the context of improvements to the various developed countries, including the EU's, standard GSP, as well as in the context of regional preferential agreements, including the FTAs which the EU is in the course of negotiating, for example, with Mercosur. Clearly, in terms of tariffs, per se, the EU cannot improve on their offer of zero tariffs to the ACP States through EPAs. But as will come up throughout this report there are a large number of instruments for improving access outside formal tariff preferences. These include improvements in the rules of origin, relaxation of protectionist SPS regulations or, where such regulations are genuinely necessary, help to the ACP countries to meet the required standards, sensitivity to the ACP interests as regards the trade-related issues such as competition are concerned and development assistance through the EDF and other existing and new financial instruments.

Article 24 of the GATT and Article V of the GATS: In arguing for EPAs, the EU has put a large emphasis on the need for WTO-compatibility and the fact that the waiver granted for the Lome Convention will expire in 2008. The Cotonou Agreement stresses that the EPAs to be negotiated between the ACP States, either singly or in regional groupings, must be WTO-compatible. The problem with this arises because, as the Agreement recognises, the ACP States that may feel in a position to enter

⁵⁰ In June 2003 the Africa Group trade ministers met to work out common positions for Cancun and subsequent Doha Round negotiations. These were later coordinated with the ACP trade ministers and the trade ministers of the LDCs. Detailed positions on, inter alia, strengthening STD and putting it into operation, Mode 4, emergency safeguard actions, reductions in tariff peaks and tariff escalation especially in agriculture were agreed. The limelight, at Cancun, may have been on the G20 but the G90 also played a significant role in formulating and concerting developing country policies.

negotiations require certain ‘flexibility’ in meeting the requirements of mutual trade liberalisation, reciprocity and equality of treatment which lie at the heart of the WTO provisions on regional trading arrangements. This flexibility is interpreted in the Cotonou Agreement (article 37:7) as pertaining to the length of the transitional period, the final product coverage and the degree of asymmetry in the timetable for trade liberalisation. As regards merchandise trade, the relevant articles in GATT 1994 are Article XXIV, those contained in Part IV and the so-called Enabling Clause.

There is no explicit flexibility for developing countries in Article XXIV, but the Enabling Clause does not explicitly deal with RTAs involving both developed and developing countries. Although one route would be through extending the scope of the Enabling Clause, as Onguglo and Ito point out, the legal validity of that clause is itself being questioned. Opening up negotiations on the Enabling Clause might have the perverse effect of tightening up the conditions on RTAs comprising only developing countries. Article XXXVI in Part IV of the GATT 1995 could be amended to permit non-reciprocity in mixed developing-developed RTAs but that approach is likely to be resisted as introducing an excessive degree of flexibility.⁵¹ Thus the modification of Article XXIV is likely to prove the most rewarding approach. Moreover its ‘clarification and improvement’ by 2005 is foreseen in the conclusions of the Doha ministerial. Thus the best way to proceed about the reciprocity issue is through the Art. XXIV.

Article XXIV:8 states that a FTA is understood to mean that duties or other restrictive agreements “are eliminated on **substantially all the trade** between the constituent territories in products originating in those territories”. In addition, Article XXIV states that FTAs and CUs must be established within a ‘**reasonable**’ but unspecified period of time.

The Understanding on the Interpretation of Article XXIV, one of the Uruguay Round Agreements which include various interpretations of GATT 1994 articles, did not, given EU and US interests perhaps not surprisingly, clarify the critical expression ‘substantially all the trade’. It did, however, define a ‘reasonable length of time’ as not greater than ten years except in exceptional cases. In such a case there would be a full explanation to the WTO Council for Trade in Goods and Services of the need for a longer period. Most of the Understanding consists of the basis for the assessment of changes in overall tariffs in the event of the formation of a customs union (CU) and procedures to be followed when a Member forming part of a CU proposes to increase a bound rate.

The EU Commission has chosen to interpret the ‘substantially all the trade’ clause as implying variously 80 or 90 per cent of overall trade among members of an FTA, i.e. the sum of all bilateral trade flows free of tariff and non-tariff barriers relative to the sum of all bilateral flows. In its Commission staff working paper concerning the establishment of an inter-regional association between the EU & Mercosur, it writes

“[s]ubstantially all the trade” is understood to have both a quantitative and a qualitative dimension, meaning that 90 per cent of all trade between the parties is covered, with no major sector being excluded. It should be noted that only products subject to total trade liberalisation count for the substantially all the trade. As regards the quantitative element, it should be noted that the 90 per cent

⁵¹ Onguglo and Ito.

requirement is an estimate, based on current interpretation and reviews in the WTO. There is, however, no definite limit for when the quantitative requirement is met, and the requirement is understood to have a dynamic element, allowing for account to be taken of potential trade. Therefore the treatment of products for which or little trade takes place, in particular if this is due to a high level of external protection, are also taken into account for the WTO assessment of the agreement. For any specific FTA the limit would have to be decided in the WTO Committee on Regional Trade Agreements, or by a dispute settlement panel. The ‘major sector’ has not yet been defined, neither in the Uruguay Round Understanding itself, nor by the WTO Committee on Regional Trade Agreements. It is clear, however, that substantial coverage of the different sectors would be essential for defending the WTO compatibility of the agreement.⁵²

The EU interpretations – whether the 90 per cent figure, the addition of trade flows between partners or the use of current trade as the base - have had no support from the WTO membership. Article XXIV:8 gives no indication as to whether the sum of bilateral flows is the appropriate variable. Clearly the European Commission has doubts. Hence the mention of a “qualitative dimension” and the “requirement .. to have a dynamic element, allowing for account to be taken of potential trade”, though that requirement is not elsewhere expressed in any practical terms.

But obviously the quantitative EU interpretation makes a nonsense of the clear intent of Article XXIV.8 since, where trade barriers are such as to rule out – or largely rule out – major areas of potential trade, the share of fully liberalised trade in actual trade is actually increased. The EU concentrates its protectionism among agricultural goods, processed foods and organic chemicals in such a way as to effectively exclude whole HS chapters – or even ‘major sectors’ depending how one defines them. By using actual trade as a denominator, the EU has excluded imports in large areas of agricultural trade from countries with whom it has signed an FTA and still met its self-imposed criterion of 90 per cent of trade with each of those countries. It claims to honour Article XXIV while effectively excluding most potential agricultural imports. This is clearly against the liberalising intent of Article XXIV.

The reference to “no major sector being excluded” is in line with the Preamble of the Understanding, which states that the contribution of integration agreements to the expansion of world trade is “increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded”. The parallel condition for WTO-consistency in the GATS, which requires ‘substantial sectoral coverage’ and which is further clarified as ‘understood in terms of numbers of sectors, volumes of trade affected and modes of supply’. Thus Article XXIV.8 could be interpreted to refer to substantially, say 90 per cent of, all tariff lines, either defined across the board or broken down into sectors, for example by HS 2-digit chapters. Of course the EU will fight any clarification to the concept of ‘substantially all the trade’ based on tariff lines – with a restriction on the share of non-liberalised lines in each sector – rather than shares of actual trade. But it is in the interests of the developing countries – who will be actively supported by the developed members of the Cairns Group, in particular Australia – to push for such a clarification.⁵³

⁵² European Commission (undated), *Commission staff working paper concerning the establishment of an inter-regional association between the European Union and Mercosur*, see http://europa.eu.int/comm/external_relations/mercosur/bacground_doc/work_paper0.htm.

⁵³ For more details of the implications of such an interpretation, see Davenport (2002)

Mozambique may have comparative advantages, or may be able to acquire competitive advantages, in some agricultural products. Thus it is in Mozambique's interest to join with other developing countries in advance of the conclusion of the Doha Round in seeking a clarification of Article 24 that would prevent the wholesale exclusion of large areas of agricultural products while still claiming WTO compatibility.

There is another aspect to the clarification of Article XXIV that could be in the interests of the developing countries. S and D treatment in Article 24 is confined to a possible differential phase-in period for liberalisation, now generally taken as 10 to 12 years, and the fact that 'substantially all the trade' is interpreted by the EU as the sum of exports by each party to the other. But S and D treatment for the LDCs could be taken further. The GATS does go further in making explicit special treatment for the developing countries. "[I]n evaluating whether the conditions under paragraph 1(b) [that is on non-discrimination] are met, consideration may be given to the relationship of the agreement to a wider process of economic integration or trade liberalization among the countries concerned". In general the special treatment of developing countries is well-founded in the GATS. On the whole this is recognised in the agreements between the EU and developing and transition countries. It would be in the developing countries interests at the WTO meetings on Article 24 to make consideration of the degree of development among the parties to an RTA an explicit justification for a more flexible interpretation of 'substantially all the trade' where the imports of the developing country, or specifically LDC, partners are concerned. This is also likely to be resisted by the EU on the grounds that its own self-serving interpretation of Article 24 can provide sufficient flexibility.

4.2 The SADC trade protocol

Yet another set of parallel negotiations that will inevitably impinge on the EPA negotiations are those concerned with further integration between the members of SADC. In this section we examine the implications of the SADC Trade Protocol for various possible EPAs. In some ways the process of regional integration and progress towards realisation of an EPA could be mutually reinforcing. On the other hand particular problems could arise where the EPA negotiating groups are not commensurate with existing regional integration groups – in this case SADC. Again we will sum up the conclusions at the end of the chapter.

The members of SADC have signed an agreement leading to an FTA by 2015. The rate at which trade among members will be liberalised depends on whether the member in question is South Africa, an LDC or one of the others, as well as on the sensitivity of the good in question for each member.⁵⁴ Full liberalisation as regards SACU imports is due in 2006, for Zimbabwe 2001, for Mauritius 2006 except that with respect for South-African products for which will be 2011, for the LDCs

⁵⁴ The RISDP (Regional Indicative Development Plan) goes much further than the creation of an FTA. It deals with policy coordination in a wide range of fields, including trade, industry, finance and investment; food, agriculture and natural resources, infrastructure, services and social and human development. Cross-cutting issues such as AIDS, poverty reduction, gender issues, the role of the private sector, statistics and science and technology are also included. See www.dwaf.gov.za/Docs/Other/RISDP/Guidelines

(Malawi, Tanzania, Zambia) 2012, for Mozambique 2012 except that with respect for South-African products for which it is 2015⁵⁵. The SADC members have also agreed on the phased liberalisation of trade in services, on particular transport and communications, tourism, financial services, construction and energy.

The Protocol on Trade was agreed in 1996 and its implementation got under way in 2000. Its aim is to abolish all barriers to trade with SADC – export duties and non-tariff barriers, including the relevant domestic regulations, as well as tariffs. The ultimate aim is a common market, though the time framework is at present limited to the establishment of an FTA. But as the Economic and Social Research Foundation report argues, a lot can be done to encourage intraregional trade besides the gradual reductions in tariffs. This includes the elimination of temporary import and export bans or temporary increases in tariffs, elimination of licensing, publication of applicable tariffs in good time, harmonisation of standards and where appropriate mutual recognition, and simplification of customs procedures.⁵⁶

The liberalisation of trade within the region is expected to lead to more competition. Enhanced trade throughout the region, particularly in agricultural goods, is seen as an important step towards the alleviation of poverty. Most SADC economies are predominantly based on agriculture. At present South Africa exports far more to the SADC region than it imports from SADC members. Moreover the share of South Africa in SADC imports is substantial while SADC is minor as a supplier to South Africa (see Annex 1). “It imports a narrow range of products from SADC countries and these imports have fluctuated considerably over time. South Africa’s imports constitute an opportunity for SADC suppliers to South Africa’s agribusiness sector. While total agricultural imports have increased, the growth rate has been lower than that of exports, hence the agricultural trade balance has moved in favour of South Africa. Furthermore, South Africa’s imports of agricultural goods include an increasingly large component of goods that were not imported in any significant degree in the past from SADC countries.”⁵⁷

4.3 The Common Agricultural Policy

Unlike the situation with the WTO negotiations and the development of the SADC FTA and CU, Mozambique has no formal voice in the future of the CAP. Nevertheless that is of considerable importance to Mozambique in that it will be a critical factor in the determination of world agricultural prices, which will have a significant impact upon Mozambique’s export revenue, stability of export revenue and decisions with regard to industrial, investment and export policies. Indeed the extent and details of reform to the CAP is of critical interest to all the ACP States. This section will concentrate on identifying the major issues for the ACP, and in particular Mozambique.

⁵⁵ It must be noticed that there is a difference between what has been committed and what is being implemented in reality (i.e. especially Zimbabwe)

⁵⁶ Economic and Social Research Foundation, *Trade Policies and Agricultural Trade in the SADC Region: Challenges and Implications*, 2003

⁵⁷ *idem*, p. 16

The future of the CAP will play a role in the EPA negotiations – not because the ACP countries can expect to play a significant part in the broad sweep of CAP reforms, though they may play some role as regards the details – but because⁵⁸:

- present and planned CAP regimes for the main ACP agricultural and processed food exports set the basis for ACP and EBA preferences. The more closed are EU agricultural markets, the greater is the competitive edge given by preferential treatment of ACP or LDC exports;
- on the other hand, if there is little headway made towards liberalising EU markets, the EU negotiators may argue that ACP preferences are adequate and resist any further improvements. This of course would help the EBA beneficiaries;
- changes in certain of the ACP regimes may have significantly different effects on different groups of ACP suppliers. For example a liberalisation of the EU sugar regime will damage the ‘protocol’ exporters which are paid the internal EU price on set quotas of exported sugar. However it may benefit non-protocol exporters if the increased volume of exports more than compensates for the lower price, assuming that lower prices are not below marginal costs of production, and that non-protocol exporters can adjust volumes and costs to new market conditions.
- where the ACP countries present a consistent and unified argument in favour of particular reforms, they will have a greater impact, especially where the exports in question do not compete significantly with EU production, or where EU production is diminishing in importance, such as is the case with tobacco leaf production;
- and finally there is the possibility that the EU and its ACP partners could form alliances to support each other in the WTO negotiations – perhaps to limit market liberalisation in the EU, probably in particular sectors, to sustain existing ACP preferences in those sectors and to limit the liberalisation required of the developing countries in those sectors.

First we shall review the recent measures that have been taken to reform the CAP. Then we shall briefly consider the pressures in turn, before turning to the prospects for further significant changes in the CAP and their likely effects of the ACP States and, in particular, Mozambique. These possible changes will be examined in terms of the removal of export subsidies and of the opening up of world agricultural markets.

CAP reform: The EU Council of Ministers in June 2003 agreed a set of CAP reforms. Those that matter most from the EPA negotiations viewpoint are the anticipated

⁵⁸ Because of its importance the case of sugar is analysed more in detail below. Basically it concludes that, although their respective interests are not identical, the ACP Protocol suppliers and the other suppliers – including Mozambique – should get together to try and work out a common negotiating strategy and that the ACP LDC producers should, if possible, seek a guarantee by the EU of sugar import values or prices.

proposals for reform in the sugar and tobacco sectors. Proposals for reform in the sugar sector, ranging from complete liberalisation to retaining the status quo, have been announced, but no decisions have yet been made.

Earlier CAP reforms suggest what might lie ahead for ACP exporters. The beef sector has been subject to diminishing subsidies since the Agenda 200 reforms were put into effect. According to Agricultural Commissioner Fischler these resulted in a 13 per cent decline in average EU beef prices. This has significantly damaged the returns to ACP beef exports to the EU market.⁵⁹ In general this process will be extended across all commodities. Internal EU supports and access barriers will gradually be dismantled across all commodities with two main implications. Exporters to the EU will receive lower prices for their goods, while world prices will tend to rise as the EU eliminates export subsidies with negative consequences for importing countries.

The European Commission has estimated that if reform of the sugar sector were to be pursued involving a 25 per cent reduction in the EU sugar price, ACP sugar exporters would incur annual income losses of around US \$ 250 million. In terms of income losses the worst affected countries will be those in Southern Africa. However, the worst affected in terms of their domestic economies are likely to be Guyana and the small and vulnerable islands states of the Caribbean and Pacific which currently benefit from the access to the high priced EU market provided under the Sugar Protocol and Special Preferential Sugar arrangement. The precise effects of sugar sector reform on ACP economies will depend on how the EU manages the process of reform, and the extent to which the reform process impacts on EU production levels and EU exports.

The WTO and agricultural liberalisation: The announced reforms to the CAP will make a Doha Round Agreement easier for the EU. When the agreed measures are fully implemented, some 70 per cent of subsidies will be decoupled from the level of production. Further measures for dairy products, sugar, tobacco and other products will complete this process. The reforms will allow a proportion of currently production-linked subsidies to be shifted from the WTO's "blue box" category to the "green box", which are deemed to be non-trade-distorting (or only minimally so). These subsidies would not be subject to any reduction commitments. Moreover, even partial decoupling of subsidies from production would weaken incentives for European farmers to maximise output, leading to reduced surpluses and the need for export subsidies to dispose of them. The agreed changes would have allowed agreements on deeper cuts in export subsidies and tariffs than the EU originally proposed to the WTO last December.

⁵⁹ A presentation of the effects of CAP reform on the ACP countries cited a report by Swaziland Meat Industries to the effect that the UK price of chilled steak cuts suffered a 28 per cent decline between 1994-95 and 2003, while the price of forequarter frozen cuts fell from by 30 per cent. Similar price declines are reported on Namibian and Botswanan beef exports. In the case of Swaziland these price falls have led to an under-utilisation of allocated quotas. Paper submitted to the Royal Institute of International Affairs (Chatham House) informal discussion on the EU negotiating instructions convened by the Cotonou Monitoring Group of European Development NGOs and networks on Friday 10th May 2002 by an ACP Ambassador who led of the discussion on one of the issues discussed (Market Access, External Effects of CAP-Reform, Fiscal Implications and Supply-Side Constraints).

The US has also said that it would be willing to reduce its effective export subsidies – which are mainly in the form of export credits and food aid rather than formal payments to reduce the price of exports to under international price levels.

Thus the problems that contributed to the breakdown of negotiations in Cancun were less a refusal on the part of the EU to agree a major phasing out of export subsidies but, first, a reluctance to subject EU farmers to additional price reductions stemming from increased imports, secondly, an unwillingness on the part of the US to renegotiate the 2002 Farm Bill – in particular in respect of the dumping of cotton – or to significantly open US agricultural markets, and, thirdly, the demand by both the US and the EU for significant market opening by the developing countries. Some limited market opening in agricultural goods by the developing countries over a longer transitional period in return for the phased elimination of most developed country export subsidies and their equivalents is still the most likely outcome. The developing countries could aim to secure S and D treatment through inclusion of a ‘Development Box’ (a range of measures which developing countries could use to protect and promote their domestic agricultural sectors, including domestic support and import tariffs) in any new Agreement on Agriculture.

The interests of developing countries: But before the Doha Round moves forward in that direction the developing countries – perhaps through the initiative of the Group of 21 – should analyse the gains to them from emphasising reductions in developed countries export subsidies at the expense of further opening of developed country markets. The agricultural exports of many developing countries are frustrated by trade barriers in the developed countries as well as in other developing countries. According to World Bank estimates, the policies of industrialised countries (including tariffs and subsidies) inflict losses of at least \$20bn per year on developing countries, 40 per cent of the amount they receive in aid (World Bank 2000). In addition to tariffs, the EU imposes a complex system of non-tariff barriers (such as sanitary and phytosanitary standards) and anti-dumping rules which often can frustrate the export initiatives of developing countries.⁶⁰

It is true that the access of ACP countries has been improved by the Cotonou Agreement while that of the LDCs, including Mozambique, has been greatly bettered by the EBA initiative. But it is interesting that the EU Commission has not undertaken, or commissioned, a comprehensive study of the effects of the CAP on different groups of developing countries. Indeed it is not unusual to hear European politicians defend the CAP and the system of preferences that it allows as actually beneficial to the developing countries.

On the other hand certain developing countries depend upon imports to meet the nutritional needs of their citizens. For these the end of export subsidies and the reduction of protection in the developed countries could mean higher prices for imported food. Of course this may lead to greater investment in their domestic agriculture. However, such investment may not be able to deal with an immediate and pressing crisis.

Likely impacts of negotiations on important agricultural products:

⁶⁰ Examples of the impact of non-tariff barriers can be found in Mauritanian camel milk/cheese or South African citrus fruit.

Cereals: If EU liberalization ends up increasing the world prices due to reduced EU supply, Mozambique can suffer a negative impact, at least in the short term. However higher price may set incentives for increasing the production but the supply reaction cannot be assumed beforehand given the structure of agricultural market and the strategy and organization of Mozambican producers.

Tobacco: This will be one of the sectors mostly affected by the CAP reform and it is extremely important that Mozambique follows this process in order to (a) influence, jointly with other interested countries, the direction of this reform; (b) take into account the impact of the reform on its domestic production. In fact this sector has recently grown at an impressive rate and can provide an important springboard for the development of a more commercial oriented agriculture in major agricultural provinces (i.e. Tete, Nampula, Manica, Zambezia, Niassa) . It will be important for the government to develop and link a strategy for developing tobacco which should be reflected at the level of the EPA negotiations

The Protocol commodities: Another, and more pressing, problem for many developing countries is the future of the so-called Protocol Agreements. Four products are now subject to special protocols to successive Lome Conventions: beef, bananas, rice and cane sugar. These need to be considered separately because they are subject to new regime changes which are critical to ACP producers. Here we will only presents the main conclusions but for a more detailed analysis see Annex Chapter 4.

Sugar: This is a crucial sector and its importance must be very carefully taken into account during the EPA negotiations. The main objectives for Mozambican negotiators, likely to be shared with others ACP 'competitive sugar' producers are:

- Slow down the liberalisation of the EU market as much as possible,
- Influence the liberalization in order to concentrate on domestic subsidies rather than border protection, i.e. tariffs are maintained as high as possible given the WTO process, in order to maintain the preferential margins
- Further, until all quotas are eliminated, as some producers become unable to compete at lower prices, their quotas be reallocated according to a formula agreed between all remaining ACP suppliers.
- Finally, the LDCs should try to negotiate some mechanism which will protect their earnings as prices fall, this should be vigorously pursued.

Rice: Mozambique is today a net importer of rice. Domestic production covers only about 1/3 of consumption. The Government of Mozambique has recently been promotion rice as a strategic priority in cereal production, because of market opportunities in Southern Africa, which imports about 2,000,000 tons of rice per year. This plan is still in a starting phase.

If the Government rice production goes ahead, the EU market should also be considered and rice should be discussed in the framework of an EPA. This discussion should focus on mechanisms to create domestic productive capacities, promote

product quality and find markets with attractive margins. In this case, domestic development objectives of promoting commercial production of rice in large scale could be complemented and supported by the EPA negotiations.

Banana: The banana regime is under modification and the new regime will allow to Mozambique duty free access to EU market under EBA. Mozambique was in the past an important producer of banana and has potentially the right agro-climatic conditions, however it is difficult to envisage that in the short term there would opportunity on the EU market for Mozambican banana. To be noticed that today the ACP quota under zero-tariff is not fully utilized.

*Beef*⁶¹: The reform of CAP regime is reducing the preferential margins which is already creating problems to some traditional ACP suppliers (i.e. Botswana, Lesotho, etc.). Further Mozambique production of livestock will take long time to get back to the pre-independence level and opportunity to supply EU market are hard to envisage.

4.4 Conclusions on parallel negotiations

The coincidence of three principal sets of trade negotiations for Mozambique – those of the Doha round of multinational trade liberalisation under the WTO umbrella, those within SADC on extending the Trade Protocol and those on an EPA with the EU (together with the preparatory talks for the last of these with the other members of the SADC EPA negotiating group) – imply a major strain on Mozambique’s negotiating capacity and budgetary requirements. At best, these fora need full participation by Mozambique and, where that is not feasible as in the many WTO groups and committees meeting in Geneva, at least careful monitoring. Similarly, careful monitoring of reforms to the EU’s Common Agricultural Policy is important since such reforms will directly affect Mozambique’s access to the EU’s markets as well as, indirectly, impinging on world agricultural prices and market opportunities.

The failure to make progress in the **WTO negotiations** in Cancun means that the EPA negotiations start from a situation of greater uncertainty that might otherwise have been the case. If the broad lines of the likely outcome of the Doha Round had been clarified at Cancun, the ACP countries would have been in a stronger and less uncertain situation at the onset of the EPA negotiations. As it is the Doha Round might ultimately undermine many of the attractions of EPAs, particularly through the erosion of EPA preferences. This applies less to Mozambique which is benefitting from the EBA but even here the scale of its preference margins against non-LDC developing countries and developed countries could be significantly impaired. Perhaps more worrying would be a significant liberalisation of the EU’s barriers to sugar imports and domestic subsidies which could significantly cut the price that

⁶¹ This is not a sector with a major direct interest for Mozambique. However it has some indirect significance because of (i) the importance of beef to other SADC member countries in particular Botswana and Namibia and the importance of a negotiating position with other likely EPA members, and (ii) the fact that liberalisation of the EU’s beef regime will imply continued rises in the world price of beef and thus Mozambique’s import costs.

Mozambican sugar could command on the EU market. Some of Mozambique's likely partners in the EPA negotiations – Namibia, Swaziland and Botswana – are not LDCs and, with significant preference erosion, the attractions of an EPA compared to the EU GSP scheme could be significantly eroded.

The situation with regard to some of the trade-related issues – in particular the Singapore issues – that the EU might want to see in an EPA might also have been clarified in Cancun. We will come back to these questions in Chapter 9 below.

Another issue being negotiated or 'clarified' by the WTO's Committee on Regional Agreements is Article XXIV. These negotiations could have a significant effect on the WTO's interpretation of the phrase 'essentially all trade' and thus affect the share of Mozambique's imports from the EU and other EPA partners on which all tariffs will need to be eliminated. It is likely that the EU will resist any other interpretation of that key phrase other than its own. In any event those negotiations need to be carefully monitored.

As regards **the SADC negotiations**, the critical points are that they present yet another, now inescapable, demand on the negotiating resources – human and financial – of Mozambique. The gradual liberalisation of trade within the full SADC membership does not immediately create major problems for the negotiation of an EPA with a subset of that membership (either Mozambique alone or the BLNS countries, Angola, Tanzania and Mozambique) and the EU. Those problems will come later as the SADC FTA overlaps with the geography of the EPA. That will be discussed at length in the next chapter.

Reform of the EU's CAP is

- of particular concern to the ACP States is the outlook for the so-called protocol commodities, bananas, rice and sugar. The banana regime, whose special quotas for African and Caribbean ACP producers was found illegal in the WTO, is being dismantled and will be replaced with a more open system, albeit with significant tariff preferences for the ACP producers. The interested developing countries are nervously waiting for the EU's proposals on sugar and rice. Both of these – particularly the former – are of importance to Mozambique. Through the EBA arrangement Mozambique enjoys tariff-free – though temporarily quota-constrained – access to the EU sugar market.
- Mozambique was formally a regional exporter of bananas and also has potential as a rice exporter. EU CAP reform and the gradual dismantling of export subsidies will tend to raise world prices which will benefit net exporters and damage net importers. The government may also want to exploit the increasing access to the EU market in these products through the EBA. The critical question is whether Mozambique can produce competitively relative to other suppliers – given that the tariff preference will be shared with other ACP and LDC producers. Significant investment would be required but it is also important to recognise that the tariff preference will be eroded – possibly quite rapidly – with the Doha and subsequent WTO rounds.
- These same considerations apply to sugar. However the initial situation is different in that Mozambique is already a sugar producer and indeed sugar exports contributed about 4 per cent of export earnings in 2001-2002. In 2003

Mozambique exported under the EBA scheme about 8,000 tonnes to the EU which was the quota agreed by the LDC producers. This quota will grow over time and finally be eliminated in 2009. The EU will decide on the future of the sugar regime in the forthcoming months. The chances are that the regime will slowly be unwound, resulting in significant falls in the EU price. Some of the existing ACP producers will not be able to compete and this will give new opportunities to the remaining suppliers – including the EBA beneficiaries. The interests of the remaining ACP non-LDC producers and those of the EBA producers including Mozambique are not necessarily identical. In general however their interests have sufficient in common – including an interest in as gradual a reduction in EU prices as possible – that they should be able to work out a joint negotiating strategy. In particular it might be worth some restraints on overall quantities exported to the EU in return for somewhat higher prices or earnings, especially if this could be formalised in an agreement among all the major parties.

Chapter 5: Quantitative analysis of options

The annex 13⁶² examines the broad options facing Mozambique in the forthcoming round of EPA negotiations. Ideally it would be possible to make reasonably confident estimates of the effects of the alternative scenarios on Mozambique's GDP level and growth rates – as we shall see there are likely to be both static and dynamic effects from any agreement – as well as the balance of payments, the inflation rate, employment and so on. This is simply not possible given the current state of the art of economic modelling and the quality of the data available. The appropriate details of the model itself would be subject to significant disagreement, the needed data are either not available or not accurate enough and the hundreds of needed coefficients have not been systematically estimated.⁶³

However partial equilibrium (p.e.) analysis, though restricted by the same catalogue of imponderables, is much less demanding in terms of modelling, data and coefficients. Unfortunately it can only shed some limited light on the import side of trade liberalisation – the effects of reducing or eliminating tariffs and their equivalents on the value of imports and its direct consequences⁶⁴. In this chapter we use p.e.

⁶² *Annex 13: Options facing Mozambique: geographical configuration*

⁶³ The appropriate methodology would be a so-called general equilibrium (GE) model. These shortcomings have not discouraged researchers from using GE models to attempt to answer such questions. Given these problems, whether the results have had any useful policy implications is doubtful.

⁶⁴ The reason why no impact on exports is analyzed is because there is no direct effect on exports to the EU (because of EBA) or to other SADC members (because tariffs are being eliminated in any event). In fact Mozambique faces today zero tariffs and quota on the EC markets because of the EBA, therefore first round effect on export would not be derived by the reduction of tariffs, already zero, and could be modeled only through modeling the tariff like impact of ROOs and other regulatory barriers (i.e. SPS measures) which would be well beyond the terms of reference of this study.

analysis to look at the broad impacts of removing all tariffs on EU imports. We also look at the revenue effects of such removal of tariffs, as well as suggest those sectors were barriers might be retained due to revenue and other economic impact.

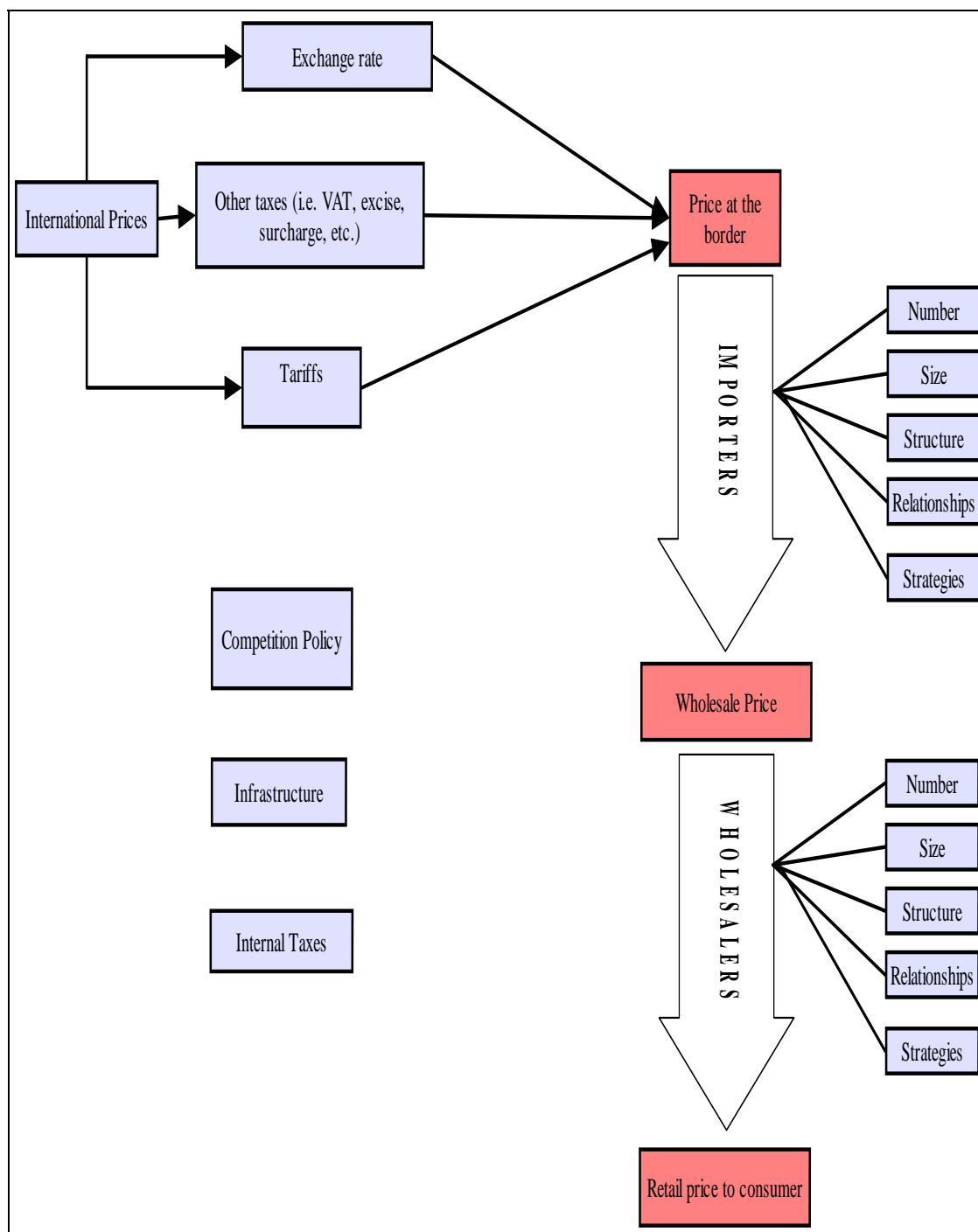
As argued earlier in Chapter 4, Article 24 of the GATT uses the slippery concept of 'essentially all trade'. This is interpreted by the EU as 80 or 90 per cent of the sum of exports between all partners – though how that would be calculated when there are more than two partners has yet to be determined. However suppose there were an EPA including just Mozambique and the EU, and the EU will, by the end of the transition period for sugar, admit all their imports from Mozambique without tariff barriers. Say that Mozambique's exports to the EU are only half the value of Mozambique's imports from the EU. Then, to reach the 80 per cent figure of the sum of exports between partners, only 70 per cent of Mozambique's imports from the EU would need to be fully liberalised.⁶⁵ If the critical figure is raised to 90 per cent, then roughly 85 per cent of Mozambique's imports from the EU would have to be tariff-free. Of course the granting of reciprocity itself could increase imports from the EU. More importantly there is no certainty that the EU's 80 or 90 per cent interpretation of 'essentially all trade' will be accepted after the WTO committee currently working on a 'clarification' of Article 24 has reported.

Finally we list the mechanisms through which an EPA might positively impact on exports. Since Mozambique already enjoys EBA status these will be mechanisms other than tariff-free access to EU markets. If there is no compensating export effect it is quite possible that any gains from reducing tariffs will be lost through the need to compensate for their balance of payments effects through more borrowing abroad, through currency depreciation or through restrictive monetary and fiscal policies.

This chapter does no more than list these mechanisms. The questions of how, and on which sector, these mechanisms operate are left for other sections of the report. Notice that a detailed discussion about the restrictiveness and the assumptions behind the partial equilibrium analysis is presented in the annex 14⁶⁶.

⁶⁵ The mathematics is as follows. If the EU imports 50 units of Mozambican exports and exports 100 units worth to Mozambique, total trade equals 150 units, of which 80 per cent is 120 units. Since 50 of these are already fully liberalised. Mozambique would have to liberalise a further 70, which is 70 per cent of its imports from the EU.

⁶⁶ Annex to chapter 5



Source: Based on Winters et al (2001)

5.1 Trade Flows

As stated earlier, the p.e. analysis assumes that cuts in tariffs are passed on to buyers in Mozambique. It is important to underline that the price transmission mechanisms may not work in favour of the final consumer due to various reasons that include,

amongst others, transport infrastructure, marketing costs, non-competitive markets related to market power exerted by intermediary agents. All these features are particularly strong in less advanced countries and appear very clearly in Mozambique. An interesting illustration of this point can be made graphically presenting the mechanisms of price transmissions in a schematic way and showing how market concentration is a very strong feature of the Mozambican economy.

The level of concentration of importer activity in the agro-food sectors is very high, with a C-5 index of 67 per cent, meaning that 5 importers are responsible for more than two thirds of all imports of goods in the agro-food sectors. This case is particularly important for consumer welfare and industrial policy making and evaluation, because food constitutes the lion share of consumption of Mozambicans, and Mozambique is a net importer of food products. Thus, consumer welfare based policy analysis that looks at theoretical gains from liberalisation assuming perfect price transmission mechanisms make no sense whatsoever.

| Grau de Concentração* na Importação no Sector AgroAlimentar, 2001 (Dólares, números, e percentagem) | | | | | | | | | | |
|---|----------------------------------|--------------------|------------|---------------|--------------------|------------|---------------|--------------------|-------------|---------------|
| Cap. | Descrição | Bens Consumo Final | | | Insumos | | | Total | | |
| | | Valor Imp. | Nº Emp | Quota | Valor Imp. | Nº Emp | Quota | Valor Imp. | Nº Emp | Quota |
| 01 | Animais Vivos | 10,494 | 7 | n.a. | 3,241,765 | 41 | 67.72% | 3,252,258 | 48 | 67.50% |
| 02 | carnes e Miudezas | 2,048,814 | 47 | 71.64% | 0 | 0 | n.a. | 2,048,814 | 47 | 71.64% |
| 03 | Peixes e Crustáceos | 85,514 | 15 | 79.56% | 7,931,203 | 24 | 76.30% | 8,016,716 | 39 | 75.54% |
| 04 | Leite e Lacticínios | 1,499,997 | 61 | 74.25% | 2,054,788 | 23 | 97.84% | 3,554,785 | 84 | 77.12% |
| 05 | Outros de Origem Animal | 543 | 3 | 100.00% | 7,075 | 4 | 100.00% | 7,618 | 7 | 96.08% |
| 06 | Plantas Vivas | 24,979 | 6 | 99.88% | 55,540 | 13 | 74.68% | 80,519 | 19 | 70.92% |
| 07 | prod. Horticolas | 725,266 | 76 | 80.22% | 633,198 | 24 | 97.54% | 1,358,464 | 100 | 69.90% |
| 08 | Frutas | 484,014 | 45 | 83.67% | 2,411 | 3 | 100.00% | 486,425 | 48 | 83.31% |
| 09 | Café, Chá, ... | 248,574 | 42 | 74.36% | 4,065 | 6 | 98.62% | 252,638 | 48 | 72.43% |
| 10 | Cereais | 6,389 | 5 | 100.00% | 87,322,337 | 119 | 62.43% | 87,328,726 | 124 | 62.42% |
| 11 | Prod. Ind. Moagem | 234,568 | 52 | 96.38% | 3,657,528 | 24 | 99.24% | 3,892,095 | 76 | 98.21% |
| 12 | Sementes e Frutos Oleaginosos | 154,783 | 14 | 99.68% | 1,067,922 | 34 | 81.56% | 1,222,705 | 48 | 80.08% |
| 13 | Gomas | 0 | 0 | n.a. | 155,990 | 9 | 99.65% | 155,990 | 9 | 99.65% |
| 14 | Mat. Enrançar, Prod. Veg. | 0 | 0 | n.a. | 50,553 | 4 | 100.00% | 50,553 | 4 | 100.00% |
| 15 | Gorduras e Óleos | 5,956,933 | 102 | 54.78% | 7,253,787 | 47 | 91.32% | 13,210,720 | 149 | 59.54% |
| 16 | Preparações de Carne, Peixe, | 1,849,522 | 48 | 83.76% | 0 | 0 | n.a. | 1,849,522 | 48 | 83.76% |
| 17 | Açúcares | 748,019 | 40 | 66.80% | 3,689,533 | 59 | 75.75% | 4,437,552 | 99 | 62.99% |
| 18 | Cacau e preparações | 278,059 | 32 | 87.88% | 3,219 | 2 | 100.00% | 281,279 | 34 | 86.87% |
| 19 | preparações de Cereais, Farinhas | 2,250,030 | 79 | 45.50% | 1,167,987 | 34 | 97.63% | 3,418,017 | 113 | 43.61% |
| 20 | Preparações Prod. Horticolas | 1,554,515 | 77 | 50.72% | 233,312 | 10 | 94.66% | 1,787,827 | 87 | 51.20% |
| 21 | Prep. Alimentícias Diversas | 1,569,206 | 89 | 76.80% | 924,314 | 42 | 78.31% | 2,493,519 | 131 | 67.95% |
| 22 | Bebidas, álcool,... | 8,233,808 | 102 | 76.93% | 840,684 | 12 | 95.89% | 9,074,492 | 114 | 74.39% |
| 23 | Resíduos Ind. Alimentares | 143,516 | 13 | 94.06% | 3,663,562 | 21 | 94.70% | 3,807,078 | 34 | 92.58% |
| 24 | tabaco e sucedâneos | 413,026 | 4 | 100.00% | 3,471,756 | 3 | 100.00% | 3,884,781 | 7 | 99.97% |
| | TOTAL | 28,520,566 | 959 | 69.03% | 127,432,527 | 558 | 70.16% | 155,953,093 | 1517 | 66.88% |

Fonte: DAP, na base das Estatísticas do TIMS, DGA, 2001

* O Grau de Concentração num sector e medido como a quota de Mercado dos 5 principais Importadores

Another particularly important problem affecting the price transmission mechanism is transport costs and logistics of distribution, both of which are linked to market size. The low level of infrastructure and the dispersion of population does make the logistic and distribution costs relatively high which creates a barrier to entry into commercial and retail services, explaining part of the high degree of concentration in the commercial system. This is also aggravated by the dispersion and very small scale of production, particularly of food and other agro products, which tends to create and reinforce concentrated trade networks.

The impact analysis of change in tariffs is, traditionally, concentrated on the effects of the accession to a CU of a country that had previously imposed the same tariffs – the

so-called Most Favoured Nation or MFN tariffs – on all foreign suppliers. The world is not so simple but rather is a patchwork quilt of regional (and inter-regional) trade arrangements. In Mozambique's case, the SADC has initiated steps towards a FTA. Thus an EPA covering the EU and Mozambique would cut across an existing preferential arrangement involving Mozambique and other SADC members. As a result there could be diversion of imports from a country to which Mozambique already gives tariff-free or preferential access. This is called trade deflection, considered in mainstream orthodox analysis as a positive form of trade diversion.

We have calculated trade diversion – both sorts combined – and trade creation on the basis of a World Bank-UNCTAD model called SMART. The limitations of the exercise are as follows

- SMART is a static, partial equilibrium (p.e.) model. Cross-price elasticities of demand within each country are assumed at zero – implying that changes in the consumption of one good have no effects on those of any other good. Like all p.e. models, it ignores the effects of trade and output changes on factor markets, whether those of labour or of capital. In particular, it ignores the costs of adjustment to the new equilibrium, for example the costs of unemployment or of retraining. Most importantly it only considers the gains on the import side, oblivious to the fact that a rise in imports that are not matched by a rise in exports may result in a macro-economic imbalances that require adjustments of different sorts: devaluation of the exchange rate or other policy moves to correct balance of payments disequilibrium. Such an adjustment can offset any gains from cheaper imports and if the economy cannot quickly respond to such adjustments by increasing exports, the adjustment process may actually lead to unemployment and recession. None of these problems is even considered in the model;
- the data available to SMART is the UNCTAD COMTRADE data. SMART is able to use trade data at the 6-digit classification. However the latest year for both trade flows and tariffs for Mozambique in the SMART data base is 2001;
- while using 2001 data may not be a significant problem as regards trade flows, although it is strongly influenced by the surge in aluminium exports, it is a major problem as regards tariff data. The tariff data are overstated since Mozambique undertook a significant downward shift in tariffs in 2002. For this reason trade creation and diversion may be over-estimated;
- on the other hand the tariff data included do not take account of all the tariff-equivalent charges on imports from the EU into Mozambique. The EU has insisted in previous FTAs that all such charges on imports equivalent to tariffs be eliminated. The SMART data do include import taxes and these are treated as additional tariffs. However they do not include consumer taxes such as VAT. Whether Mozambique would be required to eliminate all such consumer taxes is not clear. To the extent that these are levied on competing domestically-produced goods, it could be argued that they do not discriminate against imports (even if, on imports, they are collected at the border). The same argument could be advanced if there were no such domestic goods

produced but there were a potential for such production. Where there is no such potential they can be considered equivalent to tariffs. These issues will have to be resolved between Mozambique and the EU if they form an EPA – or between SADC and EU in the event of such a EPA – but they probably imply some underestimation in our estimates of trade creation and diversion;

- another weakness of the SMART model is its focus on the demand side and the assumption of infinite supply elasticity for the EU and the rest of the world suppliers. The assumptions on other elasticities, the substitution and demand elasticities, are based on econometric estimation. However the range of studies estimating such coefficients is limited, their results may be out-of-date and they suffer all the uncertainties associated with econometric modelling. Worse, still, the vast majority of the elasticities are assumed ‘by analogy’ with the coefficients estimated for similar products;
- furthermore, the model is not, and could not be, smart enough to take into consideration product specificity associated with technical specifications, intra-firm trade, post sale services, regional strategies of corporations, and so on, that have a bigger impact on imports of investment and durable goods. As the share of these goods in total imports fluctuate around 75 per cent, the impact of product specificity and corporate strategy on demand rigidities is likely to be very important to the extent that changes in trade flows are overestimated;
- finally, as discussed above, the assumption that tariff changes are passed on to the consumer is likely to be a significant over-simplification in Mozambique and other developing countries.

Despite these shortcomings we consider that the results from the application of SMART to the Mozambique case are an approximation of the magnitude of changes that may arise in Mozambique’s pattern of imports in the event of a Mozambique-EU EPA. As will become clear, we also take them to be indicative of the outcome of a SADC-EU EPA on Mozambique. Note that the analysis does not distinguish between negative trade diversion and positive trade diversion (or deflection). However if and when South Africa, the source of most of Mozambique’s non-EU imports and thus of most potential trade diversion, becomes part of the same FTA incorporating Mozambique and the EU, both forms of trade diversion will in due course disappear.

Our estimates of the outcome of a Mozambique-EU EPA by HS chapter are presented in Annex 18, Table 1. Overall trade creation comes to 4.4 per cent of total imports while trade diversion comes to only 1.4 per cent. This suggests a “**not large but not insubstantial**” theoretical gain to Mozambican consumers from the elimination of tariffs on imports from the EU, approximately US\$ 2 per head of the population (whether this “gain” happens, and whether trade creation represents a “gain”, depends on the various factors discussed earlier, which, of course, are not captured by the model in use). The results suggest that the 78 per cent of trade creation will take place in only 10 chapters, though they account for less than 50 per cent of imports, with more than 59 per cent occurring in just four chapters: electrical and non-electrical machinery and parts, furniture and vehicles, assuming perfect product substitutability. As for trade diversion, the same four chapters account for 48 per cent of the total with

machinery responsible for 27 per cent, vehicles for 12 per cent and furniture for 9 per cent.

Table 2 looks at the estimates of diversion from SACU to the EU. Overall SACU experiences three-quarters, or \$ 8 million, of all trade diversion from other suppliers to the EU. Of this the greater part (51 per cent) is, not surprisingly, explained by the same four chapters. Beverages and spirits account for almost a further 10 per cent.

Tables 3 and 4 look at the estimates at the 4 digit HS level. This adds some detail to the estimates at the chapter level. For example the main items of machinery that explain both trade creation and trade diversion are transmission apparatus, telephonic equipment and data processing equipment though the product groups accounting for trade diversion are led by furniture and, especially, motor cars. As regards SACU, 21 per cent of trade diversion is explained by furniture, motor cars, ethyl alcohol and wine in that order.

A sensitivity analysis was undertaken to determine to what extent the results depend on the elasticity assumptions. The demand elasticities were all reduced by a quarter and all increased by a half, while the elasticity of substitution was reduced from the default level of 1.5 to 1.0 and raised to 2. Under the assumptions that Mozambique faces export supply curves with infinite elasticity, trade creation for each product is proportional to the elasticity of demand (see Table 5). Under the same assumptions trade diversion depends on the elasticity of substitution and the initial market shares and, of course, the change in relative tariffs. Here it can be seen to increase more than proportionately with the elasticity of substitution rising from 0.9 per cent of Mozambique's imports at an elasticity of 1.0, to 3.1 per cent at an elasticity of 2.0. The total trade effect – that is the increase in Mozambique's imports from the EU because of both trade creation and trade diversion – can then vary from 4.3 per cent with the lowest set of elasticities to 9.8 per cent with the highest, which is roughly from US\$ 2 to US\$ 5 per head of population per year.

These results are also indicative of the magnitudes of the likely gains and losses to Mozambique from a SADC-EU EPA, taking SADC in this case as the current negotiating group, the ACP SACU countries, Tanzania, Angola and Mozambique and excluding South Africa (which would effectively mean the end of SACU). Since trade between Mozambique and these countries is very small, by far the greater part of the effects on Mozambique will derive from trade creation and diversion vis-à-vis the EU. The gains and losses to Mozambique would be only very slightly different from those arising from a Mozambique-EU EPA – with a marginal improvement from the elimination of trade diversion from those countries. If, however, as seems likely, a way were found to allow South Africa to participate in that EPA as – or as if it were – a member, the welfare gains would be significantly greater since the negative impact of most of the trade diversion *which comes with the EPA* would be eliminated⁶⁷.

⁶⁷ The reason that a SADC-EU EPA without South Africa would imply more trade diversion than a SADC-EU with South Africa is because a Moz-EU or SADC-EU EPA without South Africa implies trade diversion from South Africa which means that Moz is buying from more expensive sources because of tariff preferences. Including South Africa would mean that most of that negative element would disappear.

5.2 Summary and Conclusions

This chapter has reviewed some partial equilibrium estimates of the effects of Mozambique entering an EPA with the EU, and by inference those of Mozambique entering an EPA with the EU as a member of the reduced SADC group (the BLNS states, Angola, Tanzania and Mozambique). The p.e. analysis seeks to measure the value of trade creation – Mozambique’s extra imports that would derive from abolishing tariffs on EU goods and hence the lower prices to consumers – and the value of trade diversion, or of imports that will be redirected from other suppliers – largely from South Africa – to the EU because EU goods now come in tariff-free.

The estimates of trade creation and trade diversion must be treated with a strong dose of caution. First of all, these estimates are based on assumptions that are too strong and unlikely to hold all together, as it is discussed in annex 14. Furthermore, there are specific problems related to the data and model available (discussed in the first half of 5.1). The estimates are based on a limited number of observations of the elasticities of demand and a great many assumptions regarding ‘like’ products, on a default elasticity of substitution and the assumption that Mozambique faces infinitely elastic export supply curves from the EU and the rest of the world (RoW). In fact as a relatively small country and limited importer facing two large suppliers – the EU and the RoW – this last assumption is perhaps the least worrisome of all. In addition the tariff data are from 2001 and thus ignore the significant tariff cuts of 2002, therefore trade diversion should actually been smaller than estimated in the previous section. Against this the tariff data ignore some tariff-equivalent taxes which are supposed to be abolished on EPA-partner country exports.

The central estimates of trade creation suggest that it will be equivalent to some 4.4 per cent of Mozambican imports. A sensitivity analysis, given the uncertainty of the elasticity assumptions, suggests a range between 3.4 per cent and 6.7 per cent. Trade diversion is estimated at 1.4 per cent of Mozambican imports with a range of 0.9 to 3.1 per cent. The total change in imports from the EU ranges from 4.3 to 9.8 per cent with a central estimate of 5.8 per cent.

To what extent are these estimated effects ‘big’ or ‘small’? The answer seems to us to be that a rise of imports of 4.4 per cent cannot be dismissed as insubstantial. Indeed any such increase in Mozambique’s imports, while perhaps implying some gain in consumer and maybe producer welfare in Mozambique, would put an intolerable strain on Mozambique’s balance of payments⁶⁸. P.e. analysis does **not** deal with that problem or the damage that might be done to Mozambique’s productive structure.

Nor does p.e. analysis deal with the question of Mozambique’s exports under a EPA. In fact any increase in exports must come from mechanisms other than the lowering of tariffs in the markets for Mozambican exports. In the EU as an LDC Mozambique benefits from the EBA and zero tariffs – except temporarily on sugar. On its exports to SADC Mozambique will in due course benefit from zero tariffs and even now in its main market, South Africa, tariffs are minor. Any boost to exports must come from other sources. We seek to shed some light on those issues in the next chapter.

⁶⁸ It must be noticed that *nearly every FTA has the standard clause about temporarily allowing tariffs to be reimposed in balance of payments crises*

Chapter 6: Implications of an EPA with EU - Further than trade flows

This chapter discusses other implications of an EPA with EU, beyond changes in trade flows. Namely, the chapter emphasises that a quick and sustainable export response is necessary for the Mozambican economy to be able to benefit from an EPA. This response results from specific strategies and policies that create the required capacities and are not detrimental for the economy as a whole.

Trade in services is an area to explore. An agreement with the EU may open the opportunity for Mozambique to supply services (such as tourism, as source of foreign currency) and to develop production related services that may help to improve the productivity, quality and standards of the Mozambican economy, generate economies of scale and develop engineering capacities.

Section 6.3 shows that the fiscal impact of an EPA due to tariff elimination and trade creation and/or diversion is minimal. The analysis also points out that it is not clear whether non-trade distortion taxes will be removed (like the VAT on imports), but this is unlikely to happen. In this case, tariff revenue losses can be kept at a minimum. In the event that trade liberalisation helps the development of production and exports, such revenue losses may be more than compensated by fiscal revenue accruing from direct taxes on profits and wages, and indirect VAT.

Section 6.4 discusses the impact of an EPA on the productive sector, and argues that the nature and magnitude of such an impact depends on what is done in Mozambique to tackle the production structure and dynamics, to identify and select areas and capacities to explore and acquire, and to deal with the synergies accruing from the dynamics of South African economy. This chapter also identifies specific strategy and policy related activities to pursue, sectors to prioritize and criteria to select them.

Section 6.5 discusses institutional capacities and identifies major problems associated with institutional culture, information and quality of personnel, which should be addressed if Mozambique wishes to become a more relevant and competitive player in the regional and international arena.

6.1 *Hypothetical mechanisms by which and EPA may affect exports and the balance of payments*

According to our estimates discussed in the last section, tariff-free access to Mozambique's markets for EU imports would lead to an increase in total imports of about 4 per cent. Other things being equal, Mozambican consumers could only benefit from this. True there would be a redistribution of revenue from the government to consumers but that would be more than offset by the gains to consumers even after alternative taxation arrangements were set in place to make up the shortfall. Of course, this assumes that an increase in imports would not displace productive

capacities and jobs in Mozambique, such that consumers could actually afford to benefit from more and cheaper imports.

However an increase in the value of imports has to be financed. Ideally that would happen through an increase in exports. According to the EU model, an EPA would lead to increased investment, both domestic and foreign, to exploit the new opportunities from improved access to the EU market and itself would improve productivity through the transfer of technology and know-how and opportunities for economies of scale. In Mozambique's case, however, there will be no automatic gains in access to the EU market since EBA already exonerates Mozambique from tariffs on all goods except arms and, for transition periods, sugar, rice and bananas. True there will be an improvement in accelerated access to the SADC market if the Mozambique joins SADC in a joint EPA with the EU. But a SADC FTA would imply further increases in Mozambican imports which themselves would have to be financed. In any event such an FTA is scheduled for completion by 2012.

How, then, could Mozambique's exports gain from signing an EPA, either alone or with the currently established SADC group of countries (the BLNS, Tanzania, Angola and Mozambique itself). There are a number of possible mechanisms:

- the price of imported inputs into the productive process (e.g. fertilisers) is reduced, enabling exports to become more competitive. However, export competitiveness involves more than comparative costs (quality and standards, certification, reliability of supply, reputation, trade related finance, etc); costs are associated with more than inputs (productivity of factors and labour, financial commitments, transports and marketing costs, etc.); and actual exports require more than competitiveness (demand elasticities, market reputation, loyalties, and so on). Thus, even if inputs are made cheaper through trade liberalisation, it does not mean that exports will necessarily increase proportionally. Further more, imported input costs become very important comparative costs determinants only when production is heavily import dependent. In this case, domestic linkages and capacities may not develop, and export gains may be minimised through import promotion productive structures. Therefore, this mechanism of export promotion may not necessarily promote exports, and may not be desirable as a way of accelerating development and balancing external trade.
- Mozambique on its own or along with the others in the SACU group, or along with the ACP as a whole, might be able to negotiate improved rules of origin. This may have a real impact on some industries, like textiles and clothing, but not on the resource based or linkage based industries.
- and, similarly, the reduction of protection-based SPS or TBT rules (which would have to cover all suppliers), and financial assistance to comply with the others. In Mozambique, production standards are often far below acceptable levels. Thus, even if SPS and TBT rules are relaxed to a reasonably negotiated level, Mozambique has a lot of ground to cover to achieve minimum standards and a reputable system of quality management and quality and standards certification. There are examples of firms that have been successful at introducing quality and standards management systems (such as, for example, Agro-Alfa), and their experience should be generalised. In addition to

achieving the minimum quality and standards, Mozambique has to build a reputation of reliability and stability with respect to quality and standards. At the moment, even good and successful firms suffer from the country's reputation of being a bad, or unreliable, quality producer. This is one reason why some firms export under the brand name and reputation of South African firms.

- any improvement in export opportunities could have a multiplier effect. Foreign direct investment is encouraged into those sectors where export prospects have improved, leading to the transfer of technology and know-how, improved competitiveness and permitting the exploitation of economies of scale. This is more likely to happen under mid to long run supply contracts, international product chains, specific production linked with natural conditions, and production of scale for quality markets. All fast growing and/or large export industries (aluminium, sugar, tobacco, cotton, timber and fishing) are related to more than one of the above mentioned conditions.
- an improvement in the climate for inward investment in export sectors. This may emerge from many sources: the establishment of competition laws, the opening of public procurement to foreign companies, trade facilitation in the reform of customs and other border processes, better protection of intellectual property and so on. These are discussed in Chapter 9 below. Any of the above mentioned factors may have a detrimental impact on the economy as a whole, and on the long term sustainability of export growth and diversification. Thus, it is important to consider all of such factors within strategic and more global views of the development of the economy as a whole;
- an EPA may be associated with additional flows of technical and financial assistance which lead directly or indirectly to more exports. The Cotonou Agreement does not envisage increases in the present EDF package though additional assistance could be made available from the EIB or directly from Commission funds. There could also be some reallocation of funds between countries (perhaps in favour of the LDCs), or to more export-oriented projects within individual countries.

Other resolutions to a worsening in the trade balance might come through an increase borrowing from abroad, through the depreciation of the currency or through a restrictive macroeconomic policy. The first of these would slow down the adjustment process. The last two would reduce imports by raising their costs and squeezing consumer and investment demand, thus frustrating any significant gains to the economy accruing from cheaper imports.

The bigger question is how to make the productive sector to respond aggressively and more competitively and generate more exports. Unless an answer to this question is found, international trade agreements and liberalisation are unlikely to result in any significant gains to Mozambique, not to speak of a possibility of significant losses as those they may occur if the balance of trade is worsen. Hand in hand with the negotiations/liberalisation agreed there should be a very clear and focussed strategy to increase supply response.

In this chapter we examine other aspects of an FTA which must be considered in an analysis of the costs and benefits from an EPA with the EU.

6.2 Trade in services

This section analyses a number of issues related to the possible impact of EPAs in the area of services.

This section is divided in 4 main parts, in which one of them a particular question will be addressed. In section 1, we will analyse why it is important to analyse separately services and why trade in services is different from trade in goods. In section 2, we will set the stage for the analysis of the EPAs negotiations on services analysing the extent and the objectives of GATS negotiations and Cotonou Agreement. In section 3, we will consider the importance and possible influence of DDA negotiations. Finally, in section 4 we will present some strategic issues concerning the development of Mozambican negotiating position.

The importance of services is expanding in Mozambique, such that negotiations in this area can have important impacts on the evolution of the Mozambican economy. As mentioned in Chapter 1, main services and infra-structures in Mozambique (transports, roads, construction, tourism, industrial and productive services in general, including energy and communications) have been developing fast, but heavily concentrated in Maputo and dependent upon the dynamics of mega projects and luxury durable goods (like luxury houses). The question, then, is how to change that trend such that services become a more dynamic component of a development strategy with a broader social, sectoral and regional basis.

6.2.1 Characterisation

There are at least four reasons that make trade in services very different from trade in goods and therefore raise the need for a specific analysis of this area separately from the more general part of negotiations on goods.

Movement of services suppliers: Since many services, such as nursing, require physical proximity between producers and consumers, trade in them can involve the movement of the actual supplier, or indeed the consumer, an issue that does not arise in goods trade. Indeed a major effect of liberalising services is an increase in movement of people and capital

Nature of barriers: Services tend to be subject to all sorts of regulations including, for example, the need to achieve important objectives of public interest. Not all regulations can be equated with barriers to trade. While barriers to the flow of goods are usually imposed at national borders, the removal of barriers to market access for service providers (such as in the case above of the restriction on the number of pharmacies) will open services markets to new local, as well as foreign, entrants, and do imply changes in domestic regulations (within the borders measures).

Measuring issues: In certain service sectors, including telecommunications, banking and insurance services, cross-border trade is relatively minor. The main form of trade is commercial presence, which is generally not captured in conventional trade statistics (Arkell and Johnson, 2003).

Services and PTA: When considering the inclusion of services in PTAs two important elements should be considered that makes services different from goods. Firstly, differently from liberalisation of goods for which the net results tend to be ambiguous, a country is likely to obtain net benefits by liberalising trade in services because barriers to trade in services are often prohibitive and not revenue generating. This should imply that there are few costs from trade diversion. Secondly, the sequence of liberalisation of trade in services may matter more than of liberalisation of trade in goods because the benefits of eventual non-preferential liberalization may be different. Non-preferential liberalisation may not materialise if it is preceded by preferential liberalization, because location-specific sunk costs of production are important in many services. So an inferior supplier can acquire long-term advantage in the market even if its privileged access to a market is temporary. This means that the entry of more efficient service providers may be durably deterred if their competitive advantage does not offset the advantages conferred by incumbency (Matoo et al., 2002). The conclusion to this is the following: (1) The concerns over trade-diversion in services preferential agreements are not too important which is a positive element towards negotiating services at bilateral/regional level; (2) The principal advantage of multilateral advantage is that it offers a wider choice of providers to the consumers and can avoid to give the 'first mover' advantage to a provider that is less efficient and once get established acquire market power and impede the entry of other more efficient providers; (3) regulatory cooperation can be easier at bilateral/regional level and considering the importance of regulatory barriers for services access this appear to be as the most important element favouring the negotiation of services at regional/bilateral level rather than multilateral.

Crucially the decision about negotiating services in PTA or multilaterally will crucially depends on the balance between the point 3 (complexity of regulatory barriers and level to which the negotiations over these is easier within a smaller number of countries rather than multilaterally) and the point 2 (risk of giving market power to less efficient provider). In the case of the EPA negotiations we feel that the complexity of regulatory barriers especially for 'mode 4' and the fact that EU is likely to be a quite efficient provider seem to suggest a preference towards regional rather multilateral negotiations.

6.2.2 Extent and objectives of negotiations

Cotonou

The Cotonou Agreement refers to trade in services in section IV, art.41-43. The main elements that emerge from it are the recognition of S&D treatment for ACP countries, the importance of flexibility as a principle and basis for the EPA negotiations.

Special and differential treatment

General provision states “need for S&D treatment to ACP services suppliers”. Furthermore, the EU “shall support the ACP States [...] to strengthen their capacity in supply of [...] services” in order to enhance their competitiveness and increase their integration into global markets.

Flexibility as basis for negotiations

Cotonou Agreement mandates that “negotiations on services shall reflect a degree of flexibility in accordance with the provisions of GATS, to reflect specific constraints which ACP countries face, and taking into account the different needs and levels of development of ACP countries and regions”.

Furthermore in the Cotonou Agreement some services, of particular importance to ACP countries in general and to Mozambique in particular are mentioned:

- Maritime transport: promote liberalisation on a non-discriminatory basis [...] national treatment of ships owned or registered in the other party
- Information and communication technologies: In particularly taking into consideration “measures that will enable inhabitants of ACP countries easy access to information and communication technologies [...] low-cost wireless network”

GATS

As EU and most ACP countries are WTO members the GATS sets the wider context in which the EPA services liberalisation must be embedded.

The main characteristics of GATS negotiations are worth to spell out because should be taken into account:

- Progressive reduction and elimination of measures that hamper market access
- Process carried on “mutually advantageous basis”

It is useful to stress here what are the conditions that must be fulfilled in RTA (art. V), that allowing a de facto an exception to the MFN principle:

- Substantial sectoral coverage (by number of sectors, volume of trade and modes of integration)
- Elimination of ‘substantially all discrimination’ (i.e. full national treatment)
- The overall barriers must not be raised compared to the level prior to the RTA

What must be noticed is that the wording “substantial sectoral coverage” and “substantially all discrimination” are rather ambiguous.

Article V is now being examined by the WTO Committee on RTAs for 'clarification' - including possibly the SDT for the developing countries (and especially the LDCs). The changes could be of major significance inter alia to Mozambique. The ACP and the LDCs should participate as much as possible in these negotiations to get a favourable outcome. Under the present rules, the EU must open its service sectors with substantial sectoral coverage. One of the main challenges to Mozambique and other LDCs is to be able to take advantage of this rule (or whatever rule replaces it).

Flexibility for LDC: The GATS provides for special priority to be given to LDCs by developed countries in the matter of market liberalisation and capacity building, and also in taking "particular account" of the serious difficulty of LDCs in accepting specific commitments under GATS. Therefore 'asymmetric' commitments in services under EPA would be accommodated easily.

GATS differentiate services on the basis of their mode of supply:

- Cross border supply referred to as Mode 1: from the territory of one Member into the territory of any other Member;
- Consumption abroad referred to as Mode 2: in the territory of one Member to the service consumer of any other Member;
- Commercial presence referred to as Mode 3: by a service supplier of one Member, through commercial presence in the territory of any other Member;
- Movement of natural person referred to as Mode 4: by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member."

6.2.3 Influence of DDA negotiations on services⁶⁹

Given the priority of the undergoing WTO negotiations on services, which have to be conducted on shorter timescale and will determine the global environment for trade in services, it is advisable not to duplicate, in the EPAs, these negotiations, especially given their dynamics nature, and wait until the floor is set by the conclusions of WTO negotiations.

Therefore, three potential strategies are suggested:

- As it is likely that sectors of interest of ACP will be subject to demands made to the EU by negotiating partners with stronger negotiating leverage, it is advisable to follow, support and benefits from

⁶⁹ This section is fundamentally based on Arkell and Johnson (2003).

negotiating positions taken and/or initiated by others. But it must be noticed that leaving initiatives to others may be risky as ACP individual interests can be left out and the benefits to ACP from increased market access in services area may prove unimportant because of the simultaneous increased access gained by stronger and more competitive countries. Therefore this strategy must be carefully weighted.

- A pressing priority for ACP is today to identify priority sectors and modes of delivery where the negotiation of additional concessions under EPAs could have real economic benefits. Additional concessions to the GATS offers should be seek. The main problem with this strategy is that it is unclear that EU would be prepared, on the top of the GATS commitments, to offer further preferential commitments to the ACPs
- An alternative to the previous would be to simultaneously seek market opening from EU parallel to negotiations under the WTO (as general market opening objectives) and under Cotonou (with the aim of securing preferential arrangements for ACP countries, even if the EU is unwilling to offer general access commitments). The main problem with this strategy is that it may be difficult for ACP to have resources and capacities to simultaneously conduct two separate negotiations (GATS and EPAs)

6.2.4 Strategic issues

The negotiation on services in the EPA should take into account two rather different perspective that we can define as ‘offensive’, related to access to EU market, and ‘defensive’ related to EU accessing Mozambican market. These definitions may be misleading because the access of EU service providers to the Mozambican economy may be beneficial to the Mozambique, such that the best strategy may need to be more than a simply ‘defensive’ one.

6.2.4.1. Offensive strategies

With regards to the ‘offensive strategy’ we consider that the government should perform three crucial tasks that would, consequently, lead to the definition of a clearer negotiating position

- Identify areas that could be relevant and where Mozambique could export services
- Identify barriers for export of ACP services to EU are identified

- Determine scope for reduction of the barriers identified

On the basis of the interviews done and the revision of the secondary literature we present here some preliminary findings. It is our opinion that the area of services is a very crucial one. The specificity and importance of this area raise the need to a detailed study on the economics of services in Mozambique and the potential areas to be promoted aiming at exporting services.

Tourism is one sector of particular importance to Mozambique. In comparison with neighbouring countries, Mozambique has the advantage of having potential to provide diversified types of tourism products (eco-tourism, beach tourism, cultural tourism, safari, in lodges and hotels) within relatively small geographical areas. The EU could provide an important market for tourist and tourism operators and investors. Linking tourism development in Mozambique with the EU could also help to diversify tourism products and capabilities away from the mainstream product offered in this region of the Southern Africa, which is usually linked with the interest and patterns of South African tourism industry.

The strategy to promote Mozambique's potential as a tourist destination should incorporate different elements, namely: (a) attraction of EU tourism investors and operators to develop the infra-structure, supply of travel agency services and information, and supply of tourism products in a diversified fashion (Italian and Portuguese tourism operators are already working in Mozambique); (b) establishment of tourism offices in EU countries, or identification of adequate representatives of Mozambican interests in these areas (this can be done by using different means: the Mozambican Embassies, establishing links with international tourism chains, travel agencies, tour operators, small local companies and/or general public networks and information offices, being fully included in virtual (internet) tourism and reservation networks, developing promotional and targeted advertising (including participation in tourism fairs), etc.); (c) identification and utilisation of possible financial and regulatory facilities that may be available in the EU and accessible to Mozambique.

In order to develop and adequate strategy to promote tourism potential of Mozambique in the EU, a few, nuclear activities have to be performed, namely: (a) a study of the market for Mozambican tourism in the EU, which would also include a more efficient utilisation of the linkage potential between Mozambican and neighbouring countries facilities (such as the, for example, the full utilisation of the externalities that arise from the Great Limpopo and the Pequenos Libombos tourism projects that link Mozambique, South Africa and Swaziland), in order to focus the strategy for both, product development and information provision in order to attract diversified layers of the EU tourism market; (b) a study of commercial advantages that EU investors and operators could acquire by investing and operating in Mozambique, in order to devise the best strategy to attract them (including industry and product specific incentives); (c) identify the main tourism products and locations that should be fully developed in first place, as well as establishing the regulations and procedures that would maximise and balance local and national interest, environmental protection and the interest of tourists, investors and operators; and (d) identify fundamental problems that may prevent the development of the tourism industry and, on the basis of it, devise the priorities in terms of policy and strategy, investment and development.

The development of tourism would benefit significantly from adequate technical assistance and funding for research, policy development and promotional activities. Thus, Mozambique could negotiate the access to such technical assistance and funding with the EU and link this to market access for EU companies.

Another general area of possible interest to Mozambique is the provision of services under mode 4, movement of natural persons, in particular with regard to low-skilled workers. In fact, Mozambique has a tradition of migrant workers providing services to the South African mining sector. For this purpose there are already in place one private agency that recruits workers in Mozambique to the South African mining companies. However, such an agency is closely linked with the chamber of mines in South Africa, and therefore may not be capable of providing services to a different market. Nonetheless, the experience of such an agency, as well as of the Ministry and Labour and other public agencies that perform services and develop and apply regulations related to labour migration to south Africa, may be useful if recruitment of unskilled labour to EU markets is to be considered. Operatively it would be advisable to involve directly both the Ministry of Labour as well some of these agencies in negotiations over mode 4 services.

Still related to the movement of natural persons, another area that could be of particular interest to Mozambique is construction services. In fact, EU is the largest construction market in the world. But it must be noticed that construction services imply a sub-set of activities like design, engineering, project management and supervision of site operations, import and re-export of equipment, import of materials and pre-assembled equipment for lifts, boilers, electrical and air conditioning apparatus and so on. It is clear that for the present Mozambique could not consider competing in these dimensions. However, thousands of foreign construction site workers enter EU every year. In the EU, these movements of foreign workers are perceived as posing potential public order and immigration problems of a major order, such that it is difficult to foresee the EU being willing to undertake more than a modest degree of liberalisation in this area.

Due to arguments related to the political and security sensitivity of migration, and the difficulty in distinguishing workers seeking temporary jobs from those seeking long term or permanent employment, the EU not only avoids introducing any overall bindings, but inscribed Community-wide restrictions on temporary immigration of natural persons for business purposes. Furthermore, country-specific requirements apply (educational and professional qualifications, requirements of residence and, in some cases, nationality, economic needs test). However, the majority of migrant workers that can be provided by ACP countries are semi- or un-skilled, aiming the low paid layer of the labour market, and lack the necessary education and training. This puts them at a disadvantage when responding to the market needs of EU entrepreneurs. Therefore, the EU should be requested to provide funding for training in selected sectors (i.e. tourism related services, construction services, etc.).

In order to overcome the so-called 'non-trade concerns' the best strategy should involve an approach at the most possible detailed level. But this approach should be accompanied by setting minimum sufficient international standards to avoid negative impacts.

Nevertheless given the importance this issue may acquire, it should be carefully targeted and explored by Mozambican negotiators, but we would also suggest that further analysis should be done in this area in order to better define: (a) potential net benefits for the economy, arising from employment, transfers and skill acquisition minus potential long term, structural impact on employment, production, consumption and the economy, all weighted by the magnitude of actual migration; (b) modalities to protect labour rights and general living and working conditions; and (c) concrete modalities and requests for implementation.

In any case, it must be notice that increased market access would not get transformed into increased export of services unless a number of problems that hamper the supply capacity response are adequately tackled. Without aiming at being fully comprehensive we do underline some of the sensible areas that should be carefully considered (Arkell et al., 2003):

- a) Human resource development and technological capacity-building to ensure that professional and quality standards are met;
- b) Upgrading of the telecommunications infrastructure and a higher profile for telecommunication and information technologies to promote the export of labour-intensive services through the cross-border mode of supply;
- c) Coherent pro-competitive regulatory framework for goods and services and trade and investment, which should include incentives to enhance the competitiveness of domestic service firms;
- d) Government support to help service firms, particularly SMEs if potentially competitive, to improve the quality of the services and meet international standards as well as to access new technologies, management techniques and financial resources;
- e) Appropriate national strategy for the export of services, to raise the profile of service industries and exports within the country so that everyone understands how vital they are to economic development and promotion of exports;
- f) Establishment of service industry associations as to introduce or reinforce codes of conduct for professionals, to put their members in touch with potential partners in target markets, and to voice the needs of the service industry they represent;
- g) Use of new business techniques, such as the creation of alliances and consortia and networking;
- h) Presence in major markets and the capacity to exploit the opportunities offered by foreign markets;
- i) Use of the knowledge and capacity built up in manufacturing and agricultural sectors to export service-related activities and to offer an integrated package of goods and services.

When faced with the question of ‘what are the barriers preventing Mozambican services providers from accessing the EU markets’ two methods are equally possible, and probably both should be used in a complementary manner: (1) direct interviews with potential providers that are kept out of the market, (2) analysis of commitments taken by EU and remaining ‘unbound’ areas. In the case of Mozambique we could not perform the first approach because of limited time and because we were unable to identify providers of services kept out of the EC markets because of specific barriers. Therefore, relying on the analysis of Arkell (2003), we follow the second route.

On the basis of the offers done by the EC during the GATS negotiations we must differentiate the barriers on two dimensions: country specificity (country specific or community wide) and type (horizontal or sector specific).

| | Community wide | Country specific |
|-----------------|--|--|
| Horizontal | <p>No NT to branches or agencies of non-EU companies unless “continuous link”</p> <p>Public utilities may be subject to public monopolies or grant of exclusive rights</p> | <p>Additional restriction in Finland and Sweden</p> |
| Sector Specific | <p>For aircraft leasing activities there are requirements relating to the registration and ownership of aircraft in Member States</p> <p>Banking and financial services do have a number of requirements with prudential objectives that in fact determine barriers to access: investment funds must have a registered office in EU; detailed regulations related to establishment and operations of banks and finance companies</p> | <p>General business services: some regulations are in place for prudential reasons and others for economic planning reasons</p> <p>Professional and residency requirements for business services are required in various countries (i.e. Austria, Denmark, Sweden)</p> <p>Residency and nationality conditions are applied in various sectors like real estate, maritime chartering, security services, publishing and construction</p> <p>Special requirements do apply primarily in health, tourism, recreational services, transport (especially bus and taxis)</p> |

General barriers

With regards to horizontal commitments it could be relevant the fact that “as general principle EU Member States are not required to extend national treatment to branches or agencies of non-EU companies, and that national treatment may also be granted on a restricted basis in the case of legally established subsidiaries unless an effective and continuous link with a Member State economy can be demonstrated” (Arkell et al., 2003). The meaning of ‘continuous link’ is not clarified further by EC which clearly leave ample margin of manoeuvre to the single states in order to limit market access and discriminate among different providers.

MFN Exceptions

A number of barriers are present because of MFN exceptions with regards to treatment of foreigners and non-residents in sectors which do not seem to be of crucial importance of Mozambique (i.e. audiovisual services, publishing, news

agency, maritime transports, chartering of vessels, computerised reservation systems for air transport, etc.). Pushing for elimination of these exceptions do not appear a priority for Mozambique

Sectors not bounded

Various sectors have not been scheduled for commitments, but the impact on Mozambique seems to be minimal

- Certain R&D services including R&D services on natural sciences
- Business services incidental to manufacturing and energy distribution, and related scientific and technical consulting services
- Postal, courier, audiovisual and other communication services
- Human health services other than hospitals
- Cultural services including libraries, archives and museums
- Betting and gambling
- Most aspects of transport services including maritime and internal waterways transport, air and space transport, railways, pipelines and cargo-handling

6.2.4.2 “Defensive” strategies

The other area to be considered is the one related to the pressures to eliminating of barriers increasing the possibility of entry of EU operators in the Mozambican market. The use of word ‘defensive’ should not mislead in the sense that we consider that Mozambique need in every case to defend itself from the entry and the competition with foreign providers. Furthermore, as mentioned before, in some cases the entry of foreign service investors and operators may help to develop economic capacities to the point of increasing the Mozambican competitive position. Thus, in such cases Mozambique should actively and strategically, or offensively, seek liberalisation and/or other forms of attraction of service providers, operators and investors in order to develop specific capacities and competitive conditions. Therefore, the entry of EU services into the Mozambican services requires analysis that distinguishes different situations and conditions, and responds strategically, thus offensively, to them.

Hence, although entry of foreign service providers into domestic market falls within the so-called “defensive” policy and strategy, responses should not be defensive in nature, and “defensive” should not be mistakenly identified with blind protection of the domestic market for domestic operators.

The first step in this area would be to define a criterion for prioritising the sectors to be analysed more in details, and as recommended in a recent study prepared for the Commonwealth Secretariat it ‘is suggested to take account of how each sector can increase the overall competitiveness of the economy, and improve logistical support for non-services exports’. It is important to underline that the priority sectors now will be rather different than the priority sectors considered when discussing the market access in EC.

| Level of priority | Sector |
|---------------------|---|
| <i>HIGH</i> | infrastructure services (transports, telecoms); professional, business and industrial services (including regulation, certification, professional training, investment services, insurance, other, non-banking financial services, etc); computer related, environmental plus tourism |
| <i>INTERMEDIATE</i> | distribution, other utilities (energy, water); construction and maintenance; |
| <i>LOW</i> | education, health, recreational, and cultural sectors |

It can be useful to take into account the findings of the literature on liberalisation and the positions of ACP countries to define some of the issues that are important to bear in mind and would be important to inquiry further.

6.2.5 Potential impact of liberalisation in ACP and EU service providers' entry

Depending on the sector and local conditions, local reaction could vary from welcoming the investment (job opportunities, higher pay and training, new services and facilities to develop other business activities, better services, etc), or concern over being crowded out.

Public utilities (Water, electricity, etc.): There are some sensitive issues at stake especially with regards to services that could be considered a human right (like universal access to water) or merit goods. It can be very difficult to associate attraction of foreign investments with situations where consumers cannot afford the cost of universal supply. This problem is often compounded by the small scale of local markets for fully paid utilities, which is typical in low income economies like is the case of Mozambique. This invariably leads to increasing unit costs due to high fixed costs associated with utility provision and development. Hence, non realisation of economies of scale leads to higher prices for utility provision, further market shrinking and non fulfilment of basic human and economic needs. Experience shows that mounting social and economic pressures, associated with the inability or unwillingness to pay for privatised provision of utilities, force governments either to reverse liberalisation and privatisation measures, to subsidise the operation of foreign companies, or to subsidise consumers (domestic and industrial alike). Given this background the commitments in these services should very carefully compounded with their impacts in terms of investments and cheaper services of some areas against social problems that could follow from the to low attractiveness of other areas and the lack of services provision there.

Distribution: Opening distribution services to foreign investors could be politically risky and socially sensitive because of the large number of people employed in these services, and because of their adaptability for capital accumulation of local entrepreneurs due to low fixed and investment costs and relatively high turnover. In any case, it is likely that EU firms will be attracted only in cases when local demand can sustain supermarkets or hypermarkets in high density areas, or specialised distribution chains.

In both cases, utilities and distribution, blind liberalisation and privatisation may have significant social, political and economic negative impacts, which could easily offset potential positive effects. However, there are cases when liberalisation may actually help to develop strategic capacities by increasing the provision of quality services, introducing new services, or improving management. Therefore, the best response requires: a broad (but clear) identification of which capacities are lacking and have to be developed, the role that liberalisation can play and how to manage it, and some degree of ex-ante impact analysis.

If the option of “managed liberalisation” is not available, specific incentives can be used to direct entry into strategic capacity areas previously identified (for example, specialised distribution chains). Such incentives could be associated with both, the relative incentive of investing elsewhere, and the expected direct gains and gains from externalities that arise from developing service provision in strategic areas and activities.

For example, to ensure that liberalisation of services leads to development of previously identified specialised distribution chains, rather than of general, retail related, urban distribution, specific incentives should take into consideration how much incentive service providers have to go into general distribution, as well as the economic gains from the development of the specialised distribution chain. In the case of the EU, the incentive to service providers moving into general distribution in Mozambique is probably very weak. However, there might be a significant incentive to making a move into large scale distribution (for example, a hypermarket) associated with a specialised chain of production, distribution and consumer pre and post sale services (for example, computer hardware, software and consumables). In this case, no further incentives are required to direct investment into the specialised chain. However, it might be necessary to help developing business linkages between the new service chain and potential beneficiaries (firms and other organizations, as well as individual consumers) and regulate the market to allow economies of scale to develop and quality and reliable business associated distribution services to spread quickly at low cost.

A case by case analysis is required. Above all, it is important that liberalisation (or protection for that matter) result not only from exogenous pressure and defensive reaction to pressure, but that decisions are fundamentally concerned with maximising real (rather than assumed) economic benefits and are based on careful analysis of data and experiences.

Maritime transport: National and international maritime services are crucial for nearly all physical imports and export. Their efficiency depends crucially on investments in vessels, ports, containers, links with road transports, management, etc.. Lack of investments in this area has been a reason of economic backwardness in ACP countries. In this connection, priorities should be given to attracting investment and modern management capacities, and also to labour conditions which could be a very sensitive matter. Furthermore, it is important to disentangle private investment in these infrastructures and management from narrow interests of large, current private customers, or infrastructure development becomes biased towards existing large economic interest as opposed to promoting broader and diversified productive and competitive conditions.

Finally, in some cases it is not physical investment, but availability of services, that constitutes the bigger obstacle. For example, one of the crucial bottlenecks for Mozambican domestic and foreign trade is related to the shortage of ship cargo carriers that go through the Mozambican ports, which forces causes delays and increase costs of transport. Better coordination between exporters and importers, and between these and freight companies could help to increase the frequency of cargo ships going through main Mozambican ports. Negotiations with the EU should include technical assistance to developing adequate, business oriented strategies and practical implementation of measures that could broaden the role of maritime transport and ports, and strengthen the linkages between these and road transports, importers, exporters and producers.

Financial services: Mozambique has already fully liberalised this sector under WTO-GATS

Environmental services: This is an important area as EU has already made a request to Mozambique in order to liberalise all sub-sectors. The MICOA who should be the principal involved stakeholder is still building its capacity and no analysis have been done for the potential impact of liberalising these services. One important element noticed by the officers of MICOA is that these services are presently under-supplied in Mozambique which seems to suggest that the entry of foreign providers would be beneficial, however some concerns about the impact on prices for the services were also raised.

Business services: Whilst for some other ACP countries EC made explicit requests in this area, in particular in relations to “computer services and management consultancies”, this didn’t happen in the case of Mozambique. The principal reason of this could be that despite EC being interested in this area they may consider the Mozambican market as not big and attractive enough. However this is an area for which EC will be probably interested in expanding its market access and of course given the higher level of competitiveness of EC services providers local competition could be seriously disadvantaged. At the same time the access of more and efficient providers may both improve quality and reduce costs of these services with an important positive impact on the rest of the economy. One potential solution would be to link, in case Mozambique would have enough leverage which is not ex-ante clear, extra market access in this area with special funds targeted to build and expand capacities of Mozambican providers.

Telecom services: This sector is clearly one that is of most interest to EC, a request has in fact been put forward to Mozambique in the framework of GATS negotiations. The policy orientation of Mozambique is presently towards a liberalisation of these services, this has already happened with the entry of a second operator in the mobile communication, and further liberalisation is in principle under consideration being the final objective the increase of consumer access to TLC services. This is a very important service in terms of impact on the rest of the economy and still an insufficient level of information and analysis is available to take sound and well grounded decision. A recent study done for the National Institute of Communication of Mozambique (INCM) with relation to the GATS negotiations stressed that first of all the priority should be put on the development of an appropriate regulatory

framework, only after liberalisation should be done. The INCM is itself a result and a key actor in the process of development of a regulatory framework, its two principal priorities are to develop a framework for guarantee competition and universal access to these services⁷⁰. Because of the reduced market size in Mozambique the issue of the competition framework is especially pressing because for the incumbents may be easy to exploit their ‘first mover’ advantage and for possible entrants the entry may not be worth because of small market size and high fixed costs involved in the initial investments. The INCM consider this issue as the most pressing and problematic priority at this stage and would prefer a strategy that focus on this first before further liberalisation. As for other areas a negotiating option for Mozambique could be to link tightly the assistance in developing the regulatory framework and the necessary institutional capacities to run it with expanded market access.

6.3 Fiscal implications of reciprocity

This section explains in broad terms the model used to estimate fiscal revenues associated with Mozambique’s external trade related to an EPA with the EU. Taking into account basic assumptions, some scenarios are designed to study the fiscal implications of such agreement.

6.3.1. Macroeconomic Assumptions and Imports

6.3.1.1. GDP and growth

The model takes actual and estimated data up to 2004. From 2005 to 2030 growth rates are assumed as follows:

- 2005-2010: growth rates of 6 to 8% per annum, due to the effect of mega projects in this period.
- 2011-2020: growth rates of 6% per annum.
- 2021-2030: growth rates of 6% per annum.

The assumptions on the growth rates are based on government policy documents, as well as on international agreements linked to the NEPAD and the Millennium Development Goals (MDGs).

The structure of the economy will change very little. For example, agriculture will be around 19-20% of GDP, and manufacturing will move from 6 to 8% of GDP.

Inflation is projected at 7% per annum. Exchange rate projections are based on the Purchasing Power Parity assumption in relation to the American Dollar and the South African Rand. To attain such goal the nominal depreciation of the Metical will be in the range of 3 to 4% per year.

⁷⁰ Based on interview with INCM Director and other INCM’s functionaries

The population growth rate is reduced over time to account for the HIV/AIDS pandemic. This rate will move from 2,3% to 1,6% per year. However, there is no attempt to account directly the effect of this disease on the productivity levels, but the lower GDP growth rates assumed in this exercise is a proxy of this effect on the productive sector.

6.3.1.2. Imports: totals, structure and commercial blocs (SADC, EU, and the Rest of the World)

The macroeconomic assumptions are the basis to determine the level of imports for the estimations of the fiscal implications of an EPA. In general, imports of goods will vary from 30% of GDP to 25% in 2030.

The level of imports in the macroeconomic framework is higher than the value of imports used for tariff revenues estimations. This is due to exemptions related to mega projects, and for capital goods and others. Therefore, the level of imports used to estimate tariff revenues and other fiscal impositions correspond to 95% of total imports.

Data on external trade in Mozambique are still weak. We use a combination of some type of aggregation and some specific commodities of relevance to the Mozambican economy. The data are obtained from published official sources and estimations. Based on them, we define the basic structure of imports. The broad aggregations are: Consumer Goods, Intermediate goods, Capital Goods and Fuel and Energy. For each of these basic aggregates we define specific commodities either due to its weight in the structure of imports or due to its economic significance.

Imports are then divided into three major blocs: SADC, European Union (EU) and the Rest of the World (ROW). This division is based on historical data and basic assumptions on the structure for each one of these blocs.

6.3.2. Scenarios

This section is focused on the fiscal implications of a decision to embark into an EPA with the EU. First of all, we define a base scenario (scenario 1), which essentially assumes the current situation, i.e., it assumes the ongoing SADC protocol.

In this base scenario, the EU is treated as the ROW. This is a situation without any preferential agreement with the EU. The potential revenues from tariffs, the value added tax on imports (IVA) and the specific consumer tax on imported goods are estimated. In all scenarios, there are projections up to 2030.

Then two other scenarios are produced to compare with the base scenario. The first one, scenario 2, uses the same import structure from scenario 1, but assumes that Mozambique negotiates an EPA with the EU and starts its implementation in 2008,

applying the same rates as in the SADC protocol. We are exaggerating the effects with this assumption because in practice a process like this would be applied gradually, in particular due to the structural characteristics of an economy like Mozambique. Under these conditions, the ROW is treated as in scenario 1.

The second, scenario 3, uses the same level of imports as in the previous scenarios, but assumes that some trade diversion would occur. The scenario 3 assumes that 20% of the imports from the ROW are directed towards the EU. This diversion is across the board including all aggregations and the specific commodities defined in the structure of imports (consumer, intermediate, capital end fuel and energy goods, except electricity). Scenario 3 tries to put forward an “extreme” case that can then be compared with other scenarios.

For each scenario tariff revenues, IVA on imports and the specific consumption tax are estimated. Once calculated, the weights as a percentage of GDP, as a percentage of total revenues, and the structure of each revenue and for each trade bloc are defined. The exercise then ends with a comparison between scenario 2 and 3 with respect to the scenario 1, in order to grasp the implications as a percentage of GDP, as a percentage of total revenues, and on the structure.

In what follows, a set of tables show the major conclusions over time on the revenue estimates in each scenario.

A look at the total revenues (tariffs, IVA and consumption tax) show that in 2004 they represent 5,5% of GDP, and in 2030 reaching 3,8% (scenario1), 3,7% (scenario 2), and 3,6% (scenario 3).

Table 1: Revenues in each Scenario as % of GDP (%)

| Year | Scenario 1 | Scenario 2 | Scenario 3 |
|------|------------|------------|------------|
| 2004 | 5,50 | 5,50 | 5,50 |
| 2008 | 5,30 | 5,10 | 5,00 |
| 2010 | 5,10 | 4,90 | 4,80 |
| 2020 | 4,20 | 4,00 | 3,90 |
| 2030 | 3,80 | 3,70 | 3,60 |

For each type of revenue, scenario 1 shows that the tariff revenues move from 2% of GDP in 2004 to 0,8% in 2030. Scenario 2 shows that in 2030 tariff revenues would be around 0,7% of GDP, and scenario 3 around 0,6% of GDP.

In what concerns to IVA, it represents 3% of GDP in 2004, and 2,7% in 2030. In the other scenarios, the same percentages apply. The specific consumption tax represents 0,34% of GDP in 2004, in 2030 it would represent almost 0,3% of GDP (the same percentages for the other two scenarios).

Table 2: Tariff Revenues as % of GDP (%)

| Year | Scenario 1 | Scenario 2 | Scenario 3 |
|------|------------|------------|------------|
| 2004 | 2,00 | 2,00 | 2,00 |
| 2008 | 1,29 | 1,10 | 0,98 |
| 2010 | 1,08 | 0,90 | 0,79 |
| 2020 | 0,89 | 0,74 | 0,65 |
| 2030 | 0,82 | 0,68 | 0,60 |

Table 3: IVA on imports % of GDP (%)

| Year | Scenario 1 | Scenario 2 | Scenario 3 |
|------|------------|------------|------------|
| 2004 | 3,11 | 3,11 | 3,11 |
| 2008 | 3,62 | 3,62 | 3,62 |
| 2010 | 3,62 | 3,62 | 3,62 |
| 2020 | 2,99 | 2,99 | 2,99 |
| 2030 | 2,74 | 2,74 | 2,74 |

Table 4: Consumption Tax % of GDP (%)

| Year | Scenario 1 | Scenario 2 | Scenario 3 |
|------|------------|------------|------------|
| 2004 | 0,34 | 0,34 | 0,34 |
| 2008 | 0,35 | 0,35 | 0,35 |
| 2010 | 0,35 | 0,35 | 0,35 |
| 2020 | 0,29 | 0,29 | 0,29 |
| 2030 | 0,26 | 0,26 | 0,26 |

It is worth looking at the estimated revenues in each scenario as a percentage of total government revenues. The following tables show that the revenues from external trade of Mozambique represent 37% of the total government revenues in 2004. The projections in this study demonstrate a downward trend in these revenues. In 2030 they will reach 17% (scenario 1), 16,4% (scenario 2), and 16,1% (scenario 3). In the case of tariff revenues, in 2004 they represent 13,7% of the total government revenues. In 2030, the projections show that they will reach 3,6%, 3%, and 2,7%, for scenarios 1, 2, and 3, respectively.

Table 5: Revenues per Scenario as % Total Government Revenues (%)

| Year | Scenario 1 | Scenario 2 | Scenario 3 |
|------|------------|------------|------------|
| 2004 | 37,10 | 37,10 | 37,10 |
| 2008 | 33,30 | 32,10 | 31,40 |
| 2010 | 30,80 | 29,70 | 29,10 |
| 2020 | 21,50 | 20,70 | 20,30 |
| 2030 | 17,00 | 16,40 | 16,10 |

Table 6: Revenues from Tariffs as % Total Government Revenues (%)

| Year | Scenario 1 | Scenario 2 | Scenario 3 |
|------|------------|------------|------------|
| 2004 | 13,70 | 13,70 | 13,70 |
| 2008 | 8,20 | 6,90 | 6,20 |
| 2010 | 6,60 | 5,50 | 4,80 |
| 2020 | 4,60 | 3,80 | 3,40 |
| 2030 | 3,60 | 3,00 | 2,70 |

According to scenario 1, SADC shares on trade revenues would go from 45,4% of total revenues from international trade in 2004 to 42,3% in 2030. The EU would go from 10,8% in 2004 to 11,3% in 2030. Finally, the ROW would move from 43,8% in 2004 to 46,3% in 2030. In Scenario 2, and for 2030, SADC would represent 43,9%, the EU 8%, and the ROW 48,1%. Finally, in scenario 3, the shares will be 44,9%, 15,8% , and 39,3%, for SADC, UE, and ROW, respectively.

Table 7: Structure of Revenues per Trade Bloc (%)

| Scenario 1 | | | | | |
|------------|------|------|------|------|------|
| Bloc | 2004 | 2008 | 2010 | 2020 | 2030 |
| SADC | 45,4 | 41,8 | 42,3 | 42,3 | 42,3 |
| EU | 10,8 | 11,2 | 11,3 | 11,3 | 11,3 |
| ROW | 43,8 | 47,0 | 46,3 | 46,3 | 46,3 |
| Scenario 2 | | | | | |
| Bloc | 2004 | 2008 | 2010 | 2020 | 2030 |
| SADC | 45,4 | 43,4 | 43,9 | 43,9 | 43,9 |
| EU | 10,8 | 7,8 | 8,0 | 8,0 | 8,0 |
| ROW | 43,8 | 48,8 | 48,1 | 48,1 | 48,1 |
| Scenario 3 | | | | | |
| Bloc | 2004 | 2008 | 2010 | 2020 | 2030 |
| SADC | 45,4 | 44,3 | 44,9 | 44,9 | 44,9 |
| EU | 10,8 | 15,8 | 15,8 | 15,8 | 15,8 |
| ROW | 43,8 | 39,9 | 39,3 | 39,3 | 39,3 |

In 2004, SADC represents 43,7% of total tariff revenues, the EU 11,8% , and the ROW 44,4%. According the projections, in 2030, these shares will be 12,7%, 19,9%, and 67,5%, respectively, in scenario 1. In 2030, scenario 2 shows that the shares will be 15,3% for SADC, 3,5% for the EU, and 81,2% for the ROW. Finally, scenario 3, the shares become 17,4% for SADC, 8,7% for the EU, and 74% for the ROW, in 2030. These conclusions are based on a structure of imports very similar to the existing in the most recent years, but they give a point of reference.

Table 8: Structure of Tariff Revenues and per Trade Bloc (%)

| Scenario 1 | | | | | |
|------------|------|------|------|------|------|
| Bloc | 2004 | 2008 | 2010 | 2020 | 2030 |
| SADC | 43,7 | 16,8 | 12,7 | 12,7 | 12,7 |
| EU | 11,8 | 18,1 | 19,9 | 19,9 | 19,9 |
| ROW | 44,4 | 65,1 | 67,5 | 67,5 | 67,5 |
| Scenario 2 | | | | | |
| Bloc | 2004 | 2008 | 2010 | 2020 | 2030 |
| SADC | 43,7 | 19,8 | 15,3 | 15,3 | 15,3 |
| EU | 11,8 | 3,4 | 3,5 | 3,5 | 3,5 |
| ROW | 44,4 | 76,7 | 81,2 | 81,2 | 81,2 |
| Scenario 3 | | | | | |
| Bloc | 2004 | 2008 | 2010 | 2020 | 2030 |
| SADC | 43,7 | 22,2 | 17,4 | 17,4 | 17,4 |
| EU | 11,8 | 9,3 | 8,7 | 8,7 | 8,7 |
| ROW | 44,4 | 68,5 | 73,9 | 73,9 | 73,9 |

Scenario 1 serves as a reference basis for analysis. In this respect, it is now important to compare the outcomes of the projections for the scenarios 2 and 3 with this reference base. In the following tables, this comparison is undertaken. Comparing scenario 2 and 1, the differences between these two scenarios are in the range 0,14-0,2% of GDP in the period from 2008 to 2030. This is essentially due to the implementation of the same SADC protocol tariff rates in the trade with the EU. The differences between scenarios 3 and 1 are estimated to be in the range 0,22-0,31% of GDP in the period between 2008 and 2030. This is related to trade diversion from the ROW towards the EU, and applying the same rates as those of the SADC protocol to all trade with the EU.

In what concerns to the differences related to total government revenues, scenario 2 and scenario 1 show differences in the range of 0,6-1,2% of total government revenues, while the differences between scenario 3 and scenario 1 range in the order of 1-1,9%.

Table 9: Differences between Scenarios (% of GDP)

| Year | Scenario 2-Scenario1 | Scenario 3-Scenario1 |
|------|----------------------|----------------------|
| 2008 | -0,20 | -0,31 |
| 2010 | -0,18 | -0,29 |
| 2020 | -0,15 | -0,24 |
| 2030 | -0,14 | -0,22 |

Table 10: Differences between Scenarios (% of government total revenues)

| Year | Scenario 2-Scenario1 | Scenario 3-Scenario1 |
|------|----------------------|----------------------|
| 2008 | -1,20 | -1,90 |
| 2010 | -1,10 | -1,70 |
| 2020 | -0,80 | -1,20 |
| 2030 | -0,60 | -1,00 |

6.3.3. Conclusions

In this exercise, we have assumed that the structure of the economy and of imports would not change significantly up to 2030. Based on these assumptions, this study concludes that the fiscal effect is relatively small (in the range of 0,14-0,31%) as a percentage of GDP, and in the range of 0,6% to 1,9% as a percentage of total government revenues, when compared to the baseline scenario of the full implementation of the SADC protocol. However, the structure of the revenues will change due the composition of imports of Mozambique for each of the trade blocs defined in this exercise (SADC, UE e ROW).

These conclusions suggest that Mozambique must design an industrial policy appropriate to grasp the gains from industrialization and competitiveness for several reasons. These include: the pressures of trade liberalization, equilibrium of the trade balance, productive and employment dynamics, and generation of alternative sources and dynamics of fiscal revenues to finance public activities, in particular public investments with spillover effects within the economy: roads, railways systems and ports, rural development, education, health, and the judicial system.

6.4 *Impact on Mozambique's productive sector*

There are three possible types of impacts of an EPA on the Mozambique's productive sector: displacement of existing capacities through substituting domestic production by imports; improvement of existing capacities; and creation of new capacities. The last two possible impacts result from investment and opening up of market opportunities for Mozambican products. The combined effect of such impacts will determine the direction of specialization of the Mozambican economy.

However, such effects result not only from an EPA, but also from the cross combination of different regional and international agreements that Mozambique is part of.

To develop this analysis, we interviewed top officials in various government departments, as well as private companies and social organizations that are

established in Mozambique. Additionally, we made use of available studies and data about the Mozambican economy and, some about the region (see bibliography).

In the vast majority of the interviews with private companies and social organizations, it was emphasized by them that the expected short run impact of an EPA on the Mozambican productive sector is expected to be minimal, in the sense that there are not many activities remaining to be displaced, or that are not going to be displaced by other trade protocols, such as the SADC TP. The main exception was found in the wheat-based cereal milling and bakery industry, which could be displaced by cheaper imports of low quality flours and biscuits from Holland, Belgium, Greece and Turkey. It is possible to get flour from Holland and Belgium at a CIF price cheaper than the CIF price of imported, high quality hard wheat from the USA that is utilized in the largest cereal milling plants in Mozambique.

The dynamic industries in Mozambique are cereal milling (mentioned above), sugar (which has a specific protocol), beverages (protected by strong regional corporate strategies), cement (linked with an European corporation), aluminium (property of one of the largest multinationals in world), tobacco (international companies), and some smaller activities that are emerging, like citrus exports, soya and some metal-engineering products (water pumps and agricultural tools). With the exception of the cereal milling industries, none of the others is threatened by the reciprocity clause of the EPAs. The only 'dynamic' industry in Mozambique that is threatened by the EPAs is wheat-based cereal milling and bakery industry.

With the exception of aluminium (with its main market in Belgium), citrus, soya (Norway), and sugar (specific protocol), none of the other dynamic sectors is particularly focused on the European market.

Fishing is a different matter altogether. The domestic market for fresh and frozen sea products is not threat by an EPA, but an EPA may prevent processing of sea products from developing because of strong competition from the European fishing industry. Additionally, exports of sea products (fish, lobster, prawns) represent around 10 per cent of total exports of goods, and the EU is Mozambique's main market. Thus, Mozambique's fishing industry is structurally linked with the European market, and may be particularly sensitive to negotiations with the EU. We need to have a closer look at fishing. How can we attract processing in Mozambique?

Tourism is an area of potential investment and market opportunities, but not well known. There is very little information about what can the link with the EU provide, and it is not clear that more can be done with the EU in tourism with an EPA than without an EPA. At the moment, the most important aspect is to gather information and develop more knowledge about the possibilities of attracting investors, operators, finance and tourists, such that the Mozambican economy can benefit from its potential as supplier of diversified tourist products. This is an area to explore.

More generally, current productive dynamics in Mozambique are not deeply linked with the EU. They are far more connected with, and influenced by, the dynamics of internationalization of the South African capital. Four fifths of all FDI in Mozambique is made by South African firms or in association with South African firms. With the exception of soya and cement, the dynamic sectors of the economy are associated with South African capital and are part of international (ex., Mozal) or regional (ex.,

sugar and beverages) corporate strategies of internationalization under oligopolistic conditions, and/or expansion of the minerals-energy complex.

The vast majority of relatively successful small and medium firms are associated with South African firms and financial sector: South African firms are often main suppliers of inputs, technology, maintenance, industrial and training services; South African industries are main sources of information; Mozambican products are being traded under South African certification, and under the branding and reputation of South African firms; finance is also available through links with South African firms.

South African providers of industrial services have relocated activities to Mozambique when fixed costs and risks are low, market is guaranteed and turnover high. For example, reputable maintenance companies have transferred warehouses and small repair workshops to Mozambique to provide industrial services to Mozal and other large projects, benefiting from concentrated markets, long to medium term contracts, duty free imports, and need of almost no fixed capital investment. In other cases, South African engineering firms have rented facilities and some institutional capacities of existing Mozambican engineering firms in order to establish large scale engineering operations for mega projects at the minimum possible investment cost. In very specialized areas, such as industrial waste removal of specific nature and degree of contamination, new capacities have been created in relation to mega projects.

The South African financial sector, that used to be influential through financing foreign private investment rather than through direct banking presence in Mozambique, is starting to penetrate the banking sector in Mozambique in a strong and aggressive manner – two commercial banks have been acquired, one of which is the second largest in Mozambique; and a third has been introduced (all over the last two years).

South Africa is, also, the main trading partner of Mozambique, particularly with respect to imports of the Mozambican economy (around 45 per cent). Even in the event of significant trade flow changes resulting from an EPA, South Africa would continue to provide more than 40 per cent of Mozambique's imports.

Additionally, services and private transfers, almost entirely linked to the South African economy, represent about 40 per cent of Mozambique's export earnings. Thus, if services are included, South Africa is the major trading partner also with respect to Mozambique's exports.

Thus, Mozambique's current and capital accounts are very strongly linked with the South African economy.

Could we argue that since many South African firms are already established in Mozambique, they might try to access the European Market through Mozambique? (Tariff jumping in case that Mozambique gets preferential access into the EU market). What barriers are South African firms facing in the EU? An analysis of this type may help us in knowing whether this type of investment will be possible.

Hence, with few exceptions, Mozambican firms were not particularly concerned with the negotiation of an EPA with the EU in the short run, as it seems that the dynamics of the relationship with South Africa are far more important.

However, there are a few aspects, in the mid to long run analysis, that have to be considered. First, trade liberalization within SADC and with the EU will restrict opportunities for the recovery and development of the productive capacities in Mozambique. This restriction will operate at two related levels, the policy instruments that will be available and the sectors and activities than can be developed.

The first restriction, available instruments of policy, is further discussed in the next chapter. However, it is clear that the trend is to remove traditional instruments of trade policy, and to make it more difficult to build selective and discriminatory action at other levels. However, there are many other policy instruments still available, and Mozambique, being a LDC with chronic balance of payment problems, has some leverage to negotiate the terms of liberalization of policy.

As far as the second restriction (the sectors and activities) is concerned, the options are not many: activities that are promoted by international and regional capital as a result of their strategies of internationalization and regionalization; resource based activities that are interesting for international markets; activities that can become part of business chains, formally or informally; and more isolated cases of technology and market niche opportunities.

Second, the negotiation of an EPA may emphasize the creation of development conditions as a counter part to trade liberalization. The EU is not new to this experience, as all its mid income members have received adjustment packages to upgrade their economies to a level compatible with EU dynamics. Thus, Mozambique can unite with the other LDC countries in ACP and regional groupings (say, SADC or SACU+3-1) in order to make sure that financial, technical, informational, training, private direct investment and other packages are introduced in the negotiations to provide adequate competitive capacities to key sectors (including the development of the private entrepreneurship, management and operational capacities).

Third, FDI from EU may play an important role in Mozambique, particularly with respect to four main aspects: (a) diversification of financial institutions and products available for investment support; (b) diversification of the investment and productive dynamics away from the South African minerals-energy complex and regional oligopolist expansion; (c) penetration of EU markets; and (d) development of an engineering and industrial services structure (including support to development of reputable quality, standards and certification systems, technical and management training, information and business advise services, innovation systems, maintenance, and so on) for supporting productive development and improving the quality of investment.

However, it is not that clear that Mozambique is going to become more attractive to EU investors. EU investors may have access to SADC markets (including those of South Africa and Mozambique) through agreements established with South Africa and/or other countries in the region at the same time that the SADC protocol is implemented. In this case, which is very likely to happen, Mozambique has very little to offer to attract more foreign investment independently of the dynamics of the South African economy. If FDI continues to be attracted to Mozambique through the dynamics of the South African economy, then current patterns of production, investment, trade and specialization (discussed in an earlier chapter and summarized below) will be replicated.

As far as FDI is concerned, it seems that there are two areas to explore further. One is how the economy can benefit more, through linkages and other factors, from the dynamics of the South African related investment. Another one is the identification of the key activities, capacities, resources and markets that Mozambique should try to attract from the EU for specific sectors, and the definition of the best strategy to do so (including the gathering and analysis of the necessary economic information).

The main challenge for industrial and investment policy, within the limits imposed by international and regional agreements, is how to build a more competitive, diversified and developmental productive dynamics on the basis of such options. There are a few actions that are crucial to develop useful industrial and investment strategies and policies. One is to develop a detailed and profound knowledge about what has been and is being done in Mozambique with respect to production and investment, in entire industries or by isolated firms. This information can be used to identify problems to solve, capacities to support and/or acquire, links to establish, examples to generalize and to develop information sets to be used by other investors, foreign or domestic.

Another activity is to develop a detailed knowledge of the trends of production, investment and public and corporate strategies in the region and how they may affect the Mozambican productive patterns and capacities. This information could be used to improve the negotiation capacity with foreign investors, design better and more industry tailored systems of incentives, and try to identify and mobilize resources, investors and capacities to those areas that are thought to be better suited for the development of the Mozambican economy.

A third set of activities would include: (a) identification of opportunities and mechanisms to develop a financial sector linked with productive investment, and to mobilize domestic surplus to finance the creation of productive capacities, rather than being continuously wasted in creating a trading and services sector that only represents foreign brands and firms without creating any significant economic value added; (b) development of a coordinated and integrated approach to investment and development of productive capacities and competences, which is independent of sectoral tutelage, competition and fragmentation, and instead unifies the action of the government and supporting institutions around common goals; (c) development of the supporting services for investment and industrial and productive development, particularly with respect to provision of information and technical assistance, certification and quality, training, engineering services linked with maintenance and product design, marketing information and analysis, data bases on financial facilities available, and linkages services that are business oriented; and (d) identification and removal of barriers that are unnecessary, play no developmental role and may impede investment and production.

The following fundamental criteria should guide choices with respect to selective development of productive capacities in Mozambique: (a) significant, sustainable and growing impact on export revenue; (b) deep, foreign exchange saving, import substitution related to backward and forward linkages, within and across sectors and industries, linking firms and agents of different types and scales of operation, developed around major projects, product and value chains, and efficient and competitive use of domestic resources and capacities; (c) dynamic and expanding markets, also characterized by dynamic innovation and diversification opportunities; (d) development of economies of scale and scope; (e) employment and skill

generation; and (f) opportunity to diversify location, but concentrate capacities and resources around chains and clusters.

The following sectors, according to the above criteria, seem to be the more relevant in the short to medium run, in terms of requiring a deeper analysis with respects to threats and opportunities emerging from an EPA: (a) cereal milling and bakery – what is its future? How can it be restructured and made more competitive? How can market and opportunities be expanded and products diversified and improved?; (b) tourism – what are the investment and market opportunities opened up by exploring the EU; What are the financial and technical assistance facilities that can be used? What type of tourism product Mozambique can offer that may be in demand? How to link the tourism sector with the networks in the EU? No defensive strategy for the tourism sector? (c) fishing – what would an EPA add to what already exists? Are there market opportunities yet to be captured and what are the technical, quality and standards and productive capacities required? Are there opportunities for development of the fishing processing industry and for what markets? (d) sugar – monitoring the development of the protocols and international trends; opportunities to expand exports without declining marginal revenue; opportunities for diversification within the industry; (e) processed cashew and cashew related products, soya, fresh fruits and rice – market analysis (size, standards, price monitoring, etc), finance, technology and technical assistance in production and marketing, opportunities for diversification within each industry; (f) other agro-industries: will there be opportunities for developing domestic industry (competition, capacities and resources, investment, product diversification); existing product and value chains with European companies and companies from other parts of the world (example, India, other African countries, Brazil); dynamics of markets, technology, standards, investment and finance; (g) metal engineering and electronic industries, related to industrial maintenance and other services, with and specific products and investment programs: opportunities for training, certification, product design, innovation; threats of competition; opportunities to link domestic firms with EU corporations in the provision of industrial services and development and production of products that can find a market in the country, the region and world markets.

6.5 Institutional capacities and development policy

The interviews with several public and private institutions revealed how weak the policy and negotiating capacities are, particularly with respect to dealing with the dynamics of international economic processes and their impact on the Mozambican economy.

The main problems identified are created by institutional culture, informational limitations and quality of the personnel.

With respect to public institutional culture, there are four main problems that have to be dealt with, urgently and seriously. First, government departments and supporting institutions tend to balkanize their information and activities, to the point that the quality of the information is significantly reduced, existing information becomes useless, decisions and debates are seldom based on sound information, information systems are seriously underdeveloped, and information is bureaucratized and becomes part of a general, hidden bargaining over petty bureaucratic power. Second, and as a

generalization of the first problem, many of such institutions have no idea of what their strategic role should be, what their daily routine tasks are for, and have no interest in coordination around common goals. In most departments we visited, coordination is a bureaucratic function of planning and budgeting, mostly because no one knows anymore what the roles of planning and budgeting are. Related to this, the most dangerous problem is that each department has a clientele, and no one sees the economy as a whole.

Let us look at the example of agro industry. While one government department is concerned with agro processing as a palliative measure to cope with fragmented markets for agricultural surplus, irrespectively of any conceptualization of industrial development; another is concerned with the rehabilitation of existing, so-called, agro industrial factories irrespectively of any linkages with the agriculture sector, maybe even by promoting cheap imports of agricultural inputs that may be produced in Mozambique. Nobody is even trying to link the two, and none of the two considers taking the initiative to approach the other in order to develop an integrated approach to agro-industry that strengthens the Mozambican economy.

Another example of sectoral balkanization is the fact that the responsibility to developing and supervising industrial policies is distributed through different ministries and departments within ministries, without any significant coordinating mechanism and effort between them. Such distribution of responsibility matches the so-called tutelage responsibilities of each ministry and department. The different capacities of the state and productive sector have no way of being coordinated around nuclear and common objectives, and policies and strategies of the different ministries and departments tend to be either irrelevant or in conflict to each other, and tend to reinforce fragmentation in policy making and implementation.

The third problem of institutional culture, specifically related to this study, is that international markets and economic dynamics tend to be seriously neglected in the process of development and implementation of policy. In all ministries that we visited, issues of international markets, agreements and economic dynamics are the exclusive area of work of one department of cooperation. In some cases, this department is a bureaucratic and support institution to the office of the minister; and in other cases, it is part of the economics directorate. In any case, this department does little else than attending meetings, collecting documents from international fora, and so on.

The most important issue, however, is that the regional and the international economic and business environments do not form part of strategy and policy development, information gathering, and strategic decision making processes. In most policy documents we had access to, the international environment is a paragraph or two, rather than a nuclear component of the main analytical framework.

In brief, sectoral expertise in international economic and business dynamics is extremely weak, the understanding of the importance of such dynamics is, consequently, poor, and, as a result, such dynamics do not form part of the main analytical framework for policy making.

Under these circumstances, Mozambique is in a very poor position to negotiate in international fora with any strategic vision beyond current pressures of existing and dominant sectors. Also, it would be very difficult for the professional team of

negotiators to receive any substantial support from the sectoral ministries and departments.

The fourth problem of institutional culture is that, exercises on strategy and policy making are, mostly, routine and bureaucratic activities, usually performed as a result of exogenous pressures: donor aid, pressure from a group of large investors, conflicts between different agents, and so on. Therefore, in most cases there are five problems with the resulting strategy and policy documents: (a) they are too big and too vague, and make no selective and informed choices; (b) they are not based on sound data and good analysis of data and processes; (c) they are not aimed at guiding decisions, negotiations, methods and approaches, and routine activity. Hence, after approval, they tend to have no further role to play in actual institutional activity; (d) as a result, it is not clear which type of information and analytical framework is necessary to develop relevant strategies and policies, nor is the role of the strategy and policy clear; and (e) as part of the previous problem, market and business environments, at local, domestic, regional and international levels, are barely addressed or taken into consideration. As a result, we found that privatization and liberalization decisions are taken under pressure (usually political, but also from the EU, other donors and/or from individual and powerful economic agents), and that there is no serious and systematic attention being paid to the need to develop strategies of selective and offensive liberalization. Some public officials have almost a religious faith on the advantages of privatization and liberalization, without analyzing the objectives, agendas and the conditions under which such measures are taken. The culture of “giving up to whatever pressure” seems to be wide spread.

Every day there are state decisions, of strategic importance, taken without any sound information about, or concern for, regional and international market, price and business dynamics. At the same time, it is terribly difficult for the team of government negotiators to get substantial and systematic support from different sectors to sustain their negotiation positions.

So, Mozambique runs the risk of developing policies that are irrelevant given the international context; and of not knowing the details and interests that should be negotiated to influence the international context, at least when Mozambique has a negotiating role to play.

The problems of information and quality of personnel can only be solved within the context of addressing the more general issues of collective and institutional culture. Information needs and skills and training programs required are related to the demands of the work, decisions to be made and implemented, the role attributed to different institutions, the nature and dimension of the policy and coordination process, the relationship with productive and trade sectors and dynamics. Thus, these two issues (information and quality of personnel) are not discussed further here.

The private productive sector, particularly the Mozambican entrepreneurial group, is seriously disorganized. Associations are mostly political entities, and their activity is often limited to trying to capture the state and government policy. There is very little that is done by these associations with respect to business development: information, assistance, branding, reputation building, development of standards, organization of partnerships and linkages, negotiation with the financial sector, organization of imports of crucial inputs and exports, training, and so on. The industrial association (AIMO) is trying to start developing some of these activities, but generally these

associations are weak, weakly supported by its hypothetical constituencies, and fundamentally perform the role of making claims on government policy and action.

When asked about partnerships and industry based associations, most entrepreneurs mentioned conflicts and lack of trust between entrepreneurs within the same industry as a reason for industrial disorganization. These conflicts may well reflect conflicting interest between large and small firms, between exporting and inward oriented firms, between firms in different phases of business cycles, between competitors trying to increase market shares, and so on.

Most of these conflicts can only be addressed by developing specific industrial strategies that involve all agents in positive business cycles. If private, productive agents and capacities continue to be disorganized and competing against each other, rather than against the common problems they face, it will be very difficult to develop a negotiating basis upon which to develop strategies, policies and negotiating agendas in the international arena.

All of the problems mentioned above need further elaboration. It is necessary to understand better the genesis of the problems, as well as to understand them in the specific contexts of detailed sectoral studies.

6.6 Conclusions

This chapter has looked at various issues, namely: (a) economic benefits from an EPA require a significant export response of the Mozambican economy; (b) the mechanisms by which exports may or may not be encouraged and developed in relation to the adoption of an EPA; (c) trade in services and the importance of considering it as a special case; (d) the fiscal impact of an EPA; (e) the productive impact of an EPA; and (f) institutional conditions that have to be addressed.

It was emphasized that without a quick export response, Mozambique could not benefit from an EPA (6.1). On the contrary, a potential increase in tariff free imports and a very slight reduction in tariff revenue (6.3 and 6.4) would combine to worsen both the current account and the state deficit.

An EPA may create export opportunities and other economic synergies that help exports to develop. However, it is not clear and guaranteed that exports will grow. In order to do so, specific strategies and policies that are export oriented and do not crush the economy as a whole may be required to developed the necessary productive, investment, market and informational capacities that enable supply responses of the scale and quality demanded.

Sections on trade in services (6.2) and impact on productive capacities (6.4) discuss these issues in detail.

A section on institutional capacities (6.5) argues that three major problems (institutional culture, informational limitations and quality of personnel) have to be addressed. Four aspects of institutional culture (balkanization of information and activity, marginalization of international economic and business issues in policy making, and the limitations of the policy process) were discussed. It was also argued

that information and skills/capacities are related to institutional development and should be solved in the context of addressing the institutional culture issue.

Chapter 7: Trade-related issues

In this chapter trade related issues are examined. These include first the Singapore issues which the EU sought to have incorporated in a single multilateral agreement in the context of the Doha Round but had to withdraw in the face of opposition from developing countries in Cancun.

- trade and competition,
- trade and investment,
- transparency in public procurement and
- trade facilitation

Secondly three other issues explicitly raised by the Cotonou Agreement:

- trade-related intellectual property rights (TRIPs),
- labour standards,
- and standards and certification.

Finally it considers two other issues raised in recent bilateral FTA agreements

- trade and the environment and
- data protection⁷¹

The EU has added data protection and government procurement to those they want to have negotiated within the EPAs although they were not mentioned in the Cotonou Agreement.

We will examine these issues in terms of the possible pressure by the EU to include some or all of them in any EPA and to what extent that might create problems for the ACP States – and, in particular, Mozambique. The exercise is by its very nature speculative since it is not yet clear to what extent the EU will come to the negotiations with requests for agreement on these issues, though its vigorous backing for an agreement on the Singapore issues up to Cancun and its insistence that others be identified in the Cotonou Agreement imply that there may be some far-reaching demands in these fields. Secondly a number of Commission officials have spoken of the EPAs as WTO-plus, suggesting whatever, if anything is agreed in the Doha Round, the EU would like to go further in establishing rules and commitments in the EPAs.

For many years the EU, along with Japan and South Korea but, interestingly, not the United States, has been championing a single multilateral agreement covering the so-

⁷¹ Note that what is considered as an ‘issue’ in the Cotonou Agreement is somewhat arbitrary. For example protection of the environment is mentioned but in very general terms and there is no suggestion that it would explicitly feature in the EPAs.

called Singapore issues: trade and competition, trade and investment, trade facilitation and transparency in government procurement. Despite a last-minute willingness on the part of the EU to ‘unbundle’ and accept separate agreements on each or some these issues, the EU’s earlier intransigence was a major contributing factor, perhaps the final straw, that broke the back of the Cancun Ministerial meeting. With no agreement at Cancun, the EU may well press for the inclusion of these issues, or at least of competition policy and the treatment of direct investment, in the forthcoming negotiations on the ‘clarification’ of Article XXIV of the GATT, which covers the minimal conditions for FTAs and CUs.

In any event, EU representatives insist that even though there is no agreement to discuss Singapore issues in the WTO, these issues will be discussed in EPAs as EPAs are WTO-plus arrangements.⁷² It is doubtful that were the ACP – or regions thereof – to argue that the Cotonou Agreement represents as far as they will go in these issues would satisfy the EU negotiators.

The ACP countries have expressed strong views in the negotiations in trade-related issues in general:

- they are reluctant to make commitments which go beyond the Cotonou Agreement per se, which focused of the establishment of arrangements to strengthen ACP capacities;
- they argue that it is essential that they acquire the necessary expertise before entering into negotiations on these issues and would like to have support programmes in place before negotiations begin;
- the ACP States are reluctant to go beyond any commitments that they would accept in a multilateral context, i.e. they resist the WTO-plus notion;
- and, critically, they argue that multilateral trade rules on these issues must precede negotiations in the EPA context, at least as regards data protection, government procurement, competition policy, investment and trade facilitation.⁷³

The Cotonou Agreement includes a fair amount on competition policy, something on investment and little on government procurement or trade facilitation – though as indicated earlier the EU has proposed that public procurement be added to the Cotonou list. But the TCDA between the EU and South Africa is also clearly relevant, particularly insofar as a SADC-EU EPA is concerned for reasons discussed in Chapter 5. Also in the most recent of the bilateral FTAs signed by the EU, that with Chile, the Singapore issues are more extensively covered than in any previous bilateral EU FTA. Thus both of these agreements might be indicative of the approach that the Commission may pursue in the EPA negotiations and they will be considered in the context of the issues under consideration. It is also worth noting the many of the recent FTAs agreements between the United States and individual developing countries go even further than the EU-Chile FTA in making explicit the means of cooperation over competition questions, the liberalisation of investment, the mutual opening of government procurement markets (when can we expect to see Nicaragua

⁷² See Trade & Development Update, Volume 3, Issue 2, December 2003

⁷³ But if the ACP insist on waiting till these issues are agreed at the multinational level and also refuse any WTO-plus rules there would be no point in negotiating them in the EPA context.

firms bidding for major public works projects in the US?) and measures to make border processes more cost-efficient.

7.1 Competition policy

There is a major difference between the trade and competition issue and the other Singapore issues – the cost to developing countries from export cartels and other anti-competitive behaviour is very clear. A World Bank study found that ‘[i]n 1997 ... developing countries imported \$81.1 billion of goods from industries which had seen a price-fixing conspiracy during the 1990s. These imports represented 6.7 percent of imports and 1.2 percent of GDP in developing countries. They represented an even larger fraction of trade for the poorest developing countries, for whom these sixteen products represent 8.8 percent of imports.’⁷⁴ The prevalence of hard core cartels, both domestic and international – the OECD investigated over 120 cases between 1996 and 2000 – and the magnitude of the welfare losses that they have caused justify international action on competition policy.

The EU may have another motive. Rules that require countries to open their doors to trade may be rendered meaningless by commercial constraints – on the part of national or foreign firms – which block access. This appears to have been the principal rationale behind the EU’s insistence on the need for a multilateral competition agreement (MCA) which predates the Singapore Ministerial. Since then the Commission has watered down its proposals, which at Cancun were quite imprecise.

Anti-competitive behaviour of export cartels and dominant suppliers, largely based in developed countries, imposes significant costs on developing countries, which might benefit from a minimalist MCA established under the auspices of the WTO. However the rationale for a MCA does not extend to requiring that members establish a full-bodied corpus of competition laws and a competition authority. That would not be cost-efficient in most developing countries. The emphasis should be on an agreement which commits member states to outlaw both anti-competitive behaviour that compromises market access and export cartels.⁷⁵ It must also commit Members to the principle of international cooperation to combat anti-competitive behaviour with transborder effects.

If an MCA incorporating a ‘minimalist’ agenda is agreed – or is in the process of negotiation – before the issue arises in the EPA negotiations, the ACP States, ideally as a whole but otherwise at the regional or country level, should resist any efforts on the part of the EU to go any further in terms of implementing laws, establishing institutions or cross-border cooperation. At the same time even the implementation of an MCA along these lines would imply significant costs for the ACP States. Thus

⁷⁴ Levenstein and Suslow (2001). See also Evenett, Levenstein and Suslow (2001) for further evidence from World Bank research on the topic.

⁷⁵ see Michael Davenport, A Multilateral Competition Agreement and the Developing Countries, in Ivan Mbirimi, Bridget Chilala and Roman Grynberg (eds.), *From Doha to Cancun*, London: Commonwealth Secretariat, 2003

they should argue strongly in favour of substantial amounts of technical and financial assistance from the EU⁷⁶.

In Mozambique there is currently no competition policy per se. The Commission for Legal Reform is examining the issue. The MIC is also examining the appropriate parameters of a competition policy. The policy would have to be 'minimalist' in the sense discussed above. It would have to reflect the limited expertise and funds available. At present there is a serious dearth of lawyers and economists trained in competition law. Ideally the costs would be largely assumed by the EU.

Apart from the costs and lack of expertise, the serious problems in collecting data and delays in the legal system have to be taken into account. Any new institutions such as competition courts or tribunals would not be practicable for the foreseeable future. Initially the policy would be centred on a law banning certain anti-competitive practices. It would focus on price-fixing through import cartels and the abuse of dominant position. It would allow for a significant cooperation with other jurisdictions, in particular the EU. Laws governing mergers and acquisitions, forms of vertical agreements and anti-competitive distribution practices would have to come later.

However, a bigger question is what Mozambique would want to achieve with a competition policy. On the one hand, there are international trends and rules that Mozambique may need to accept, and some that can be renegotiated. On the other hand, competition policy would have to deal with trade and trade policy, licensing and the legal and bureaucratic investment environment, but also with many other equally fundamental, if not more fundamental issues: industrial policies and investment strategies that have to face issues of economies of scale in production and services, product differentiation and specification, corporate strategy (regional and international), technological innovation, etc, which are often dealt with not enough attention and accuracy. Thus, a competition policy that states its aims as increasing competition or facilitating investment and do not link these objectives to concrete development target and strategies could be at the best useless and at the worst dangerous. On the other hand, most of the so-called anti-competitive practices come from MNEs. How would a competition policy, adopted by a LDC like Mozambique, attract such MNEs and, at the same, restrict the very practices that the MNEs adopted to become larger, powerful and multinationals?

7.2 Trade and investment

Article 75 of the Cotonou Agreement essentially commits the ACP States and the EU to take measures to encourage private investment, to create and maintain a predictable and secure investment climate as well as enter into negotiations on agreements which will improve such climate, to encourage the EU private sector to invest and to provide specific assistance to its counterparts in the ACP countries through partnerships and joint ventures, and to support efforts of the ACP States to attract financing, with particular emphasis on private financing, for infrastructure investments and revenue generating infrastructure critical for the private sector. The parties commit themselves

⁷⁶ Refer to Rodrigues (2004), report for MIC

to promoting such investment, particularly through an ACP-EU private sector business forum.

A number of EU bilateral agreements including the TDCA include a section on the treatment of foreign investment.⁷⁷ As regards investment, Article 33 of the agreement states:

‘With regard to transactions on the capital account of balance of payments, the Community and South Africa shall ensure, from the entry into force of this Agreement, that capital relating to direct investments in South Africa in companies formed in accordance with current laws can move freely, and that such investment and any profit stemming therefrom can be liquidated and repatriated.

The Parties shall consult each other with a view to facilitating and eventually achieving full liberalisation of the movement of capital between the Community and South Africa.’

The first clause refers to investor protection and it can be presumed that the EU will either insist on separate bilateral investment treaties with individual ACP States, or investor protection will be built into the EPA. The significance of the second clause in any EPAs would be substantial. Full liberalisation goes considerably beyond that envisaged in a Multilateral Agreement on Investment (MAI). Everything is covered, with no qualifications to allow for sectors reserved for government or for domestic investors.

As with the MCA, the momentum towards a MAI is being maintained by the EU together with, in particular, again Japan and South Korea. Clearly most foreign investment between the developed and the developing worlds moves from the former to the latter. Multinational firms want a stable, predictable and transparent foreign investment framework, including freedom from threats of appropriation, nationalisation or restrictions on the repatriation of profits or capital. This implies that the benefits of an agreement on investment would essentially accrue to MNCs from developed countries, and some might argue that this explains why some developed countries – interestingly, excluding the US – are pressing for it.⁷⁸ On the other hand EU officials stress that such an agreement would be of benefit to the ACP States since it would improve the business climate, encourage investment, lead to exports growth and boost economic growth (see Chapter 5 for further discussion).

The GATS already requires MFN treatment and transparency through Articles II and III for investment – or commercial presence – to supply services and this now accounts for 85 to 90 per cent of direct foreign investment. True, the GATS operates through a ‘positive list’ approach, and even where sectors are opened to foreign investors, the host country can impose qualifications on national treatment. Mozambique has made a commitment under GATS as regards financial services. But a positive list system is the Doha-mandated approach to an MAI in any case. The GATS allows each Member to decide what sectors it will open to foreign suppliers, and to schedule or ‘bind’ those commitments. Article XII:2 of GATS foresees that the liberalisation process will respect national policy objectives and development levels while Article XIX:2 allows appropriate flexibility for developing countries in terms of

⁷⁷ Also, in Article 23, the EU-South Africa Agreement states that the GATT agreement on countervailing measures would continue to remain operational.

⁷⁸ Benno Ferrarini (2003), World Trade Institute

numbers of sectors opened, types of transactions covered and the time periods involved.

The emphasis of the developing countries must be to safeguard the 'development dimension', that is to ensure that under any agreement, whether a multilateral or bilateral level, there are substantive and binding provisions to ensure that individual countries, while subject to certain disciplines, nevertheless retain sufficient discretion to protect their developmental goals and policies, as well as national security, health and safety and other public policy goals deemed essential by the host nation.

This will also be the main concern if the EU tries to insist on a clause in the EPA similar to that of Article 21 in the EU-South Africa TDCA or Article 55 in the EU-Chile Agreement. They can be interpreted as requiring 'national treatment' (NT) insofar as investment is concerned, going far beyond the positive list approach of the GATS. If the EU insists that investment liberalisation be included within an EPA, the ACP States should require a positive list approach similar to that of GATS with the option of qualifications to NT even in sectors that are being opened up, for example that sectoral exemptions to allow for monopoly provision by the state or exclusive franchising to one or more private sector enterprises remain an option. In other words all the protections for the development dimension envisaged under an MAI would be included. This is after all the approach that the EU has been advancing in the WTO working group, as well as being the approach favoured by the United States and Canada in their BITs and in NAFTA.⁷⁹ In the services area, GATS Article VIII (Monopolies and Exclusive Service Suppliers) sets out an obligation for WTO Members to ensure that such monopolies and exclusive service suppliers do not act in a manner that is inconsistent with their obligations under Article II (Most-Favoured-Nation Treatment) and specific scheduled commitments.⁸⁰ This could be extended in the EPA to cover industrial sectors.

There are subsidiary questions that will arise including the speed of the liberalising process, retaining its flexibility and its reversibility. It is also of the utmost importance that there be no time limit set on sectoral exemptions or qualifications, or any mention of any timetable for further liberalisation in this area. It is also important that the EPA does not facilitate pressure by the EU on the ACP members to an EPA for the progressive opening of new sectors or removing qualifications to NT in sectors that have been opened. Again there must be no question of scheduling future negotiations on further market opening in the EPA - as has happened in a number of earlier EU bilateral agreements. To the extent that the EPA envisages further opening or the removal of qualifications to NT, this needs to be qualified by 'a best endeavours clause that does not commit to a legally binding policy change but allows for a gradual change in attitude without the possibility of creating binding legal rights for investors'.⁸¹ In addition market access is not necessarily a one-way street. There must be provision for the renegotiation of restrictions on entry and establishment rights, for example for environmental reasons.

⁷⁹ Muchlinski (2003), p.7

⁸⁰ Heydon (2002), p.23

⁸¹ Muchlinski (2003), p. 9

Mozambique already has a liberal policy on foreign investment. The degree of discrimination against foreign investors – deviations from NT - is now minimal. A single law governs domestic and foreign investment and roughly the same incentives are applied. There are, however, several areas in which the law differs:

- foreign investors can repatriate profits;
- minimum levels of investment required to qualify for fiscal incentive differ; for domestic investors the minimum is US\$ 5,000, for foreign investors it is US\$ 50,000;
- different rules in respect of land titles;
- exemption from import duties on certain capital goods and raw materials, and
- fiscal incentives in the form of tax holidays.

Foreign investors also benefit from the usual investment protection laws. Other than profit repatriation, they include the protection of property and indemnification in the event of nationalisation. In the economic processing zones there is total fiscal exemption.

Owing to the budgetary costs there is significant pressure to review and possibly develop a more selective approach to investment incentives. Already a number of “special incentives” have been reduced or eliminated, including those for sugar production (reduced), tourism (eliminated) and for investment in the Vale do Zambeze where the tax holiday has been shortened to 2010 rather than 2025.

The Mozambique government has concluded bilateral investment agreements with various countries, including some EU countries. These include clauses on double taxation relief, national treatment and the transfer of technology (through ‘best endeavours’). Currently there are efforts to reach more bilateral agents and in the promotion of joint ventures. The question of investment guarantees, to reduce the risk and credit costs of foreign investors, is being examined as a priority issue.

With respect to SADC, there are major areas of disagreement related to policies to attract investment. These may create difficulties in negotiating a SADC-EU EPA. In general, however, there could be mutual benefits from including an investment chapter in an EPA. A number of these issues could be taken up including a single investment agreement with the EU to cover investment protection and the general principle of national treatment. What seems to us to be important to Mozambique, and all ACP countries, is to retain its discretion over which sectors to offer national treatment, i.e. to retain a positive list approach. In addition we believe that Mozambique must resist pressures to constantly expand that list through, for example, scheduled reviews. If Mozambique is to pursue a proactive development policy – which must include, for example, infant industry considerations, geographical balance, social and environmental concerns or the regulation of natural monopolies or those dictated by market size – it seems to us that it must retain the discretion to reserve certain sectors of economic activity for its own productive agents, whether state or private.

7.3 Government procurement

From the point of view of sovereignty, this is arguably the most intrusive of the Singapore issues. It purports to require Members to submit to a number of disciplines on transparency including procedures for announcing tenders, for tendering itself and for challenging the decisions of the authorities. It also raises the issue of whether this is simply the first stage in a campaign to force developing countries to open public procurement contracts to multinationals based in developed countries.

The main proponents of an agreement on transparency on government procurement (TGP) under WTO aegis are again the EU, Japan and Korea. The inclusion of government procurement among the Singapore issues reflects an assumption that all countries and the developing countries in particular would benefit from increased transparency – particularly as that implies a step towards good governance – but also that that increased transparency will lead to greater market access, presumably for EU, Japanese and Korean companies.

Again whether or not there is an agreement to negotiate a multilateral agreement at the WTO level, the EU is likely to insist on a government procurement component to any EPA. Developing economies are increasingly entering into bilateral or regional procurement agreements whether or not they are parties to the GPA. Some RTAs have gone beyond the GPA by enlarging the scope of commitments or by providing a more detailed application of disciplines. NAFTA expands upon the obligations of the GPA by adopting lower thresholds and non-discriminatory treatment at all stages of procurement. This includes qualifications of suppliers, selection procedures, receipt and opening of tenders, and objective award criteria.⁸²

The only reference in the Cotonou Agreement to liberalising access to public procurement comes in Article 61 which states that direct budgetary assistance in support of macroeconomic or sectoral reforms shall be granted where, *inter alia*, public procurement is open and transparent. However the EU-Mexico FTA has very detailed provisions on public procurement. The EU-Chile agreement goes even further. Article 55 calls for the effective and reciprocal non-discriminatory opening of the government procurement markets of the Parties. Articles 136 to 162 explain the details of this. Article 137 makes the scope clear: ‘any procurement ... of goods and services..’ by the government entities involved (which include local authorities, schools, hospitals etc.) and above certain thresholds. They lay out detailed rules on the publication of invitations to tender, tendering procedures, qualifications of suppliers, tender documentation, time-limits, negotiations, awarding of contracts, statistical reporting and so on. Apart from doubts about the costs of tendering that all these rules imply and whether many Chilean companies might have an interest in contracts in the EU, one is struck by the comprehensiveness of this compendium of regulations. Of course, Chile is a much higher income country than almost any of the ACP States.⁸³ Given the smallness of size of enterprises in the ACP States, and the relative minor role of labour costs in most government contracts, such an agreement would be even

⁸² Heydon (2002), p.13

⁸³ In 2000 Chile had a per capita income of \$ 4590. That of Trinidad and Tobago, the only ACP State listed with a higher per capita income, was \$ 4930. (World Bank, 2002)

more imbalanced in the case of the EPAs. It would simply represent a licence for EU firms to mop up government procurement contracts in the ACP.

Mozambique is in the process of framing a new law on public procurement. In a 2002 report a World Bank team criticised the process of public procurement in Mozambique as failing on four main criteria – transparency, economy, efficiency and accountability.⁸⁴ These failures resulted from weaknesses in institutions, legislation and personnel. It concluded that adequate legal and regulatory systems were needed. These would have to include monitoring authorities at both the central government and provincial government levels, a directorate to oversee procedures and clear instructions to bidders. There was also a shortage of professional expertise and excessive centralisation. In particular the lack of transparency – the focus of the initiatives at the WTO – was a negative factor in project implementation and in allowing corruption.

The goal of the EU in pushing transparency in procurement is partly concern with good governance. On the other hand the authorities in Mozambique are well aware of the shortcomings in their system of government procurement and are taking steps to remedy those shortcomings. But there must inevitably be some suspicion that the motives of the EU go further than advancing transparency but also involve the right of EU firms to participate in Mozambique's public procurement tenders. Such suspicions are fed by the EU agreements with Mexico and Chile.

Thus if there is an effort on the part of the EU negotiators in the EPA talks to emulate those agreements in the public procurement area, it seems to us that the response of the ACP negotiators, including those from Mozambique, should be that the ACP States are far from reaching the level of competitiveness of Mexico or Chile. Any reciprocal opening of government procurement markets will simply mean easy pickings for EU companies. The EU negotiators may respond by offering a 'positive list' approach to the ACP who would then select those sectors where they saw net benefits from allowing EU companies to tender. But, of course, the ACP governments have this option in any event.

7.4 Trade Facilitation

There is general agreement that there are significant gains to be won through improved border procedures, and these gains could accrue mainly to the developing countries and, in particular, to small traders (although it is not clear whether welfare improvement of small traders is welfare improving for the economy as a whole and for specific industries involved). This is because border controls impose major fixed costs which are greater in proportion to GDP or tariff revenues for developing countries – to turnover for small traders. Trade facilitation does not only cover customs procedures. The wider aspects of border management processes are also at stake.⁸⁵ An improvement in efficiency would stimulate trade; it is thought that on

⁸⁴ World Bank, *Mozambique: Country Procurement Assessment Report*, Washington DC: 2002

⁸⁵ Trade facilitation can be defined as 'the simplification and harmonisation of international trade procedures', understood as 'activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade' (WTO)

average border costs contribute between 4 and 5 per cent of the overall value of an international trade transaction – while at the same time improving compliance with standards, reducing illicit trade, cutting costs through the elimination of duplication and unnecessary procedures and increasing revenue from tariffs and taxes.

The EU has been pushing for a multilateral agreement. This could contribute to establishing core standards, to preventing unacceptably slow and onerous procedures, and to the development of measures of facilitation using, *inter alia*, customs release times for imported goods. The main argument against an agreement within the WTO is that the problem is not one of the purposeful use of border procedures as barriers to trade but rather simply a lack of financial and human resources on the part of the developing countries. These countries would willingly accept and implement more efficient border procedures if they had the financial and technical resources to do so. As with the other trade-related issues under discussion in Geneva, the ACP countries have declared that they will wait till the issues are resolved at the multilateral level before discussing them in the EPA negotiations. But whether or not there is an agreement at the WTO level, the EU is likely to want to include WTO-plus commitments in the EPA.

Article 67 of the Cotonou Agreement says that structural adjustment support will include the harmonisation and coordination of macroeconomic and sectoral policies, including fiscal and customs areas. Article 48 of the EU-South Africa agreement stresses cooperation between customs services, the exchange of information and training schemes. It is difficult to see any reason why ACP States would object to a section within the EPA similar to, or even going somewhat beyond, that agreed in the EU-Chile FTA. However improvements to the efficiency of border procedures are both expensive in infrastructure such as computer facilities and require intensive training programmes. Thus it will be important to emphasise that progress by the ACP States would depend crucially on technical and financial assistance from the EU.

The government of Mozambique has made significant strides in bringing border processes towards international standards. In 1996 the Crown Agents were appointed to introduce up-to-date technology, train staff and in general manage customs operations. However as the report by Nathan Associates makes clear, a lot remains to be done. That report identifies, among other problems with customs and related processes,

- the complexity of the regulations and lack of information on them;
- a faulty appeals procedure;
- excessive discretion in classifying and valuing goods (and the associated corruption);
- problems with the temporary importation of goods and VAT rebates, and

homepage). In this sense it relates to a wide range of activities such as import and export procedures (e.g. procedures relating to customs, licensing, testing and certification, or quarantine); transport formalities; payments, insurance, and other financial requirements. Although this definition does not cover the facilitation of services movements, the liberalisation of transportation, financial and other services related to the movement of goods is essential in enabling goods trade facilitation to occur (Heydon, 2002, *op. cit.* p.5, footnote).

- unnecessary inspections of cargos and mandatory warehousing.⁸⁶

The government appears fully aware of the shortcomings of the customs and related processes. It appreciates that inefficiencies and corruption in border processes increase the costs and reduce the competitiveness of exports. It would be willing to agree with the EU in the context of an EPA a significant improvement in those processes. In such an endeavour there are two problems: human and financial resources. An expanded training scheme is required as well as the introduction of more information technology. All this implies significant costs and it any clause within an EPA should provide for a significant measure of technical and financial assistance.

7.5 Other trade-related issues

These include IPRs, standardisation and certification, trade and the environment, trade and labour standards (all mentioned in Cotonou) and in EU mandate data protection.⁸⁷ The following matrix seeks to highlight the principal differences in the treatment of these issues in the Cotonou, the TDAC and the EU-Chile agreements⁸⁸.

Trade and the environment: While acknowledging that trade and investment liberalisation may bring some gains to an economy (subject to the very large list of issues discussed earlier in this report), there is general acceptance of the right of any country to defend itself from imports and other economic practices (such as unregulated investment) that may be damaging to public health and to the environment. However developed countries stress that measures to safeguard the environment must not be used as a form of covert protectionism. One important principle that goes some way to avoiding protectionism is that of national treatment: foreign exporters or investors should not be subject to rules that do not apply to national suppliers or investors. Secondly the more that product standards are negotiated internationally, with full participation by producing and importing countries, the lower is the risk that they will be used as protective devices. Thirdly unilateralism in the sense of one country imposing its environmental rules on a group of supplying countries without consultation is not acceptable. Fourthly compliance with the decisions of internationally agreed disputes settlement institutions is absolutely essential if a rules-based trading system is to survive.

As concerns about the environment lead to increasingly stringent measures to exclude goods that may have damaging consequences, there will be both winners and losers. However the developing countries are particularly vulnerable. One particular area of great concern is unilateral and extraterritorial action by one country which limits or removes entirely important markets. One well-known example is the shrimp-turtle case where the United States applied domestic legislation extra-territorially to

⁸⁶ Nathan Associates Inc., *Mainstreaming Trade; a Poverty Strategy for Mozambique*, Washington D.C.: 2002, section 7.8

⁸⁷ See European Research Office, *Comparing the ACP guidelines and the EU negotiating mandate*,

⁸⁸ For a table reporting in detail certain trade related issues in the Cotonou, TDCA and EU-Chile bilateral agreements see annex chapter 7

conserve endangered turtle species. It required that all shrimp trawlers in certain exporting countries be equipped with turtle excluder devices, if wild-harvested shrimps were to be admitted into the United States market. As a result the export of such shrimps from Malaysia to the United States has declined to zero. Malaysia brought the case to the WTO disputes settlement process and both the Panel and the Appellate Body found the measure constituted arbitrary and unjustified discrimination among WTO members.

The absence of specific references to trade and environmental standards in the Cotonou Agreement – or indeed in the South Africa or Chile agreements – should help to argue that such spurious and protection-base arguments should not be used to inhibit Mozambican exports. Emphasis on liberalisation should not be used as an excuse to bring into Mozambique imports that may be damaging to public health or the environment, or to introduce investment and other economic practices of similar damaging effects.

Clearly the references to the environment in the Cotonou Agreement do not address these concerns. The articles on the environment in the South African and Chilean agreements concentrate on cooperation between these countries and the EU, especially through the exchange of information and technology, training and technical assistance. There are no references to the impact of environmental protection measures on trade. Clearly an EPA which included the sort of cooperation schemes outlined in these agreements would be acceptable. However the relevant articles should also include some protection for the ACP countries against the use, as protective devices, of environmental protection measures by the EU. In addition the ACP States should seek a commitment on the part of the EU that it would support those States in the WTO or other fora in action against the use of such measures for protective purposes by third countries.

In Mozambique's case the growing importance of tourism – both because of its potential importance in the relief of rural poverty and as a source of foreign exchange earnings – means that concern for environmental protection will increase in the years to come. However the interrelationship between tourism and environmental protection is an area where the EU could make a major contribution through technical assistance. Unlike so many of its natural competitors for the tourist trade in the Indian Ocean and the Caribbean, Mozambique's natural heritage is very largely pristine.

Trade and labour standards: In this area the relevant passages of the three agreements are very similar. Again there is no reference to trade except in the Cotonou Agreement which states that labour standards must not be used as a form of protection. Otherwise commitments to ILO core standards are reaffirmed. In the case of the Cotonou Agreement the Parties agree to exchange information on legislation and regulation and its enforcement. However in no case are trade sanctions mentioned.

In the EPA negotiations, given the growing concern among developed countries about the impact of cheap labour in developing countries on employment at home, the EU may attempt to insist on further amplifications, perhaps in the form of worker protection, which would raise the cost of labour among the ACP States. Some ACP States might argue that the Cotonou Agreement covers the area adequately and there is no need for further elaboration and in any event, such regulations should be left to individual governments. They might contend that labour market rules appropriate in

Europe are not necessarily appropriate in poor countries. However Mozambique is unlikely to be one of those ACP States.

Mozambique's history over the past half decade has bequeathed a heritage of strong concern for labour rights and worker protection. Mozambique has been an active member of the ILO for many years and has acceded to all its main conventions. The current legislation has evolved over many years. Now, in order to 'fine tune' the 1998 law, partly to achieve the right balance between protection and flexibility and partly to deal with issues such as the rights of foreign workers and the need for an improved arbitration process, the Ministry of Labour is currently in discussion with private sector employers and the trade unions. A new law will be presented to Parliament before the end of 2004.

So, while much of the developing world sees the developed countries' concern with labour standards as a form of protectionism, it would be difficult for the developed countries to use this instrument against Mozambique. Rather there have been arguments to the effect that Mozambique's labour laws are overly protective of workers and, thus, they create the same problems of labour market inflexibility with which a number of EU member states are now struggling. Perhaps there is scope here for the mutual sharing of experiences. However that does not mean that Mozambique would not incur extra costs. Not only labour legislation is involved. For example there might be certification requirements. And in the EPA negotiations it would be important to ensure that the use of labour rights (or standards) for protectionist purposes would not be possible.

Trade-related Intellectual Property Rights: Over the last twenty years or so there has been an unprecedented increase in the level, scope, territorial extent and role of IPR protection. The TRIPs Agreement includes non-discrimination and other standards for the protection of many categories of intellectual property, domestic enforcement procedures (including such details as access to courts) and international dispute settlement. But it is important to remember that, subject to certain requirements, the scope of protection under the TRIPs Agreement is for individual countries to decide. Nevertheless the Agreement has given rise to considerable controversy: for example over the extent to which patents on living forms, such as plants and micro-organisms, and on traditional knowledge, such as herbal remedies, should be included and, if so, under what conditions.

The question of trade between developing countries in generic drugs to counter endemic diseases such as HIV and malaria was largely resolved prior to Cancun – indeed that was a precondition for the Cancun Ministerial to take place – but that dispute did much to acquaint developing countries with the issues. A number of questions remain outstanding and should be raised by developing countries in the context of improvements to the TRIPs Agreement. The ACP should demand that the EU support the interests of the developing countries in Geneva. Of these the most important is the option of a longer transition period for the LDCs in fully implementing the TRIPs Agreement. The Doha Declaration began this process by agreeing on the extension of the transition period for LDCs to provide patent protection to pharmaceuticals to at least 2016. It seems logical that the extension of that transition period should now be broadened to cover the implementation of TRIPs

as a whole. The TRIPS Council should consider introducing criteria based on indicators of economic and technological development for deciding the basis of further extensions after this deadline. LDCs that have already adopted TRIPS standards of IP protection should be free to amend their legislation if they so desire within this extended transition period. Mozambique and the other SADC members should support efforts to have the TRIPs Agreement modified in this way in the WTO negotiations.

As regards the EPA negotiations, the Cotonou Agreement emphasises the importance of effective IPR protection through the TRIPs Agreement, as well as the need to join relevant international organisations and the willingness of the EU to provide technical assistance in the field. Insofar as the coverage of IPR, Article 47:5 of the Cotonou Agreement makes clear that a wide interpretation of IPR is to be used by the EU and its ACP partners – this would include computer programmes and neighbouring rights, utility models, biological inventions and plant varieties, industrial designs, geographical indications and so on. This seems to remove much of the discretion about what to include in IPR given to WTO Members under the TRIPs Agreement. The EU-South Africa Agreement could have been a good indicator of the sort of text that the EU would like to see in the EPAs, but it mostly concentrates on what multilateral agreements the partners should adhere to as well as also giving a broad, but similar, definition of IPR. In any event the Cotonou Agreement should represent the limit to which the ACP States are prepared to go beyond the WTO TRIPs Agreement. In other words the ACP countries are committed to the WTO rules including the flexibility, S&D, longer time periods for implementation, The EU could assist ACP countries to (a) implement the obligations of the TRIPs agreement properly and (b) ensure that countries have an IPR regime that cater for their needs (in terms of petty patents, traditional knowledge, flexibility to encourage technology diffusion, etc.) instead of for the needs of foreign knowledge based companies.

Standardisation and certification: The area of standardisation and certification could be of particular importance to Mozambique because it can be argued that out of the remaining barriers, once tariffs have been eliminated as it is the case for Mozambique under EBA, standards and technical regulations may be considered the biggest obstacle to access EU markets.

After the visits of the European trade commissioner, Pascal Lamy, the EU delegation enquired about the principle barriers to access EU markets for Mozambican producers and standards were considered as one of the principal barriers⁸⁹ (refer to the doc to be asked at the EU delegation in Mozambique, together with the lack of access to capital. Furthermore the exports of some important products are, or have been, negatively affected by international standards (i.e. peanuts by the standards on aflatoxins, shrimps by the standards on cholera) and it is very likely that an increase in agricultural, fishery and food-processed exports would definitely face a barrier linked

⁸⁹ Over 50% of respondents said that the main problem for exports were sanitary and phytosanitary measures. This shows two things, (a) how important this is as a trade barrier and the need to tackle it and (b) that current efforts are obviously failing if over 50% still think of SPS as the main problem. Therefore assistance should be tailored and enhanced (increased) accordingly.

with the SPS and TBT standards. Furthermore there is evidence that the elimination of tariff barriers has been associated to an increase in the importance of non-tariff barriers, among which technical standards are particularly important.

Presently, in Mozambique the system of standards and certifications is dealt with by different institutions:

INNOQ (National Institute of Quality and Standards): is the body that coordinates the development of standards at national level. Furthermore this is the focal point for the WTO Agreement on TBT

Department of Phytosanitary Safety (of the Ministry of Agriculture and Rural Development) is the state institution that deals with the quality of seeds, agricultural inputs, quarantine and field inspections. This is also the focal point for the WTO Agreement on SPS measures

Directorate of Livestock (of the Ministry of Agriculture and Rural Development) deals with the quality of production and processing of animal products, and more in general with issues related to animal health. Legislation and controls, both for domestic production and imports, follow international standards. DINAP represents the government of Mozambique at meeting of the International Office of Epizooties (OIE)

Directorate of Forestry and Wildlife (of the Ministry of Agriculture and Rural Development) deals with rules and standards referring to forestry and wildlife

Department of Environmental Health (of the Ministry of Health) is the state body that regulates and monitors health and hygiene relating to food, water and sanitation, health relating to international borders, in industry and of workers. This is also the contact point of the CODEX Alimentarius Commission

Centre for Environmental Health and Medical Examination (of the Ministry of Health) is the body that conducts medical examinations, issues official certificates, inspects factories and shops

National Laboratory for Water and Food Hygiene (of the Ministry of Health) tests the quality of water, food and drugs

Directorate of Fishing Inspection (of Ministry of Fisheries) deals with development and implementation of standards and technical regulations regarding fish and seafood

The regulation in place in Mozambique today establishes that standards to be applied to imported foodstuffs must be according to those established by CODEX Alimentarius. Inspection and quality testing is mandatory, by entities recognised and accredited, at expenses of the buyer.

It can be noticed that in general the attention to standards and quality, not to mention certification, is very low both at level of producers and institutions that deal with these issues that are still poorly equipped and understaffed. This is something to take into account because it is likely to determine a relevant supply constraint. In particular, at level of agricultural producers, the structure of production and the strategy of diversification (refer to section on agriculture) of smallholders does create a clear

obstacle because some of these issues imply a certain minimum scale and a certain level of organisation of production (i.e. quality controls, standardisation, etc.). In particular the structure of production (scattered, uneven, different qualities) and the lack of the necessary infrastructure for transport, storage, handling tend to contribute to deteriorate the final quality of the products and make unsuitable for exports (refer to “Bridging the Standards Divide: A case study and action plan for Mozambique”)

Given the lack of technical and financial resources the area of standards and certification it is clearly an area that do contribute directly to the lack of supply capacity in a situation of elimination of the barriers to access the European markets. Therefore we can say that two lines of discussions should be taken into account during eventual EPA negotiations:

1. Detect and reduce the SPS/TBT measures that do act as trade barriers without having sound scientific/rational basis (soon the government of Mozambique will launch a study with the objective of analysing the barriers to access the EU agricultural markets which should serve as a basis for the EPA negotiations)
2. Promote cooperation, mutual recognition and focus transfers of technical and financial capacity in order to raise the capacity of Mozambican institutions. In particular, mutual recognition and stricter cooperation have the latter as a pre-condition therefore these two areas could be easily linked in the negotiating process

It must be noticed that the process of investing in certification institutions/ cooperation would not be enough if producers are not able to comply with quality and health/safety standards. In this sense investments have to go in parallel in institutions checking and certifying the quality and the private sector enhancing the quality of its products. At the same time if producers are able to comply with standards and regulations but no local or regional institutions have the capacities and are accredited for certifying the producers, the situation would be equally very dangerous,

Data protection: This is an issue raised in the EU’s negotiating mandate for the EPAs. It does not appear in the Cotonou Agreement except in relation to the legal protection of data bases as an IPR. In the agreement with Chile it is included as a proviso in the exchange of information for cooperation in public administration. Only in the TDCA does it appear in its usual interpretation; that is as an issue of the protection of personal information used by public or private sector service providers. The connection with trade is not made explicit – though the TDCA goes beyond trade. Still it is difficult to see why an article in an EPA along the lines of Article 91 in the TDCA should cause a problem.

In Mozambique there is no general law on data protection, though various other laws (for example with respect to taxation) incorporate some protection against the divulging of personal information. However there is one area where a more thoroughgoing system of data protection could benefit Mozambique. That is in the growing sector of the ‘outsourcing’ of services; services such as computer software, financial and other data processing, and call centres. The language issue may imply that such services are most likely to be contracted from Portugal. In any event where they involve personal information they are likely to require that employees are subject

to strict rules about the non-disclosure of information. A broad data protection law might resolve some concerns in this regard. The costs involved are likely to be minor unless there are a lot of prosecutions but it might be wise for Mozambique to argue that there needs to be a study, financed by the EU, of the costs and benefits of introducing such legislation in ACP countries⁹⁰.

7.6 Conclusions

This chapter has confronted a large number of issues, without a great deal in common except that some or all of which may arise in the EPA negotiations. Prior to Cancun the EU put great store into the idea of a single multilateral agreement on the Singapore issues – trade and competition, trade and investment, transparency of government procurement and trade facilitation. Now the ACP States have decided not to negotiate on these issues in an EPA context until the WTO has resolved the issues of whether there will be any multilateral agreements.

However, progress on these could be positive in that they could help Mozambique become more attractive to foreign investors. But there are major obstacles. In the area of **competition policy** in particular, Mozambique lacks the legal and economic expertise to establish a sophisticated European-style competition regime. Here the EU can help in training. But even now Mozambique could take an initial step by passing a law outlawing price fixing agreements. This – it has been argued – would actually have a positive impact on the investment climate. But at the same time the EU must be required to play its part. For example neither it nor most other developed countries have outlawed export cartels which do a tremendous damage to the developing countries as a result of the higher import prices for manufactures that they are forced to pay. Arguably, such is that damage, measures taken against export cartels would justify a multilateral agreement on competition – unlike the case with the other Singapore issues.

As regards **investment**, Mozambique does not discriminate significantly between foreign and domestic projects – and, where there is discrimination, it is not always in favour of the latter. The investment law is due to be revised and some simplification – as well as the elimination of the remaining discriminatory features – would in any event be warranted. What is crucial in the EPA is that Mozambique, or any other ACP States, *if they agree to negotiate on investment*, retain control over the sectors to be liberalised in order that its development priorities are safeguarded. There must be a GATS – positive list – approach rather than any blanket undertaking or schedule for progressive liberalisation.

We have discussed in Chapter 4, the various reasons – from the paternalist to the mercantilist – why the EU might want to insist on a clause in the EPA requiring transparency, if not openness, in **government procurement** processes. But Mozambique must resist any comprehensive commitment to open its procurement to EU firms as Chile and Mexico have done. Certainly there is progress to be made in government procurement procedures in Mozambique – the World Bank report makes that clear – but the government is well aware of the current shortcomings and is

⁹⁰ Mauritius is actively looking at this area because of its linkage with business services outsourcing.

legislating to remove them. But an unrestricted opening of tenders to foreign bidders would mean that many opportunities to develop domestic service sectors would be forfeited. Only on the back of government contracts can many service sectors from construction to data processing grow. However a move to greater transparency in public procurement in Mozambique would be unreservedly welcome, *though it does need the pressure of negotiations on an EPA Agreement to do so.*

Trade facilitation is a less controversial issue. There is general awareness that inefficient and corrupt border processes are damaging to exports, both *per se*, and because they raise the costs of imported inputs. The Mozambique government has employed an outside consultancy company to advance the process of reform. But the principal obstacle to a faster and more far-reaching restructuring is finance. As EU exporters to Mozambique are going to benefit disproportionately – in value terms Mozambican imports from the EU are about double exports to the EU – it makes sense for the EU to make a major contribution to accelerating that restructuring.

Some of the other trade-related issues which the EU might want to include in an EPA are less problematic, such as trade and the environment. As regards labour standards, in its ILO-compatible labour legislation, Mozambique is arguably too protective and the labour market needs to be more flexible. Standardisation and certification is critical for Mozambique because, now that tariffs in the EU have been eliminated as under the EBA regime, SPS and TBT regulations, together with rules of origin, are the major obstacles to access to the EU markets. In this area all exporters to the EU, whether LDCs, other ACP States, other developing countries or, indeed, developed countries such as the US, need to join forces to eliminate rules that exist essentially for protectionist purposes. Where rules are justified, Mozambique needs to seek technical assistance from the EU to set up the necessary laboratory and other facilities to meet the standards. As for TRIPs, the main challenge is retaining the rights that the WTO agreement gives to individual countries to decide what activities should be protected in the face of EU arguments for blanket coverage. Finally more concern for data protection could be of help to Mozambique's potential outsourcing sector.

As was argued in Chapter 3, the purpose of EU in requiring agreement on a multiplicity of trade-related issues may be multifold. There are likely to be elements of paternalism, associated with engendering principles of 'good governance' or an institutionalised belief in the superiority of the market system. There are also elements of mercantilism, associated with the interests of the EU private sector. In general Mozambique must be careful not to compromise its discretion in its development policies. But at the same time there are opportunities for a 'positive sum' outcome. The interests of EU companies in freedom of access to the Mozambican market could mean gains for both parties – provided that Mozambique does not allow entry into those sectors where the development of a national capacity would be even more valuable. It is true that perhaps Mozambique does not need to negotiate an EPA in order to benefit from the gains from liberal policies regarding these trade-related issues. It could meet the same goals by unilateral action. On the other hand, the negotiation of these issues within an EPA may be associated with welcome technical and financial assistance, may serve as a 'political economy' argument for pushing through needed legislative changes in the face of opposition from domestic vested interests, and thirdly might create a momentum for reform in these and related areas that permits change which would not otherwise happen.

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Annex to Chapter 2

Annex 1: Methodology

This annex aims at presenting a simple but comprehensive methodology to evaluate and analyse a trade agreement which could be useful to the Mozambican government during the negotiations of the EPA.

In order to evaluate trade agreements various methodologies and approaches are possible, in this section we will present a methodology that takes into account the past analysis and literature reviewed but can be used for future analysis.

The basic idea is that Mozambique is today already beneficiary of other preferential agreements, therefore any decisions of negotiating further agreements must necessarily take into account the existing agreements for two principal reasons: (1) The existing agreements represent the ‘acquired’ basis and any further agreement must be qualitatively and quantitatively superior to them in order to be worthwhile; (2) The evaluation of the existing agreements can allow to anticipate and evaluate future negotiating proposal on the table

The elements to be taken into account are following:

1. **Degree of coverage**: The evaluation of the degree of coverage can be done on the basis of the ‘existing trade’ or on the basis of the ‘tariff lines’ and ‘potential trade’ (in absence of the existing trade barriers). Using the first option it is possible that relevant sectors are excluded because in the presence of ‘prohibitive barriers’ the trade flows will be zero in these sectors. For this reason this interpretation tends to be more restrictive and conservative with respect to the degree of coverage. It is interesting to notice that without any sound legal or economic basis the EC has traditionally insisted on this interpretation with regards to all the PTAs so far negotiated. In the second interpretation what is taken into account are the tariff lines and not the actual trade flows.
A final remark is that from the point of view of maximizing the market access the degree of coverage may not be the most crucial element as a high degree of coverage may hide important sectoral exclusions (i.e. sugar in the EBA). For this reason it may be important also to see what is really included and excluded from an agreement with a more qualitative focus.
2. **Tariff structure**: Normally the evaluation of tariff structure are principally focused on general descriptive statistical indicator (i.e. means, variance, etc.) or analyses the treatment given to different groups of products normally based on their level of processing. Another issue is to analyze the existence of tariff peaks. In reality the principal interest from the point of a exporting country is to ascertain the tariff barriers affecting the principal actual or potential exports (this implies that a list of exports of interests is developed jointly with the private sector)

3. **Non tariff trade barriers (NTBs)**: The general reduction of tariff barriers is often accompanied by an increase in barriers of different nature (NTBs) that are not particularly simple to measure. They depend on domestic regulations that have a justification based on domestic objectives and therefore are harder to negotiate than a tariff (ex. Sanitary and phytosanitary measures). The effect of these barriers is not straightforward to assess, but could potentially be more complex and negative than normal tariff barriers because NTBs tend to affect not only variable costs (in a way reducing competitiveness of foreign exporters) but also fixed costs. In this way the NTBs act as a barrier to entry and discriminate negatively against producers or countries of a smaller size and reduced financial capacity (evidently the impact of coping with the introduction of SPS measures over cashew for instance would have a completely different impact on countries with different capacities and sizes like Mozambique and Brazil)
4. **Safeguards clauses**: These are a common feature of all trade agreements and are normally necessary conditions for reaching an agreement. However these could be transformed into an instrument that reduce the value of the agreement because they reduce the degree of certainty and therefore may also reduce the incentives to invest in the beneficiary country
5. **Degree of uncertainty**: The degree of uncertainty about a trade agreement is normally linked to various elements (i.e. safeguards clause, political commitments, etc.) but fundamentally to the nature of the agreement. This tends to have an impact on the incentives of investments. It appears clear that unilateral agreements do have a higher degree of uncertainty than bilateral agreements and the fundamental reason is that unilateral agreement don't have a contractual basis but are voluntary concessions that can be withdrawn at any time. Furthermore, there is a number of elements that definitely affect the uncertainty about trade rules and therefore the ability to attract investments. For instance the system of enforcement of the agreement as well as the political will behind the agreements are two important elements to take into account
6. **Reciprocity**: This is an important element and has emerged as crucial for the EPAs negotiations because it has been one of the fundamental driving force behind the EPAs. Reciprocity is a crucial element for making preferential agreements compatible with WTO, however the interpretation of level of reciprocity required has been subject to much discussion. Reciprocity is not the only way to make a preferential agreement compatible with WTO (under art. XXIV) as there is another option under the 'enabling cause' but in this case all the countries with 'similar developmental needs' must received the preferences without discrimination. Eventually if art. XXIV was to be re-negotiated it is possible that special rules for FTAs that include LDCs could be specified in order to reduce the 'reciprocity requirements' of WTO compatibility
7. **Access to other benefits/concessions**: The agreements may involve other benefits and concessions beyond trade (i.e. aids and development, technical

assistance, etc.). These should also be factored into the evaluation of the agreement.

8. **Benefits potential/effective**: In order to evaluate potential and effective benefits we suggest a relatively straightforward approach
 - i. Analyze the principal products that are being presently exported to EU and verify how much of these exports will benefit from the reduction of duties
 - ii. Analyze the principal products exported to 'all the world' and verify how much of these exports will benefit from a reduction of duties
 - iii. Calculate roughly the implicit 'revenue transfer' from the countries giving the trade concessions to Mozambique

Another group of products that could potentially be analyzed is the products that are not being presently exported but in which Mozambique does have some export potential and for which the trade concessions can imply preferential margins bigger enough to incentivise the production (this last exercise will not be performed in the present study fundamentally because of the lack of reliable production data on 'potentially competitive products')

Annex 2: Detailed evaluation of EBA

| | |
|---|--|
| | |
| Degree of Coverage | Total ¹ : All the products except arms are included but for 3 'sensitive products' (sugar ² , rice ³ , banana ⁴) there is a transition period before the duty and quota free regime is applied |
| Tariff levels and tariff structure (escalation, peaks, etc.) | All the tariffs are zero except for sugar, rice and banana that will reach zero after a transition period |
| Non tariff barriers (RoO⁵, SPS, etc.) | <p>Rules of Origins (RoO) under the EBA are considered an element that creates a trade barrier for LDC.</p> <ul style="list-style-type: none"> - EBA, as well the GSP, allows diagonal cumulation between the LDCs and only for ASEAN, SAARC, CACM, Andean Community, and the European Union (the inputs need to come from another LDC or countries within the same regional group for ASEAN, SAARC, CACM, Andean Community⁶) and not, like Cotonou, total (the inputs can be sourced from any of the ACP countries). EBA also has an extra condition that Cotonou does not have: the value added must be superior to the value of any of inputs used. - The degree of tolerance for "non originary" inputs (inputs that do not fulfil the "origins criteria") is lower in EBA than in Cotonou. In fact in the EBA the value of non-originary inputs has to be lower than 10% of the value of the final product (ex-works price), while Cotonou's margin of tolerance is 15% - For fishery, in particular for the fishing vessels, the rules under EBA are more restrictive than under Cotonou (i.e. the property of the vessel must be, at a minimum, 51% of a citizen from exporting country or EU and not |

¹ Source: European Commission (<http://www.europa.eu.int/comm>)

² The transitory regime between July 2006 and July 2009 will lead to a complete elimination of tariffs. During the transition period (2001-2009) LDC can export under a quota.

³ The transitory regime between September 2006 and September 2009 will work in the following way:

| Data | Reducao tarifaria |
|------------|-------------------|
| 01/09/2006 | 20% |
| 01/09/2007 | 50% |
| 01/09/2008 | 80% |

On September 1, 2009, rice will be admitted duty and quota free. No 1 de Setembro 2009 o arroz nao tera nenhuma tarifa. During the transtion LDC will be able to export, within na historically established quota, at zero tariff

⁴ The transitory regime implied a reduction of tariff of 20% starting in 2002 until complete liberalisation to be reached by January 1, 2006.

⁵ Pag. 150 – 224: *GSP Handbook on the Scheme of the EC, 2003* (www.unctad.org/gsp)

⁶ For instance such cumulation is a possibility for Cambodia and Laos within ASEAN and for Bangladesh, Bhutan, Maldives and Nepal within SAARC

| | |
|--|--|
| | <p>any ACP country (as Cotonou establishes)</p> <ul style="list-style-type: none"> - The rules relative to agriculture and agro-industrial product follow the general rule that the raw products must be produced locally to be considered originary |
| <p>Safeguards clauses⁷</p> | <p>EBA includes a clause that allow the suspension of the preferences for various reasons, some were already present in the traditional GSP system (traditional causes of suspension) but the EBA includes other causes that can increase the degree of uncertainty and therefore reduce the positive impact of this initiative (non traditional causes of suspension)</p> <p style="text-align: center;">(a) <u>Traditional causes of suspension:</u></p> <ul style="list-style-type: none"> - Goods produced under forced labour, slavery, prisoners - Non-fulfilment of rules for drugs trading - Non-fulfilment of rules for money laundry, financial frauds, etc. - Non cooperation in verifying the validity of certificates of origins - Evident cases of unfair commercial practices - Evident cases of non fulfilment of legislation on management and sustainability of fishery resources - Imports are causing serious harms to EU producers, like for example: reduction of market share, reduction of production, increase of stocks, elimination of existing productive capacity, bankruptcy, low profitability, low use of installed capacity, unemployment, etc. <p style="text-align: center;">(b) Non-Traditional causes of suspension</p> <ul style="list-style-type: none"> - Massive increase of imports, superior to usual level of production and exports from LDCs - Imports of sensitive products (banana, rice, sugar) are causing serious disruptions to EU markets <p>It is illustrative to compare the system of safeguards between EBA and Cotonou. In the case of EBA it is sufficient that imported products “cause(s) or threaten threaten(s) to cause serious difficulties to a Community producer of like or directly competing products” no caso de Cotonou o uso das medidas de salvaguarda importações “in such increased quantities and under such conditions as to cause or threaten to cause serious injury to its domestic producers of like or directly competitive products”. Differently, in Cotonou the specific factors to be considered as proofs of “serious difficulties” are not specified.</p> <p>EBA, differently from Cotonou, allows “temporary withdrawal” of preferences in the case of criminal activities or breach of specific rules⁸</p> |

⁷ See pag. XXVI – XXIX of ‘GSP – Handbook on the Scheme of the EC, 2003’, UNCTAD/ITCD/TSB/Misc.25/Rev.2 (www.unctad.org/gsp)

⁸ “In the case of certain activities including slavery, forced labour, export of goods made by prison labour, manifest shortcomings in customs controls on export or transit of drugs, failure to comply with international conventions on money laundering and fraud or failure to provide the cooperation required for the verification of certificates of origin. Other circumstances qualifying for such a

| | |
|--|---|
| | In general it is possible to notice that except for the three sensitive products (sugar, rice, banana) the rules on the safeguards clauses are more restrictive in EBA than Cotonou |
| <i>Reciprocity</i> | No reciprocity because this is an unilateral EU initiative |
| <i>Uncertainty</i> | EBA is an important innovation-extension over the traditional GSP because no “periodic revisions” are needed and it has an “unlimited duration”. This characteristic reduces the degree of uncertainty of EBA with respect to previous initiatives ⁹ . De toda maneira o EBA introduz a facultade de suspender as preferencias em determinadas situacoes (ver ponto sobre medidas de salvaguarda). Por alem disso, o facto que o EBA e’ uma medida unilateral simplesmente expone Mocambique a qualquer mudanca que a EU venha a decidir sem nenhuma base negocial do nosso lado |
| <i>Access to other type of benefits (i.e. investment, R&D, finance, etc.)</i> | Any |
| <i>Degree of effective utilisation</i> | See annex 6 |

withdrawal are manifest cases of unfair trading practices on the part of a beneficiary country or manifest infringements of the objectives of international conventions concerning the conservation and management of fishery resources”.

⁹ Uncertainty has been identified in various initiatives as one of the fundamental causes of low impact of the preferential regimes unable to stimulate na adequate integration of developing countries into the global trading system

Annex 3: CONSTRAINING RULES OF ORIGINS UNDER EBA

Analysing the impact of EBA Brenton (2003) looks at the actual take up of preferences and notices that for all the ACP countries, except Lesotho, there is no take up of preferences. In contrast, he found an high take up of preferences for non-ACP. This seems to suggest that ACP countries kept exporting under Cotonou instead of using EBA – The reason for this must be to be found in the area of procedures and mechanisms for exporting under EBA, in particular RULES OF ORIGINS

CUMULATION

Under EBA, which follows the rules of GSP, *diagonal cumulation*¹⁰ can take place within four regional groups (ASEAN, CACM, Andean Community, SAARC). However there is a further constraining requirement: the value-added in the final stage of production exceeds the highest customs value of any of the inputs used from countries in the regional grouping. Cumulation under EBA is not therefore available to the ACP countries

Under Cotonou full cumulation can occur with any of the ACP countries without any requirement concerning value added. Furthermore there is also the possibility of cumulation with SA provided that the value added exceeds the value of materials from SA

TOLERANCE RULE/MINIMUM PROCESSING

Under EBA 'non-originating' materials may only be used provided that their value does not exceed 10% of the ex-works price of the final product.

Under Cotonou the threshold is set at 15%

FISH

Whilst the RoOs of the origin are the same under EBA and Cotonou ('all products must be wholly obtained'), still conditions pertaining to the vessels which catch the fish are more liberal under Cotonou

¹⁰ Diagonal cumulation allows *originating* materials (those which satisfy the EU rules of origin for that product) from regional partners to be further processed in another country in the group and treated as if the materials were originating in the country where the processing is undertaken.

Annex 4: Simple Comparison of the Rules of Origin Regarding Vessels under the EBA and Cotonou Agreement

| UNDER EBA | UNDER COTONOU |
|---|--|
| The vessel must be registered in the beneficiary country or the EU. | The vessel must be registered in the EU or any ACP state |
| The vessel must sail under the flag of the beneficiary country or the EU. | The vessel must sail under the flag of any ACP country or the EU. |
| the master and officers must be nationals of the beneficiary country or an EU member and at least 75 per cent of the crew must be nationals of the beneficiary country or the EU | 50 per cent of the crew, and the master and officers must be nationals of any ACP state or the EU. |
| the vessels must be at least 50 per cent owned by nationals of the beneficiary country or the EU or by companies with a head office in either the beneficiary or an EU state of which the chairman and the majority of the board members are nationals of those countries | er Cotonou these provisions are extended to cover all ACP states. Under certain conditions the EU will accept vessels chartered or leased by the ACP state under the Cotonou Agreement |

Annex 5: SAFEGUARDS AND POSSIBILITY OF WITHDRAWAL

The EBA also introduces new provisions allowing the EU to introduce safeguard measures when massive increases in imports of products originating in the LDCs arise in relation to their usual levels of production and export capacity. Specific safeguard measures apply especially with regard to sensitive products (bananas, sugar and rice), if imports of these products cause serious disruptions to the EU mechanisms regulating these products (the CAP and ACP-EU protocols in particular). The European Commission will review the functioning of EBA in 2005, when amendments can be introduced, if necessary.

Tariff treatment under the GSP may be temporarily withdrawn (in whole or in part) in the case of certain activities including slavery, forced labour, export of goods made by prison labour¹¹, manifest shortcomings in customs controls on export or transit of drugs, failure to comply with international conventions on money laundering and fraud or failure to provide the cooperation required for the verification of certificates of origin.

Other circumstances qualifying for such a withdrawal are manifest cases of unfair trading practices on the part of a beneficiary country or manifest infringements of the objectives of international conventions concerning the conservation and management of fishery resources.

Furthermore, under Article 28 of the above mentioned regulation, MFN duties on a product may be reintroduced where that product originating from a developing country is imported on terms which cause or threaten to cause serious difficulties to a Community producer of like or directly competing products. (This basically parallels safeguards under GATT Article XIX.) In examining the possible existence of such *serious difficulties* the Commission takes, among other things, the following factors into account: reduction in market share of Community producers, reduction in their production, increase in their stocks, closure of their production capacity, bankruptcies, low profitability, low rate of capacity utilization, employment, trade and prices.

The EBA initiative modifies the GSP scheme by adding to the reasons for the possible temporary withdrawal of preferences a 'massive increases in imports into the Community of products originating in LDCs in relation to their usual levels of production and export capacity'. This addition shall allow the Commission to 'react swiftly when the Communities financial interests are at stake'. The post-EBA GSP scheme also contains an extra paragraph in article 28 allowing for the suspension of the preferences provided by this regulation for rice, sugar and bananas, 'if imports of these products cause serious disturbance to the Community markets and their regulatory mechanisms'. The Commission announced that whenever LDC imports of rice, sugar or bananas exceed, or are likely to exceed the previous years level by more than 25 per cent, then it will automatically examine whether the conditions for applying GSP safeguard measures are met.

¹¹ A temporary withdrawal on this ground has been exercised in 1997, when Myanmar has been temporarily excluded from GSP treatment for alleged forced labour practices.

Annex 6: Potential impact of EBA on 2001 principal exports (higher than \$500,000 US) of Mozambique to the world (Excluding aluminium)

| Code | Description | Trade Value (\$ '000) | Included in EBA | MFN | GSP | ACP |
|------|---|-----------------------|-----------------|-------------------------------------|-----------------------------------|--------------------------------|
| 0306 | Crustaceans,fresh,chilled or frozen; flours,pel | 49,234.00 | NO | | | |
| 5203 | Cotton, carded or combed | 5,883.00 | NO | | | |
| 1701 | Cane or beet sugar and chemically pure sucrose, | 3,235.00 | YES* | | | |
| 5201 | Cotton, not carded or combed | 950 | NO | | | |
| 6109 | T-shirts, singlets and other vests, knitted or | 781 | NO | | | |
| 1203 | Copra | 749 | NO | | | |
| 5304 | Sisal, etc, raw or processed but not spun; tow | 620 | NO | | | |
| 3006 | Pharmaceutical goods specified in Note 3 to thi | 340 | NO | | | |
| 0302 | Fish, fresh or chilled (excl. those of 03.04) | 337 | NO | | | |
| 2516 | Granite, porphyry, etc, and other monumental or | 287 | NO | | | |
| 3808 | Insecticides, rodenticides... and similar produ | 256 | NO | | | |
| 0801 | Coconuts, Brazil nuts and cashew nuts, fresh or | 253 | NO | | | |
| 4401 | Fuel wood, in logs..., etc; wood chips or parti | 237 | NO | | | |
| 5202 | Cotton waste (incl. yarn waste and garnetted st | 222 | NO | | | |
| 0303 | Fish, frozen, (excl. those of 03.04) | 212 | NO | | | |
| 4402 | Wood charcoal (incl. agglomerated) | 183 | NO | | | |
| 4407 | Wood sawn or chipped lengthwise, sliced or peel | 177 | NO | | | |
| 1207 | Other oil seeds and oleaginous fruits | 172 | NO | | | |
| 7103 | Precious,semi-precious stones (other than diamo | 156 | NO | | | |
| 0805 | Citrus fruit, fresh or dried | 123 | YES | Between 3%-16% plus EURO per ton | Reduction between 65%- 100% | Reduction of 80% with quota |
| 6405 | Other footwear, nes | 119 | NO | | | |
| 7306 | Other tubes,pipes and hollow profiles,of iron o | 117 | NO | | | |
| 3215 | Printing ink, writing or drawing ink and other | 102 | NO | | | |
| 0508 | Coral; shells of molluscs, crustaceans, unworke | 101 | NO | | | |

| Product Code | Description | Partner Name | Trade Value (\$ '000) | Included in EBA | MFN | GSP | ACP |
|--------------|---|--------------|-----------------------|-----------------|---------------|--------------|------------------------|
| 0306 | Crustaceans,fresh,chilled or frozen; flours,pel | World | 94,031.00 | NO | | | |
| 2716 | Electrical energy | World | 57,348.00 | NO | | | |
| 2306 | Oil-cake and other solid residues, of vegetable | World | 14,751.00 | YES | 48 Ecu/ton | no reduction | no reduction |
| 0801 | Coconuts, Brazil nuts and cashew nuts, fresh or | World | 13,486.00 | NO | | | |
| 5203 | Cotton, carded or combed | World | 12,984.00 | NO | | | |
| 2401 | Unmanufactured tobacco; tobacco refuse | World | 9,099.00 | NO | | | |
| 2710 | Petroleum oils, etc. (excl. crude); preparation | World | 8,171.00 | NO | | | |
| 1701 | Cane or beet sugar and chemically pure sucrose, | World | 8,035.00 | YES* | | | |
| 4403 | Wood in the rough or roughly squared | World | 7,738.00 | NO | | | |
| 9999 | 9999 | World | 6,773.00 | NO | | | |
| 6103 | Men's or boys' suits, ensembles, etc, knitted o | World | 6,698.00 | NO | | | |
| 6205 | Men's or boys' shirts | World | 6,633.00 | NO | | | |
| 1513 | Coconut (copra), palm kernel or babassu oil and | World | 6,192.00 | NO | | | |
| 8703 | Motor cars and other motor vehicles principally | World | 6,018.00 | NO | | | |
| 4011 | New pneumatic tyres, of rubber | World | 4,561.00 | NO | | | |
| 0302 | Fish, fresh or chilled (excl. those of 03.04) | World | 3,697.00 | NO | | | |
| 6001 | Pile fabrics (incl. long pile and terry fabrics | World | 3,327.00 | NO | | | |
| 5201 | Cotton, not carded or combed | World | 2,916.00 | NO | | | |
| 7311 | Containers for compressed or liquefied gas,of i | World | 2,905.00 | NO | | | |
| 8902 | Fishing vessels;factory ships other for process | World | 2,214.00 | NO | | | |
| 4407 | Wood sawn or chipped lengthwise, sliced or peel | World | 2,193.00 | NO | | | |
| 1207 | Other oil seeds and oleaginous fruits | World | 1,706.00 | NO | | | |
| 1005 | Maize (corn) | World | 1,647.00 | YES | 94 ecu/ton | no reduction | reduction 1.84 ecu/ton |
| 2302 | Brans, sharps and other residues, derived from | World | 1,436.00 | YES | 44-89 ecu/ton | no reduction | reduction 7.2 ecu/ton |
| 2701 | Coal; briquettes, ovoids and similar solid fuel | World | 1,274.00 | NO | | | |
| 7208 | Flat-rolled products of iron/non-alloy steel, o | World | 1,249.00 | NO | | | |
| 9403 | Other furniture and parts thereof | World | 1,115.00 | NO | | | |
| 0305 | Fish,salted,dried...;smoked fish;fish flours, p | World | 1,061.00 | NO | | | |

| | | | | | | | |
|------|---|-------|----------|----|--|--|--|
| 8704 | Motor vehicles for the transport of goods | World | 1,020.00 | NO | | | |
| 8429 | Self-propelled bulldozers, graders, levellers, scr | World | 1,010.00 | NO | | | |
| 6109 | T-shirts, singlets and other vests, knitted or | World | 1,009.00 | NO | | | |
| 1203 | Copra | World | 973 | NO | | | |
| 4406 | Railway or tramway sleepers (cross-ties) of woo | World | 890 | NO | | | |
| 4401 | Fuel wood, in logs..., etc; wood chips or parti | World | 834 | NO | | | |
| 7103 | Precious, semi-precious stones (other than diamo | World | 713 | NO | | | |
| 2208 | Undenatured ethyl alcohol of an alcoholic stren | World | 712 | NO | | | |
| 8711 | Motocycles, motor fitted cycles, with or without | World | 707 | NO | | | |
| 7204 | Ferrous waste, scrap remelting scrap ingots or i | World | 704 | NO | | | |
| 2508 | Other clays, andalusite, kyanite, etc; mullite; | World | 682 | NO | | | |
| 5304 | Sisal, etc, raw or processed but not spun; tow | World | 680 | NO | | | |
| 2523 | Portland cement, aluminous cement, persulphate | World | 611 | NO | | | |
| 7310 | Tanks, casks, drums, cans, boxes and any containers | World | 577 | NO | | | |
| 8543 | Electrical machines, apparatus with one function | World | 577 | NO | | | |
| 7304 | Tubes, pipes and hollow profiles, seamless, of iro | World | 571 | NO | | | |
| 3923 | Articles for the of goods, of plastics; stopers | World | 570 | NO | | | |
| 7108 | Gold(platinum plated)unwrought, semi-manufacture | World | 529 | NO | | | |
| 0713 | Dried leguminous vegetables, shelled | World | 506 | NO | | | |

The previous table shows the principal Mozambican exports (where the value of exports exceeded 500,000 US\$ in 2001 and indicate if this product was a new product included into EBA initiatives and didn't receive previously any 'preferential treatment'. When the product is a product that didn't receive preferential treatment previously the relative MFN rate, as well the GSP rate and ACP rate is included in order to calculate the preferential margin deriving from the EBA.

Annex 7: Detailed evaluation of AGOA¹²

| | |
|--|---|
| <p>Degree of Coverage</p> | <p>Nearly total: All the products with some exceptions. The principal exceptions are: oilseeds, textile and garments, most of leather products and few others¹³. Basically AGOA expanded the existing US-GSP system (4,650 products allowed under tariff and quota free) with about 1,835 products. In particular including leather products, agroindustrial products (i.e. juices) and some other labour intensive products. For LDCs, including Mozambique, a potentially relevant advantage is that can export garments free of tariffs and quota using textiles imported from anywhere in the world¹⁴ but only till 2007. Apart from this the AGOA extension for LDC is nearly insignificant if compared with the already existing preferences¹⁵.</p> |
| <p>Tariff levels and tariff structure (escalation, peaks, etc.)</p> | <p>All tariff are zero, except for the excluded products</p> |
| <p>Non tariff barriers (RoO¹⁶, SPS, etc.)</p> | <p>The most important RoOs for the AGOA are the ones relative to textile and garments as this is probably the sector for which the potential benefits of AGOA are most relevant. In general these are very restrictive and requires that garments are produced using US textile and thread. However there are some exceptions: LDCs can use textile and thread from anywhere in the world until 2007; all countries can use textile and thread produced in Africa (within the limits of 1.5-3.5% of the total garments imports into US) It is important noticing that these rules, similar to the rules for NAFTA and CBI¹⁷ are functional to guarantee the survival of an industry that otherwise would be seriously threatened and this system has historically been successful in modifying the trade patterns for inputs used into garments exported into US¹⁸. A recent IMF study shows that without restrictive RoOs and the exclusion of some important products the benefits deriving from AGOA textile and garments preferences only could have been 5 times larger than actual ones¹⁹. In fact, the AGOA RoOs for textile and garments are even more restrictive than Cotonou and EBA (see Annex 8)</p> <p>US SPS measures are considered very restrictive and pose a barrier that most of Mozambican producers can hardly overcome.</p> |

¹² É importante notar que o AGOA é uma parte do mais amplo "Trade and Development Act" do 2000 que instituiu um novo regime de comércio e investimento para os países africanos.

¹³ Os produtos excluídos incluem "knit-to-shape apparel, flat goods, textile articles, certain steel products, canned peaches and apricots, and dehydrated garlic"

¹⁴ Obviamente para ser elegíveis os países devem de cumprir com um conjunto de condições e Moçambique tem conseguido a elegibilidade só desde o 6 Fevereiro do 2002

¹⁵ Craig VanGrasstek "The African Growth and Opportunity Act: A preliminary Assessment", Report Prepared for United Nations Conference on Trade and Development (UNCTAD/ITCD/TSB/2003/1)

¹⁶ Pag. 150 – 224: *GSP Handbook on the Scheme of the EC, 2003* (www.unctad.org/gsp)

¹⁷ Caribbean Basin Initiative

¹⁸ Van Grasstek

¹⁹ Matto et al (2002). The Africa Growth and Opportunity Act and Its Rules of Origin: Generosity Undermined?, IMF Working Paper, WP/02/xx

| | |
|---|---|
| Safeguards clauses ²⁰ | AGOA includes the possibility of suspending the preferences in various situations. Firstly, in order to benefit from the AGOA preferences the beneficiaries need to fulfil a number of criteria for eligibility (i.e. introduction of a market economy, rule of law, elimination of barriers for investment and commerce with US, labour standards, elimination of child labour, fight terrorism, etc.). The beneficiary countries are submitted to an annual revision |
| Reciprocity | No reciprocity (For details see handbook UNCTAD on US GSP, 2000) |
| Uncertainty | Being an unilateral initiative under periodic revision the risk and uncertainty are higher than other bilaterally negotiated agreements |
| Access to other type of benefits (i.e. investment, R&D, finance, etc.) | Any |
| Degree of effective utilisation | <p>The result of our analysis shows that with respect to 25 principal Mozambican exports to US in 2001 (7,060,058 US\$):</p> <ol style="list-style-type: none"> 1. 20.4% was already free of duty because of US MFN commitments (1,437,088 US\$) 2. 74.8% was already free of duty because of previous GSP concessions (5,277,473 US\$) 3. Textile and garments, purely benefited from AGOA, are about 2.5% of exports to US (179,179 US\$) <p>Multiplying the value of the preference (tariff edge) for the exports we can calculate that AGO effectively implied a transference of less than 34,000 US\$</p> |

²⁰ Ver paginas XXVI – XXIX do ‘GSP – Handbook on the Scheme of the EC, 2003’, UNCTAD/ITCD/TSB/Misc.25/Rev.2 (www.unctad.org/gsp)

Annex 8: Rules of Origins under AGOA

Rules of origin for non-apparel exports

Under the GSP scheme duty-free treatment is to be applied to any designated article that meets the requirements of the basic GSP origin and related rules²¹. The key is a requirement of 35 percent value addition within the customs territory claiming preference. However, for non-apparel products eligible for duty-free access under AGOA, the 35 percent value added content can be met also by counting production or materials from other beneficiary countries or the United States. The rules of origin clauses are supplemented with implementation requirements. For example, an importer claiming duty-free treatment must make and maintain (for a period of five years from the date of entry) the records validating facts like proof of production, value addition, shipping papers etc.

Rules of origin for apparel exports

AGOA's provisions on rules of origin relating to apparel are different²². They require essentially that apparel be assembled in eligible sub-Saharan African countries and that the yarn and fabric be made either in the United States or in African countries (as explained below this does not apply to the least developed countries in Africa until 2007). However, apparel imports made with regional (African) fabric and yarn are subject to a cap of 1.5 percent of overall U.S. imports, growing to 3.5 percent of overall imports over an 8-year period.

In addition a number of customs requirements need to be satisfied. To receive the apparel and textile benefits of AGOA, a USTR-chaired inter-agency committee must determine, inter alia, that countries have an effective visa system and enforcement procedures to prevent unlawful transshipment and the use of counterfeit documents.

AGOA RoOs are more restrictive than Cotonou. There is an interesting difference between the rules of origin under the Cotonou Agreement, which governs preferential access to the European Union, and AGOA. The Cotonou rule of origin is based on the concept of "double transformation" i.e., if two of the processing stages (yarn into fabric—weaving; and fabric into apparel—assembly) are done in the beneficiary country, duty free entry into the EU can be enjoyed. Under Cotonou, therefore, yarn can be sourced from anywhere in the world, whereas under AGOA the yarn must come from a beneficiary SSA country or from the United States.

Source: Matoo et al. 2002

²¹ See table 6 in Matoo et al. (2002)

²² See table 8 in Matoo et al. (2002)

Annex 9: Quotas and the Rules of Origin AGOA - Further details on Textiles and Garments

Textiles may **not** be exported directly to the U.S. and qualify for AGOA benefits, but will incur normal duties and quotas. However, **garments** may be exported duty **and** quota-free subject to the following:

- Garments are wholly assembled in SSA from fabrics (cut and formed) in the U.S. and yarns (formed) in the U.S.
- Garments are wholly assembled in one or more SSA Lesser Developed Countries (as previously defined) regardless of country of origin.
- Sweaters are produced from Cashmere or Merino wool.
- Garments are produced from yarns and fabrics not available in commercial quantities in the U.S.

Garments assembled from regional and other fabrics may be exported duty- and quota free to the U.S. under AGOA subject to the following limitation:

- A quota system limits the annual Square Metre Equivalent (SME's) exported to the U.S. This percentage cap is calculated as 1.5% of total U.S. imports in this category, rising in equal annual increments to 3.5% in year 8 (starting October 01, 2000). The quotas effectively allow for a doubling of SSA apparel exports to the U.S. before even the (year 1) cap is reached.

Garment (non-textile) sectors: Further Rules of Origin requirements

The article must be imported **directly** to the U.S. from the beneficiary SSA country.

The cost or value of materials produced in one (or more) of the beneficiary countries **plus** the value of processing in those countries must be no less than 35% of the appraised value of the product when it enters the U.S. However, up to 15% of these 35% may derive from U.S. sourced parts or input materials imported to beneficiary SSA countries.

Note: Imported materials may be counted towards the 35% minimum value requirements, although only if they have been "substantially transformed" into new or different input materials of which the eligible product is composed of. Where a product has been produced in several eligible SSA countries, their *combined* value of input must be at least 35% of the appraised value of a good entering the U.S.

Textile / garment sectors: Quotas and Rules of Origin Requirements

For the textile and garment sectors, the rules are significantly more stringent than for all other sectors. The average duty applicable to garment imports into the U.S. presently stands at 17.5%, but falls away where AGOA criteria are met. The most fundamental differences lie in the fact that for the textile / garment sectors, the following **general** conditions apply:

- Exporting countries have to establish an effective '**Visa System**' and have in place strong enforcement mechanisms and verification procedures, to ensure compliance with the **Rules of Origin**.
- **Quotas** are in place to ensure that for certain garments a quantitative (as opposed to value-based) ceiling is not exceeded by beneficiary countries as a whole. This cap is measured in square metre equivalents (SME's).

The **visa system** is the procedural formalisation of the Rules of Origin and refers specifically to the textile / garment industries and is a pre-requisite for exports to the U.S. in this category. The system is thus effectively a comprehensive tracking system whereby close records have to be kept for all textiles utilised and garments produced by a manufacturer in an eligible SSA country. Conformity with the requirements of the visa system are a pre-requisite for taking advantage of the textile/garment benefits offered under the AGOA. As the end of 2002, only the following countries had qualified under these special apparel provisions, namely Kenya, Madagascar, Mauritius, South Africa, Ethiopia, Lesotho, Malawi, Mozambique, Tanzania, Uganda, Zambia, Botswana, Cameroon, Ghana, Kenya, Namibia, Senegal, Swaziland (www.agoa.org)

Annex 10: AGOA EFFECTIVE IMPACTS

| TOP 25 US IMPORTS FROM MOZAMBIQUE, 2001 (Value in Actual Dollars) | | | | |
|---|---|------------------|------------|-------------------|
| HTS Item | Description | Imports | NTR Tariff | Implicit Transfer |
| Duty-Free on MFN Basis (20.4% of top 25 products) | | 1,437,088 | | |
| 0801.32.00 | Cashew nuts, fresh or dried, shelled | 1,090,211 | Free | |
| 2008.19.10 | Brazil nuts and cashew nuts | 153,020 | Free | |
| 0106.00.50 | Live animals other than horses, asses, mules etc.* | 96,758 | Free | |
| 4407.10.00 | Coniferous wood sawn etc. over 6 mm thick | 36,972 | Free | |
| 9705.00.00 | Collections and collectors' pieces of zoological etc. | 15,000 | Free | |
| 9703.00.00 | Original sculptures and statuary, in any material | 12,700 | Free | |
| 8542.13.80 | Monolithic digital integrated circuits* | 8,100 | Free | |
| 4403.99.00 | Wood in the rough | 7,142 | Free | |
| 4403.20.00 | Coniferous wood in the rough | 5,073 | Free | |
| 9503.49.00 | Toys or parts representing animals/non-human | 4,638 | Free | |
| 4907.00.00 | Unused stamps of current or new issue in country | 3,500 | Free | |
| 6815.99.40 | Articles of stone or of other mineral substances | 2,340 | Free | |
| 9505.10.15 | Articles for Christmas festivities, ornaments of wood | 1,634 | Free | |
| Duty-Free For All GSP Countries (74.8% of top 25 products) | | 5,277,743 | | |
| 1701.11.10 | Cane sugar, raw, in solid form | 5,253,319 | [Complex] | |
| 7325.99.50 | Steel, cast articles | 9,748 | 2.90% | |
| 6802.99.00 | Monumental or building stone | 6,595 | 6.50% | |
| 4420.10.00 | Wooden statuettes and other wood ornaments | 5,550 | 3.20% | |
| 4421.90.98 | Articles of wood* | 2,531 | 3.30% | |

| | | | | |
|--|--|------------------|--------|------------------|
| Duty-Free Only For AGOA Countries (0% of top 25 products) | | 0 | | |
| Textile & Apparel (2.5% of top 25 products) | | 179,179 | | |
| 6202.93.45 | Women's or girls' anoraks etc. of manmade fibers | 85,423 | 7.20% | 6150.456 |
| 6110.30.30 | Sweaters etc. of manmade fibers | 75,382 | 32.40% | 24423.768 |
| 6201.93.30 | Men's or boys' anoraks etc. of manmade fibers | 9,430 | 7.20% | 678.96 |
| 6205.20.20 | Men's or boys' shirts of cotton | 8,944 | 20.00% | 1788.8 |
| Special (2.3% of top 25 products) | | 164,619 | | |
| 9801.00.10 | US goods returned | 95,350 | | |
| 9999.95.00 | Informal entries under \$1251 | 45,229 | | |
| 9801.00.25 | Articles reimported | 24,040 | | |
| Subtotal (Top 25 Products Account for 99.9% of Total) | | 7,058,629 | | |
| All Other | | 1,429 | | |
| Total | | 7,060,058 | | 33041.984 |
| * Product for which the 2002 version of the HTS uses a somewhat different classification than was used in 2001 | | | | |

This table analyses the 25 principal exports from Mozambique to US. The first group are the products that were already duty free because of US MFN commitments (US\$ **1,437,088**). The second group are the products that were already duty free because of US-GSP (US\$ 5,277,743). The third and fourth group are the new products that are duty free under AGOA and were not before (US\$ 179,179).

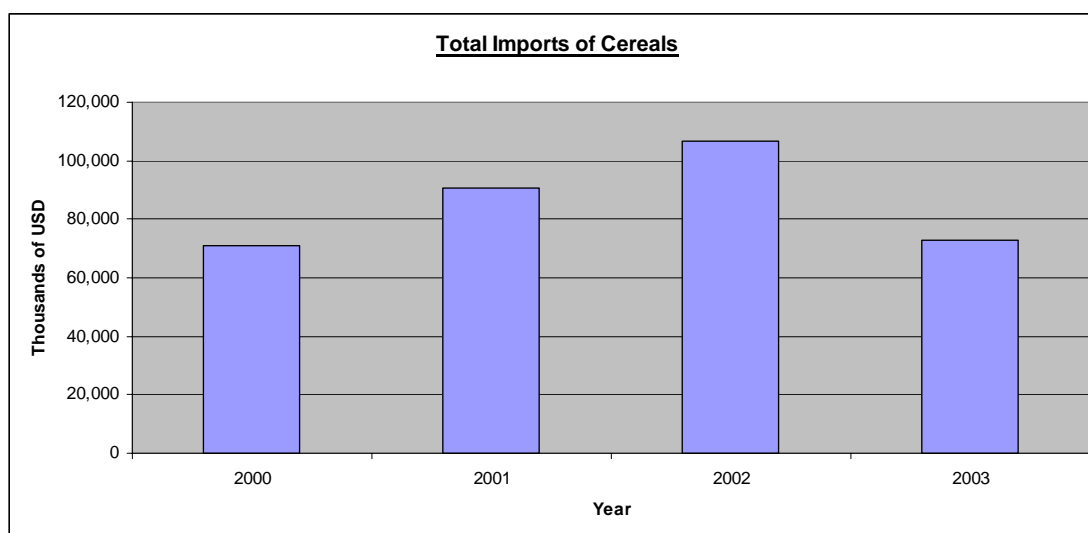
The second column presents the value of the tariff pre-AGOA and the third calculate the "implicit transference" from US government revenues to Mozambican exporters.

Annex to Chapter 4

Annex 11: Detailed analysis of agricultural products likely to be impacted by EPAs

Mozambique and cereals: Mozambique is a net importer of cereals. If the reform drives up cereal prices, the reform will have an initial negative impact on the Mozambican economy. However, a higher supply price may provide an incentive for farmers to increase cereal production, such that farmers's average income could increase whilst domestic cereal prices could decline.

However, the linkage between price and supply is not straightforward as it depends on the elasticity of supply, which in turn is linked to the structure of agricultural markets (which determines the efficacy of the transmission, or incentive, mechanism between market signals and producers); the ability and willingness of producers to mobilize and organize resources and capacities to respond to market incentives; the role that agricultural, in particular cereal, production plays for different types of producers (for example, it is important to acknowledge that production aiming at household food security tends to be relatively inelastic relative to market signals); as well as the risk and uncertainty factors associated with market fragmentation and instability that may reduce confidence and affect negatively investment and production decisions. Thus, we cannot be sure that an increase in prices may increase domestic production of cereals.



Mozambique and Tobacco: Tobacco has been, in the last 5-6 years, the fastest expanding cash crop in Mozambique, mainly due to instability in Zimbabwe, the collapse and

restructuring of the industry in Malawi, other corporate reasons that are not so clear, as well as favorable agro-climatic, productive, and policy conditions in Mozambique, which have encouraged investment in Mozambique.

The system of production is based on concessions controlled by private companies that provide inputs and technical assistance to small growers, and have the exclusive, monopsony right of purchasing the output from growers within the boundaries of the concession. The concession contracts are renewed every year, which gives the government the opportunity to reallocate concession rights if the current holder of the right is not complying with the contract. However, the government has limited monitoring capacity to reinforce the rules of the contracts. Additionally, the duration of the concession can be considerably extended if the private company intends to further invest in the industry – for example, a company that is investing in a processing plant has demanded, and obtained, a 10 year concessions.

The government has no strategy to develop the tobacco industry, or a clear understanding of who the tobacco companies are, what their strategies are and why they are in Mozambique. Thus, the government intervention is limited to issuing concession rights and managing conflicts between private, concession companies and between these companies and small growers. Therefore, the government reacts defensively to corporate demands (such as in the case of extending the concession from 1 to 10 years because of the investment in the processing plant), partly in a blind attempt to lock investors in Mozambique.

Although tobacco is important from the point of view of generating local income and the balance of trade, there is a well known trade off between the amount of incentives given to private corporations and the benefits that accrue to the economy as a whole. Thus, the government needs a much clearer strategy for the industry that can help to strike the balance between encouraging private investment and maximizing economic and social benefits from such investment.

Annex 12: Mozambican agricultural products affected by the commodity protocols

Sugar: the protocol requires that the EU purchases 1.3 million tonnes from traditional ACP producers with the price linked to the internal EU price, which is more than double the world price. The exporting countries benefit from relative market and price stability. Sugar is a critical export crop for Mauritius, Guyana and Fiji. It is generally assumed that the Sugar Protocol will not survive the end of the WTO Waiver for ACP preferences in 2008. Indeed the EU Commission has recently elaborated the broad options for the sugar regime. Since few of the producers in the ACP States could compete at world prices, the end of the protocol would represent a major blow to the major ACP producers. However as long as EU prices are maintained above world prices through border protection and export subsidies, there could still be a market for ACP sugar with a tariff preference. The EU internal price might be significantly lower than at present – as noted above, the EU Commission has mentioned a 25 per cent reduction – so it will be a question of the extent to which ACP producers can export profitably at that price. To add to their concerns, the EBA will grant tariff-free entry to sugar from non-ACP LDCs from July 2009.

The prices paid to the beneficiaries of the Sugar Protocol, that is the main ACP exporters of sugar cane to the EU, are related to the prices paid to EU sugar beet producers; this is 2-3 times the current world price. However the supply price of the EBA beneficiaries will be close to the world price plus the EU MFN tariff of 34 per cent. The demand for EBA sugar will be very high as this sugar will be cheaper than EU beet-sugar and ACP Sugar protocol. Moreover, even if the entire output of the LDCs were redirected to the EU market – not implausible because it would be profitable to import sugar for domestic consumption – as long as the Sugar Protocol survives, the ACP producers have a guaranteed volume of imports by the EU at a price related to that received by EU producers.

Beyond 2007, when the Sugar Protocol will likely be terminated, it will be a question of whether ACP sugar exports can profitably be sold in the EU market. From mid-2009, both the Protocol beneficiaries and the LDC producers will be able to sell as much as they can produce in the EU market, provided they can undercut the EU internal price – which will almost certainly be higher than the world price, but the wedge between the EU and the world price will probably have been seriously diminished. The EU price will be sustained at a level above the world price only by reducing the EU production quota and the tariff. There are serious doubts about whether a number of Caribbean producers could continue to produce at prices 25 per cent lower than the current EU price.

Mozambique is an ACP sugar exporter that does not benefit from the Sugar Protocol but have applied for a zero quota under the ACP Protocol. This means that Mozambique would eventually get part of the shortfall of the present quota holders. Considering that the sugar prices in the EU may decline, various less cost efficient Caribbean producers will lose their market shares, thus Mozambique will have an opportunity to benefit from this shortfall. Mozambique has benefited from the EBA, filling the quota (currently some 8,000 tonnes) agreed by the ACP LDC producers. This may rise over time, but will eventually be eliminated in 2009. In the future Mozambique sugar exports to the world market may benefit from any watering down of the sugar regime under the CAP as this is likely to lead to reduced EU export subsidies and may increase world sugar prices. On the other hand its exports to the EU will likely suffer from a fall in the EU price.

Fundamentally, Mozambique needs to determine its own strategy taking into account: domestic objectives (taking into account both the sugar industry and the situation of consumers), LDCs' strategy, ACPs' strategy and the EU internal debate.

The Mozambican sugar industry has been rehabilitated by foreign private investors, which have been attracted by an active price and market policy pursued by the government. At this stage, the main domestic objectives of the policy for this industry are: (a) strengthening the capacities and competitiveness of the sugar industry; (b) diversifying the industry downstream and strengthening domestic linkages; (c) increasing rural employment; and (d) reducing the price to individual and industrial consumers.

Because of the EBA, the LDCs countries have been granted an expanding quota until 2008 and unlimited access free of quota and duties from 2009. It is clear that an expansion of LDC exports to the EU may have some negative impact on the price, depending on the size of this expansion and the interaction with EU domestic reform. The EU sugar price will be determined by an interaction of: (a) sugar produced by EU producers and exit of least efficient producers; (b) reduction in tariffs and intervention price within WTO negotiations; (c) drop off of ACP producers for which the preference margins get too low. LDCs have to take into consideration the expected marginal revenue from exports to EU to determine relative gains/losses due to the trade off between higher export volumes and lower prices. The situation for most LDC, like Mozambique, is more complex than this because they could, theoretically, import all their consumed sugar at international prices and export all the domestically produced sugar at preferential prices, provided that the preferential market can absorb all their production. In this case, the deflating impact on the export price would be clearly stronger but there would also be a strong deflating impact on domestic consumer prices, provided that supply of cheap imported sugar is stable and the structure of the domestic market allows for benefits of lower import prices to be transmitted to consumers rather than only benefiting high market margins for large traders. Thus, such decisions also require a very detailed analysis of market and production dynamics, as they cannot be based on blind, ideological assumptions about the functioning of the economy.

The ACP countries are grouped into ACP-LDC and ACP-non-LDC with the latter having a more articulate strategy. Both groups of ACP sugar exporters will struggle against a reduction the EU prices and will push for a slower transition in order to keep extracting their rents from the sugar protocol. Furthermore, it is likely that the less competitive producers will have their quotas redistributed to the relatively more competitive ones, including the LDCs. An important element to take into account is the possible divide that the EBA could create between ACP-LDC and ACP-non-LDC. The interests of the ACP non-LDC that are high costs producers are for a high EU domestic price, high tariffs and a large tariff preference. The interests of the LDCs that are low costs producers, both ACP and non-ACP, are for a high EU domestic price, high tariffs but minimal preferences for the non-LDC ACP suppliers. However, the larger sugar exporter, Brazil, is also low cost and could benefit from both preferential and non-preferential markets, as well as high or low EU prices. In practice, Brazil may be the country which benefits the most from changes in the Sugar Protocol; and therefore may be least interested in preferences that may emerge under EBA.

However a stronger influence will probably come from the evolution of the EU internal debate. The Commission will put forward various options with regard to the elimination, partial or total, of subsidies to EU producers, as well as the timing of the liberalisation process. An important element to take into account is the possible evolution of the domestic struggle within the EU. The more competitive EU producers (for example certain large French producers) may seek sharp cuts in EU prices as a way of reducing the output of other EU producers (for example in Italy) as well as imports from the less competitive ACP suppliers, thus leaving a greatly increased market share for them. This would clearly be detrimental to less competitive ACP exporters. This implies that the ACP producers could have allies among the less competitive EU producers, although such allies may not be worth very much in intra EU negotiations, particularly if they are small producers and small countries.

It has been suggested that it might be feasible for the ACP producers – in particular the ACP low cost producers (LDC and non-LDC), since many of the others would be eliminated by any significant price reduction – as a group to offer to restrain exports in return for some price or earnings guarantee. Whether that would be deemed as WTO-compatible or whether border protection can be kept sufficiently high so that the agreed earnings of ACP producers would be enough to keep them in business, remains to be seen.

Rice: in 1998 and 1999 the amount of rice imported from non-ACP LDCs was negligible. According to FAO data, the LDCs produced some 41 million tonnes and consumed some 43 million tonnes. In 1998, among the LDCs only Myanmar exported to the EU – some 0.14 per cent of EU imports – but Myanmar is not, at least currently, eligible for EBA. In 1999 Myanmar exported some 0.03 per cent of EU imports and Bangladesh some 0.01 per cent. The wide disparity between EU and world rice prices – in 2001, EU prices were double of world prices – gives an incentive to LDCs to export their rice production to EU, either by increasing output or even by reducing consumption of domestically produced rice and increasing imports of cheap rice at world prices. LDCs, in particular low cost producers such as Bangladesh, Cambodia and Myanmar (if it gains EBA status), could make substantial gains in the EU market of Indica (long grained) rice. As long as the internal EU price is held significantly above the world price, it is the EU producer who is likely to be displaced by lower cost producers, rather than relatively higher cost producers such as the non-LDC ACPs (Guyana, Suriname) and Malawi.

As with sugar, the EU price is more important to ACP exports than the threat from the LDCs. If the EU price falls below ACP cif prices, the ACP will lose their EU markets. However if CAP reform goes to the point that EU producers are eliminated and the world price prevails, no preference margin will protect the ACP producers from LDC competition. This is not to say that LDC will gain the market; to do so they will have to overcome other barriers: volumes, quality and reliability of production and services related to exports.

Mozambique is today a net importer of rice. Domestic production covers only about 1/3 of consumption. The Government of Mozambique has recently been promotion rice as a strategic priority in cereal production, because of market opportunities in Southern Africa, which imports about 2,000,000 tons of rice per year. This plan is still in a starting phase.

If the Government rice production goes ahead, the EU market should also be considered and rice should be discussed in the framework of an EPA. This discussion should focus on mechanisms to create domestic productive capacities, promote product quality and find markets with attractive margins. In this case, domestic development objectives of promoting commercial production of rice in large scale could be complemented and supported by the EPA negotiations.

Bananas: under the new banana regime the specific quotas for non-ACP, i.e. ‘dollar’ producers in Latin America, are eliminated. Until 2006 they will share a single tariff quota on a ‘first come, first served’ basis, while the ACP producers also share a tariff quota and benefit from preference margins both within and beyond the tariff quotas. From the beginning of 2006 a tariff-only regime will be in place. The new banana regime was devised after successive protocol arrangements were taken to the WTO disputes settlement procedures by the United States and the Latin America producers. This was quite independent of the new EU GSP scheme, though under the EBA the LDCs will be able to export bananas to the EU tariff-free from the beginning of 2006. The ACP LDCs, Cape Verde, Madagascar and Somalia, are traditional very small, low cost exporters. For these countries – or for Mozambique – to benefit from the EBA, large-scale investments would be required to increase production, improve standards, quality, services and infrastructures, guarantee SPS certification, and so on. Such investments would increase average costs unless economies of scale could be realized.

Moreover the overall quota for ACP producers under zero-tariff is not, at least currently, fully utilized.

Mozambique was an important producer of banana in Southern Africa. During the war, production was reduced to such a low level that Mozambique has become a net importer of bananas. Still, many would argue that large production and exports of bananas from Southern and Central Mozambique could be re-established, but unfortunately no study is available about the competitiveness of Mozambican producers versus actual suppliers on the EU market.

The changes in the 'banana protocol' have two main consequences from the point of view of Mozambique. Firstly, there is a potential opening of the EU market, whereas access was not possible prior to the changes because of the system of quotas. Secondly, the increase in competition on the EU market as the preferential margins for ACP countries are eroded means that only competitive producers may be able to enter it.

Beef: as traditional suppliers to the EU market, Botswana, Kenya, Madagascar, Namibia, Swaziland and Zimbabwe benefit from a significant reduction (12 per cent plus €279.2 /100 kg) in the duty on EU beef imports. Botswana is the major beneficiary with the others not generally fully exploiting their quotas. Were there to be FTAs between the countries involved, either as a group or individually with the EU, some margin of preference could be maintained. But with falling internal EU beef prices as CAP intervention levels are gradually brought down, the available margin of preference may not be enough to sustain existing ACP exports, let alone increasing such exports. Burkina Faso, Chad, Liberia and Uganda do not benefit from the beef protocol. Thus they may gain from EBA with the abolition of the ACP tariff, provided that they can adjust production volumes, quality and costs, penetrate the market, overcome SPS and other non-tariff requirements and barriers, etc. There are no non-ACP LDCs currently exporting beef to the EU market.

Annex 13: Options facing Mozambique - geographical configuration

Introduction

This chapter discusses the critical issue of the options facing Mozambique in the EPA negotiations. There are basically three options for Mozambique:

- negotiating an EPA along with the current SADC group – Botswana, Lesotho, Namibia and Swaziland (the BLNS countries) plus Angola and Tanzania, which is the present policy of the government;
- negotiating an EPA between Mozambique and the EU alone, though whether the EU would entertain such negotiations is not clear. There are divergences between the Cotonou Agreement and subsequent EU pronouncements; or,
- declining to negotiate but continuing to benefit from the EU's EBA arrangements and any other preferential for developing countries or LDCs (such as AGOA).

Again we will review the arguments for each option and conclude the chapter with a summary.

The EU clearly favours EPAs based on regional groupings of ACP countries. The Cotonou Agreement is quite explicit about this. Article 35 is worth quoting in full

'1. Economic and trade cooperation shall be based on a true, strengthened and strategic partnership. It shall further be based on a comprehensive approach which builds on the strengths and achievements of the previous ACP-EC Conventions, using all means available to achieve the objectives set out above by addressing supply and demand side constraints. In this context, particular regard shall be had to trade development measures as a means of enhancing ACP States' competitiveness. Appropriate weight shall therefore be given to trade development within the ACP States' development strategies, which the Community shall support.

2. Economic and trade cooperation shall build on regional integration initiatives of ACP States, bearing in mind that regional integration is a key instrument for the integration of ACP countries into the world economy.

3. Economic and trade cooperation shall take account of the different needs and levels of development of the ACP countries and regions. In this context, the Parties reaffirm their attachment to ensuring special and differential treatment for all ACP countries and to maintaining special treatment for ACP LDCs and to taking due account of the vulnerability of small, landlocked and island countries.'

Article 37 includes the paragraphs:

'5. Negotiations of the economic partnership agreements will be undertaken with ACP countries which consider themselves in a position to do so, at the level they consider

appropriate and in accordance with the procedures agreed by the ACP Group, taking into account regional integration process within the ACP.

6. In 2004, the Community will assess the situation of the non-LDC which, after consultations with the Community decide that they are not in a position to enter into economic partnership agreements and will examine all alternative possibilities, in order to provide these countries with a new framework for trade which is equivalent to their existing situation and in conformity with WTO rules.'

These articles make clear that regionally-based EPAs are the EU's preferred option. Alternatively the situation in non-LDC ACP States may be examined with a view to 'alternative possibilities'. The 'special treatment' for LDCs will be maintained. Article 29 makes clear that would preferably be within regional EPAs.

'Cooperation shall, in the area of regional economic integration, support developing and strengthening the capacities of:

- regional integration institutions and organisations set up by the ACP States to promote regional cooperation and integration, and national governments and parliaments in matters of regional integration;
- fostering participation of Least Developed Countries (LDC) ACP States in the establishment of regional markets and sharing the benefits therefrom..' (Author's punctuation)

Since then the EU has made clear that whether or not LDCs join regional EPAs they will continue to benefit from the EBA. These considerations suggest that Mozambique has the options of negotiating an EPA within a regional grouping, negotiating an EPA alone with the EU or not negotiating and continuing to benefit from LDC preferences on the EU market. Officially Mozambique is committed to negotiating within the SADC group.

Option 1: A possible SADC EPA

Mozambique is a member of SADC – and not a member of any other of regional grouping in Eastern or Southern Africa (though in the past it was a member of Comesa). Thus, it might seem natural that Mozambique should join the other SADC countries in negotiating an EPA – and, arguably, that all Southern and Eastern African countries unite in such an endeavour. However, a number of SADC countries²³ have joined together with some non-SADC East African countries²⁴ to form an ESA (Eastern and Southern Africa) group which has registered with the European Commission and the ACP Secretariat as one negotiating party – without however any commitment to join the EU together in a EPA. Indeed it has been stressed by, *inter alia*, the COMESA Secretariat, which is coordinating and servicing the ESA group, that these countries have come together solely for the purposes of the negotiations.²⁵ Formal negotiations between this group and the EU are due to start in early 2004.

The Trade Ministers of all SADC members met in Malawi on 21 November and approved negotiating guidelines for a SADC EPA and a 'roadmap' for the negotiation

²³ Zambia, Malawi, Zimbabwe, Mauritius, Democratic Republic of the Congo and the Seychelles

²⁴ Kenya, Ethiopia, Burundi, Djibouti, Comoros, Sudan, Eritrea, Madagascar, Rwanda and Uganda

²⁵ See Mark Pearson, *Geographical configuration in the Eastern and Southern Africa region*, http://www.acp-eu-trade.org/documents/Geographical_percent20Configuration.pdf

process. After that, they met again in Dar-Es-Salaam, in February 2004. The first meeting of SADC-EPA countries (where the five countries that will negotiate as ESA were not present) took place in Gaborone in March 2004.

As we have seen all, the SADC countries have agreed a timetable for the formation of an FTA, which is differentiated by importing country and to some extent also by exporter. If the reduced SADC membership – the BLNS countries, Angola, Tanzania and Mozambique – were to enter into an EPA with the EU, the evolution of the FTA could presumably continue. Assuming that the EU would insist on fully liberalised trade among all the ACP members of the EPA, the process of tariff liberalisation would be accelerated among those countries. This would only affect Mozambique's liberalisation timetable if South Africa were included within the EPA FTA, since Mozambique is committed to full liberalisation vis-à-vis all other SADC members by 2012 or if the EPA negotiations led to a renegotiation of the liberalisation commitments of SADC.

The role of South Africa in the EPA negotiations, formal or informal, is critical. South Africa is not a Lomé member and thus would not participate in the EPA negotiations. But it would be an important presence behind the scenes. South Africa has already signed a Trade, Development and Cooperation Agreement (TDCA) with the EU that will lead to, in due course, a free trade area (FTA). However since South Africa has reached a Customs Union (CU) with the BNLs countries (Botswana, Namibia, Lesotho and Swaziland), these countries are inevitably part of the nascent South Africa-EU FTA. By the same token, any increased access for EU products negotiated in the SADC EPA will likewise extend to South Africa.

The TDCA between SA and EU already implies an opening up of markets to EU products for other SACU (BLNS countries) members, even before the EPA negotiations begin. Similarly the TDCA will restrict the list of goods on which the other SACU members – not only the BLNS countries but also all other members of a SADC EPA - can retain tariff barriers in an EPA. Normally, the proposed members of an EPA would jointly identify the current commodity composition of imports from the EU, rank these according to sensitivity either in relation to domestic competition or government revenue, and determine which competitive/revenue-important products could retain their tariffs without breaching the requirement that say 80 percent of imports be fully liberalised. However, given the TDCA, it will be necessary to exclude from the list of goods that can keep tariffs those that have been or are to be fully liberalised under the TDCA.

There are two other possibilities. The SACU could be changed for a customs union to an FTA which would mean that the other SADC EPA members could work out an independent trade policy vis-à-vis the EU. Alternatively the TDCA could be abolished or renegotiated to allow South Africa to become a member of the EPA, formally or more likely informally, given that it is not recognised as developing country for trade purposes by the EU. However the second – and more likely - of these possibilities would not avoid the problem of a necessary and uncomfortable compromise between the SADC EPA members and South Africa over the treatment of EU imports.

This is very important for all the potential SADC EPA members. It means that all decisions on what to designate as a sensitive product would have to be agreed with South Africa and that would then have to be incorporated in a revision of the TDCA.

Otherwise those sensitive items could be brought into South Africa duty-free and traded without duties or other restrictions throughout the EPA. It is therefore critical that that particular issue be analysed carefully in the choice of what path is most appropriate for Mozambique.

South Africa may try to use the CU as a way to renegotiate the TDCA – due for renegotiation in 2004 in any event – and benefit from a slower introduction of reciprocity in the SADC EPA. It may seek effectively, if not formally, to become a party to the EPA and also improve its access to EU markets particularly in agricultural and food processing. Still the problem remains – those goods that are sensitive as far as South African imports from the EU are concerned are very different from those that are sensitive in the other SADC countries, including Mozambique.

Then there is the question of broader integration in Southern Africa. It is sometimes assumed that the regional groupings which participate in EPA negotiations do not necessarily reflect the final geographical structure of the ensuing EPAs. In particular it has been argued that the final output might be a single Eastern and Southern Africa EPA, although the ESA countries and the seven SADC countries (the BLNS plus Tanzania, Angola and Mozambique) may negotiate separately.

But this assumption ignores the economic significance of South Africa. If the seven SADC countries were to negotiate an EPA, and if there were a significant chance that South Africa would become a member of that EPA (de facto or informally), the chances of attracting other SADC members or linking up with another EPAs negotiated by other SADC members within the ESA group would be limited. The faster the process of integration within the EPAs the less likely would be the other Southern or Eastern African countries to accept the threat of South African competition. In services, as well as in goods, South Africa is already a major regional supplier and there would be concern that SADC's plans to integrate their services markets would simply open the way to increasing South African dominance. True, the exports of other SADC countries like Zambia, Malawi or Zimbabwe would benefit from tariff-free access to the South African market – though they have substantial preferences there already – but that is not likely to persuade those countries that free trade with South Africa is in their interests, except perhaps in the long term

Another potential problem with this option is linked to the fact that some EU member states (notably the UK, Sweden and Denmark) have argued that the EBA provisions on access to the EU markets should be extended to all members of an EPA where that EPA includes LDC members. The reasons are that the gains to the non-LDC ACP States more than compensate for the loss of tariff preferences for the LDCs, preferences that will in any event be eroded through multinational liberalisation under the WTO. This, of course, would be damaging to the LDC members since they would have to compete in EU markets against other EPA members, and potentially all or a majority of ACP states.

A further problem might be the differential between the EBA and the Cotonou rules of origin. As the IDS-Botswana study points out: '[a]t present, the least developed

SADC countries are in the anomalous position of having superior EU market access to that of developing SADC countries and inferior rules of origin on these superior preferences. The key goal is to ensure that the EU has latitude to adopt whatever provisions are needed in a post-Cotonou agreement to avoid damaging regional integration'.²⁶ Unless the RoO were harmonised for all EPA members, this damage could be particularly serious for Mozambique as investment in manufacturing, including food processing where access to the EU markets is not particularly favourable to LDC suppliers, might be concentrated in the non-LDC members.

It is clear that market access for LDCs is being determined (and constrained) by Rules of Origin. On the other hand, harmonisation of RoO cannot mean that the more strict ones are adopted or that higher tariffs go hand in hand with more flexible RoO. The combination must be more flexible RoO with lower tariffs (or zero tariff).

Note that the impact of regional integration within SADC is not a key argument in the question of whether Mozambique opts to negotiate an EPA within the restricted SADC group (SACU plus three less RSA) or on its own, or indeed not at all. It might be presumed that the SADC FTA will proceed, regardless of the geographical configuration of EPAs. On the other hand progress towards the SADC FTA could be damaged by the EPA negotiations. Many necessary reforms (acceleration of tariff reductions, rules of origin, other non-tariff barriers, services, etc.) may not appeal to those countries that already have access to the South African market and at the same time are having to open their markets to the EU.

Moreover as SADC becomes closer to forming a CU, it will need to agree on a common external tariff. At that point, differences in the access of EU goods to different EPAs will need to be ironed out, presumably by taking the lowest common denominator, i.e. only tariffs on goods that have been excluded from full liberalisation within all the EPAs could remain. To avoid these problems in the future it would be helpful if the ESA and the SDAC EPA members were to coordinate as regards the negotiations with the EU. This would imply the same - or close - list of sensitive products and the same - or close - timetables for liberalisation of imports of other products from the EU. Indeed this would facilitate the amalgamation of the two FTAs implied by the two EPAs at some future stage.

Option 2: Mozambique negotiating an EPA alone

The principal justification for Mozambique negotiating with the EU alone, or, indeed, declining to negotiate at all, is that Mozambique already has the advantages of EBA status. This means that there is much less to be gained in return for reciprocal market opening or other concessions that the non-LDC ACP countries might have to make. Secondly, since Mozambique is an LDC it might obtain longer transition periods for liberalising its markets for EU exports, if not a lower target share of fully liberalised imports in total imports. It cannot be excluded that the 'clarification' of Article 24 of GATT (see above) will lead to different rules on regional agreements between developed countries and developing countries including one or more LDCs. However, as implied by the last paragraph, the benefits of any special treatment for LDCs within

²⁶ IDS-Botswana ..

a SADC EPA would come to an end as SADC reaches a CU, which may be likely to be a long way in the future.

Thirdly Mozambique would be able to negotiate exclusively in its own interest. It would not have to agree with other countries on what the 'sensitive' sectors are from the point of view of reciprocal market access. Article 2 of Chapter 1 of the Cotonou Agreement states that: 'differentiation and regionalisation, cooperation arrangements and priorities shall vary according to a partner's level of development, its needs, its performance and its long-term development strategy. Particular emphasis shall be placed on the regional dimension. Special treatment shall be given to the least-developed countries.' This could mean that an EU-Mozambique EPA could be significantly more generous in terms of adjustment finance, if not the degree of liberalisation of Mozambican markets, than one negotiated jointly with the other 6 SADC members (and with South Africa prompting from the wings). Moreover it would not have to agree a joint negotiating position on trade-related issues (see Chapter 9 below.) It would not have to sacrifice any measure of bargaining power to a 'supra-national' body. On the other hand, of course, it would put a larger stress on Mozambique's trade negotiating apparatus, which will be stretched in any event in the WTO, in Brussels over sugar, in Gabarone over the SADC Trade Protocol and, possibly, with regard to membership of SACU.

However the two main advantages that might have accrued to Mozambique by negotiating alone are in any event being lost through the SADC FTA. These are the retention of tariffs on imports from other SADC countries, including South Africa and thus the removal of certain threats to Mozambique's productive system and government revenues and the fact that in an EU-Mozambique EPA, the pressure to reduce tariffs would have been lower than the pressure of an EPA that includes the other countries also (especially if South Africa is included).

It is also necessary to consider that the EU favours negotiating regional EPAs and resists negotiating single country EPAs. In its paper on the 'Orientation on the qualifications of ACP regions for the negotiation of EPAs', the European Commission states that individual ACP states should only be eligible for the negotiations of EPAs if these negotiations do not negatively affect regional integration initiatives within the ACP. This statement is justified on two grounds: the emphasis on regional integration placed by the Cotonou Agreement as a guiding principle for the establishment of EPAs; and the contribution that regional integration can make in facilitating the integration of the ACP into the world economy. It follows that ACP countries that are members of an actual or planned CU or a FTA would not be eligible for EPA negotiations on an individual basis.

The "Orientations" document then goes on to say that for individual ACP countries not participating in a CU or a FTA, the negotiation of EPAs should only be considered if the establishment of EPAs is likely to contribute to the sustainable development of the country concerned and to the eradication of poverty in that country. This would have to be assessed on a case-by-case basis but the clear inference is that individual country EPAs would be more the exception than the rule.²⁷

²⁷ Mark Pearson, *op. cit.*

The agreement of SADC to form an FTA and ultimately a CU might suggest that Mozambique would be excluded from a single country EPA. However if the membership of SADC is divided between two (or more) EPAs the logic of the Commission position is lost.

Option 3: Mozambique declines to negotiate

The Commission favours regional negotiations leading to regional EPAs. But the Cotonou Agreement does allow for both individual ACP State-EU EPAs and for 'alternative arrangements', although these appear as reluctant afterthoughts. 'The Cotonou text is a compromise which admits to the possibility of alternative arrangements but provides so little guidance on their form that it has failed to remove ACP suspicion over the EU's intentions.'²⁸

One problem, particularly relevant to Mozambique if it were to go alone, concerns the different rules of origin under the EBA and under Cotonou. The former are significantly less generous than the latter. This means that, unless the rules are standardised, there will be an incentive to locate production of manufacturing, including processed foods, among the members of a SADC or other Eastern and/or Southern African EPA. Furthermore, the cumulation provisions of the EBA rules of origin are more demanding than the Cotonou rules. This of course may change with the new GSP to be promulgated at the end of 2004. In the meantime the LDCs might well benefit from regional processing within a regional EPA.

Of course it cannot be excluded that the EU will grant the equivalent of EBA status to all ACP countries forming regional EPAs or at least those which include one or more LDCs. In that case Mozambique would be faced with greater competition from other Southern African countries, whether or not it was in an EPA. On the other hand, an LDC might benefit from the more relaxed Cotonou rules of origin only if it joined an EPA. In any event, the details would be crucial. How for example would Protocol sugar exports be treated?

While there is no commitment on the part of the EU to provide new financial instruments for additional funding to cope with the adjustment problems of introducing reciprocity or supply-side constraints, the EU negotiating mandate does talk of 'where appropriate ... assistance to adjustment and fiscal reform.'²⁹ Thus the EU is not offering any incentive in terms of aid to countries who are considering negotiating an EPA. However, the EU is not mentioning, and therefore is not excluding, the hypothesis of reducing, or even withdrawing altogether, development cooperation and technical assistance to/from countries that may decline to negotiate an EPA.

Finally, while Mozambique would be able to benefit from EBA as an LDC in or out of an EPA, it must be borne in mind that the EU can unilaterally and without warning

²⁸ Institute of Development Studies/Botswana Institute for Development Policy Analysis, Southern Africa Ideal REPA, Revised Report, April 2002

²⁹ European Commission: Draft Recommendation for a COUNCIL DECISION authorising the Commission to negotiate Economic Partnership Agreements with the ACP countries and regions; see <http://www.epawatch.net/general/text.php?itemID=16&menuID=12>

change or even abolish the EBA regime which has been “awarded” unilaterally by the EU. Hence, there is some degree of comfort in signing an agreement under the auspices of international law, even if such an agreement may only keep existing benefits without adding any more, and may actually create new pressures associated with the principle of reciprocity.

Conclusions on options for Mozambique

This chapter has examined three main options for Mozambique with regard to the negotiation of an EPA. Firstly there is the present government policy of participating within a **SADC-EU EPA** – to include the BLNS countries, Angola and Tanzania – who have formally agreed to negotiate together and are expected to register as a negotiating group with the ACP Secretariat and the EU Commission in April 2004. The group is considerably smaller than the full SADC membership, since South Africa is excluded because of not being a developing ACP state, and a number of other members have opted to join the so-called ESA group for EPA negotiations partly because of the threat of South Africa.

The problems with the current proposal are, to a large extent, centred on the role, power and will of South Africa. Since it has formed a customs union with the BLNS countries, whose common customs schedule largely reflects South African priorities, this will to a large extent constrain the pattern of residual protection against imports from the EU after the EPA has been negotiated. In other words South Africa’s priorities as regards sensitive products will determine the final EPA tariff schedule on EU exports to the region. This problem would become a major hurdle if in fact there were, at a later stage, moves to combine different EPA FTAs, for example the ‘reduced’ SADC-EU FTA and the ESA-EU FTA.

Another factor to be considered is the renegotiation of the rules of origin. The current EBA rules are in many respects less favourable than those of the Cotonou Agreement. It would be in Mozambique’s interest if the latter were to cover all Mozambique’s exports to the EU, including those receiving EBA preferences. One of the attractions of the SADC EPA option is the possibility of increasing inward investment, especially from South Africa. Clearly the more favourable set of rules of origin is of paramount importance if such an investment is somehow oriented towards exporting to the EU.

The second option is a single **Mozambique-EU EPA**. This might be resisted by the EU since the EU has stressed the gains from regional integration and its preference for regionally-based EPAs. However if Mozambique were to argue that its interests would be significantly compromised by a regional EPA, the wording of the Cotonou Agreement would make it difficult for the EU to refuse a simple bilateral negotiation. The great advantage of a single country-EU EPA is that the negotiations, in particular those concerning the priority sectors where tariff reciprocity will be limited, would reflect only the priorities of the country in question. Since Mozambique is an LDC, it might be able to extract improved terms for an EPA in areas such as, for example, transitional periods and arrangements. In addition, since Mozambique is a beneficiary of the EBA, the EU would not be able to ‘trade’ improved market access in return for concessions on EU exports.

Finally there is the option of **declining to negotiate** but continuing to benefit from the EBA arrangements. The problem with this option is that there is limited chance of

obtaining improved rules of origin for exports to the EU, which, as noted, may have some negative impact on inward investment. Furthermore, there is a real danger that Mozambique would have to pay for its individualism in reduced development assistance from the EU (and EU member states). Finally, there is always the chance that the EU will unilaterally change the preferences and rules of origin relating to LDCs.

Annex to Chapter 5

Annex 14: Conceptual notes on Trade Creation and Trade Diversion Analysis

Trade creation and trade diversion are concepts originally designed to measure gains and losses respectively when a country enters a FTA or CU.

When an individual country enters a CU it eliminates its tariffs on imports from other members of the CU while those members eliminate tariffs on the imports of the new member. Thus, prices of the respective imports in both the new entrant and within the existing CU members will fall.

Trade creation arises when this fall in prices is translated into increased trade between the CU countries. As relative prices adjust to new free market conditions, countries specialise in what they are good at and abandon the activities they are less efficient at, thus exporting and importing goods produced in a more cost-efficient way. Due to specialisation, overall production and consumption frontiers shift outwards, consumers have access to cheaper goods (such that they are better off) and more trade is developed between CU countries due to efficiency gains. According to neo-liberal economic theory, trade creation can be a measure of, and be measured by, the increase in consumer welfare.

However, the trade creation argument has to be handled very carefully, as the all story depends upon very strong, and unlikely, assumptions, namely: (a) specialisation is always possible and adjustment is quick and either cheap or free; (b) no matter what type of specialisation takes place, countries, producers and consumers are always better off; (c) all activities and products, as long as they are produced efficiently, have complete markets and face unrestricted demand; (d) domestic markets are competitive to the extent that potential economic gains from cheaper imports are fully or mainly appropriated by consumers rather than trading corporations; (e) all agents are rational in that their decisions are mostly based upon price (or market) incentives, and (f) on the whole, markets behave competitively: diminishing returns to scale, exogenous and equally available technology, perfect information, product homogeneity, returns to factors depending on their marginal productivity, and consumer sovereignty.

However, specialisation may not be possible due to production rigidities; social and economic agendas of public and private agents; costs of adjustment; time needed for adjustment. It is no good to state that in the long run adjustment always takes place, because an economy that goes into deep recession in the process of adjusting may have no long run to rely upon.

Specialisation may not increase trade if one of the parties loses out because of being unable to adjust and relocate factors of production to new, competitive and dynamic activities. Weaker economies may be left with opportunities to specialise only in marginal and declining sectors, activities that are limited from the point of view of linkages and innovation, markets that are narrow, shrinking and volatile. In such circumstances, specialisation may not be desirable, let alone achievable.

An economy can only import cheaper products if it can also produce and sell to generate enough income to finance imports. Imports are determined by several factors: income; the dynamics of production, investment and consumption; and trade and exchange rate balances and regimes. The orthodox trade creation approach states that if trade regimes are liberalised, prices fall, imports increase and consumers are better off. This analysis does not say anything

about what happens to any of the other determinants of imports as the trade regime is liberalised, and what the impact of such happenings could be on the volume of trade and consumer welfare.

Trade creation within the CU as a whole can occur even if some economies lose out, such that even in the event of trade creation, not all consumers may be better off. Whether all trading partners benefit from increase in the volume of trade depends on the type of products and activities each partner specialises on, the dynamics factors associated with such activities, and the relative price changes between activities and products.

Consumer welfare is linked with producer welfare, because the welfare of consumers arises from their ability to work effectively. Thus, if specialisation eliminates jobs and reduces income, and does not create enough good jobs in new and dynamic activities, the so-called consumers will be worse off as producers, such that they will also be worse off as consumers.

Trade creation can also be a short-lived phenomenon resulting from short run adjustment and resulting in long run crisis. This is, for example, the case of an economy that is able to import more in the short run as prices fall, but which has no productive capacities to increase exports in a sustained and diversified way as to finance imports and changes in production and consumption patterns in the long run. Thus, short run bonanza may feed mid to long term trade imbalances and financial debt crises.

Decisions to specialise, import and export may be (and usually are) taken for reasons other than price incentives, or in addition to price incentives. For example, product differentiation opens the opportunity for specialised utilisation of specific goods (say, different qualities of steel can have different types of applications). Product specification, usually related to intra and inter firm trade rather than market trade, can be a crucial component of quality certification and, thus, of the ability to be competitive. In such cases, the price mechanism plays only a marginal role in decisions, if it has a role at all. Thus, trade flows may not change at all despite changes in price levels and relative prices, particularly when investment goods, which tend to require some level of specification and specialisation, form the lion share of imports.

As none of the conditions for competitive markets is likely to held (and all should held if markets are to be competitive), two further problems arise. First, there is no reason to assume up front that cheaper imports translate automatically into cheap consumer goods; trading corporations and groups may have enough market power to appropriate most of the gains from cheap imports by increasing their market margins. Second, trade creation analysis, which only holds if the strong and unlikely assumptions hold, is a very weak basis for policy making. At best, it can illustrate some of theoretical possibilities, which have to be handled carefully.

On the other hand, *trade diversion* arises from the reallocation of imports to the new partners simply because they now have tariff-free access to the new member states and vice versa – and thus imports may be diverted from countries outside the CU to countries inside the CU. Whether trade diversion is an economic benefit or not for the CU members depends on several factors related to the imports themselves (relative cost efficiency of production between the old and new export country, product quality and specificity, and so on); and also related to the dynamic impact of trade diversion on the economies of the CU (economies of scale and scope, market proximity, learning, skill development and innovation, development of new patterns of trade and investment, economic integration and complementarity, development of infrastructures and institutions related regional to trade, production and systems of innovation and investment, etc.).

Neo-liberal economic theory states that trade diversion penalizes the consumer, but such a statement is only based on assumed beliefs, with no sound theoretical basis. Whether the effect of trade diversion is positive or negative, or both, is an empirical issue related to specific socio-economic conditions, not a logical and foregone conclusion arising from any ideologically based assumption about the inherent superiority of the market mechanism.

Thus to sum up, trade creation stems from the increase in overall demand from some or all trading partners, which results from specialization and a fall in price levels, and whose magnitude (of trade creation) depends on effective changes in price levels and relative prices, as well as the supply and demand elasticities of exports and imports relative to prices. These elasticities are affected by many factors: production conditions, degree of market competitiveness, structure of production, imports and exports, dynamics of investment, production and trade, technological conditions and skills, amongst others. Trade diversion stems from changes in the origin of imports from some countries to others, as a result of the impact of changes in relative supply prices triggered by differential changes in tariffs on imports from different origins on. The amount of diversion will be determined by the change in tariffs, the export supply elasticities of the different suppliers and their initial market shares and the elasticity of substitution and rules of origin. Rules of origin of free trade areas may lead countries to source from the region (even if more expensive) with the sole purpose of benefiting from preferences under the FTA

The elasticity of substitution measures the percentage change in *relative* imports in response to the percentage change in *relative* prices and clearly depends on attachment of consumers to goods from particular suppliers, because of differences in quality or other characteristics. Thus, although changes in prices may have an impact on creating or diverting trade, there are many other factors, which are not only dependent on relative prices, that decide whether such an impact actually happens, as well as the direction and magnitude of the impact.

The question that may arise is that: if we are so critical of the mainstream measures of trade flow impact of tariff changes, why do we use these measures in our study? There are three reasons for that. First, most studies about the impact of EPA negotiations include these traditional measures of trade flows. The use of such measures is, therefore, a standard procedure and part of what is expected to be done. Second, making use of this model may be a clearer way to show its analytical limitations by showing under which assumptions the model works and discussing the validity of such assumptions. Third, despite all its flaws, the model can be useful in simulating situations and illustrating issues that should be thought about. Nonetheless, one should bear in mind that the results of the model depend on its assumptions; and the validity of such results depends on the validity of the underlying assumptions.

Annex to Chapter 6

Annex 15: Methodological notes about services negotiations

This section aims at underline some specific issues on which the Government of Mozambique will have to make decisions regarding the services negotiations. The section does aim primarily at raising issues that will have to be taken into account rather than providing immediate answers because it is mainly based on revision of existing literature on services negotiations in PTAs

What is the services negotiations all about?

Fundamentally the services negotiations involves 3 principal elements to be taken into account:

1. Coverage
2. Liberalisation principles
3. Depth of commitments

Coverage does have two different meanings. On one side it does refer to the modes of supply or in other words how the providers of services can access and contest the foreign market. On the other side coverage refers to the number of services negotiated. The art. V ‘substantially all’ does refer to both modes of supply and number of services covered.

With regards to coverage 2 negotiating options are available and should be compounded by Mozambique. The first is ‘positive list’ which implies that only the commitments for liberalisation are put forward and listed. The second approach is ‘negative list’ in which case all sectors and measures are to be liberalised unless specified in a list containing reservations and non-conforming measures. The multilateral approach of GATS is based on the ‘positive list’ approach whilst it has to be noticed that often in RTA the approach followed has been the ‘negative list’ (i.e. NAFTA, CARICOM, Mexico’s bilateral agreements with Southern and Central America, etc.) The ‘negative list’ approach has the advantage of higher level of transparency in the liberalisation commitments and give more information to the providers of services, however it is riskier to negotiate³⁰ and harder if the negotiating capacities and the negotiating basis is weak as it is likely to be for ACP countries. The ‘positive list’ approach poses less problems to negotiators but normally ends up in less transparency and lower degree of liberalisation.

Liberalising principles: In the services negotiations these refer fundamentally to four principles

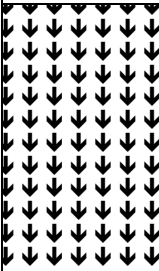
³⁰ It is indeed known as ‘list or lose’ approach

1. MFN: Classical principle implying that the ‘best treatment’ is automatically extended to all the countries
2. National treatment: also this is a rather classical principle and implies that the foreign suppliers are accorded a non less favourable treatment than domestic suppliers when providing ‘like services’
3. No local presence requirements: This principle allow the providers to choose the most efficient form of supplying the services, however it must be noticed that this requirements are often important to guarantee better consumer protection and easier supervision
4. No quantitative non-discriminatory restrictions: This principle implies that quantitative restrictions to the number of providers or other regulations that limit competitions are not allowed. These restrictions are normally introduced by the government in certain areas in order to limit competition because of consideration linked to market size (i.e. providers of radio or television frequencies, providers of mobile phone, etc.).

The principal negotiating decision with regards to the liberalising principles regards their inclusion as general obligations (as it is the case of MFN principle in the GATS) or its inclusion as part only of specific commitments (as it is the case of the national treatment in the GATS). The first option is normally more cautious and also tends to less encompassing liberalisation commitments, but also to less open and transparent access to foreign markets. A more defensive position would start from first minimising the number of liberalising principles set as general obligations, especially in the first stages of negotiations in order to avoid losing at an early stage important negotiating chips.

Depth of commitments: This implies the extent to which liberalisation are imposed and the agreements binding. Various instruments are available and we will order them by the degree to which are binding and implies higher depth.

Table 1: Depth of Commitments and Type of Instruments in Services Negotiations

| <u>Depth</u> | <u>Type of instruments</u> |
|---|--|
| Min | Transparency |
|  | Ceiling Binding |
| | ‘Freeze’ – Standstill clause ³¹ |
| | Ratcheting ³² |
| | ‘List or lose’ ³³ |
| Max | Commitment on future liberalisation |

³¹ Avoid to introduced new non-conforming measures

³² Avoid backsliding of unilateral liberalization

³³ Non conforming measures must be listed in order to be kept

Annex Chapter 7

Annex 16: Certain trade-related issues in the Cotonou, the TDCA and the EU-Chile agreements

| | Cotonou Agreement | EU-South Africa FTA (TDCA) | EU-Chile FTA |
|-----------------------------------|--|---|---|
| Trade and environment | Mentioned among areas covered in Article 8 on political dialogue | Art. 84 commits parties to sustainable devt. incl. protection of the environment, pollution control and cooperation on global environmental problems. Special consideration to capacity in environmental management; dialogue on priorities. Impact of past RSA policies on will be addressed. Cooperation on programmes in urban development and land use, desertification, waste management; and other specific fields. | Art. 28 stresses cooperation on conservation and improvement of the environment, contamination etc. of natural resources and their rational use for sustainable dev't. Significance of relationship between poverty and environment; impact of economic activities; land-use management; projects to reinforce Chile's environmental structures and policies; exchanges of info., technology and experience, training and technical assistance. |
| Trade and labour standards | In Art. 50 reaffirms commitments to ILO core labour standards: freedom of association and the right to collective bargaining, abolition of forced labour, elimination of worst forms of child labour, nondiscrimination in employment. Parties agree to exchange information on legislation and regulation and its enforcement; educational programmes. That labour standards should not be used for protectionist purposes. | Art. 86 reaffirms commitments to ILO core labour standards: freedom of association of workers, the right to collective bargaining, the abolition of forced labour, the elimination of discrimination in employment and occupation and the effective abolition of child labour. The pertinent standards of the ILO shall be the point of reference for the development of these rights. | Art. 44 gives priority to the creation of employment and respect for fundamental social rights, notably by promoting the relevant ILO conventions, including freedom of association, the right to collective bargaining and non-discrimination, the abolition of forced and child labour and equal treatment between men and women. |

| | | | |
|--|---|--|--|
| <p>Intellectual property rights</p> | <p>Under Art. 46 Parties recognise need for effective protection of IPRs covered by TRIPS inc. protection of geographical indications. Also agree on need to accede to relevant int'l conventions in line with level of development. Parties may consider agreements for protecting trademarks and geographical indications. For this Agreement, intellectual property is defined to include a range of rights, copyright, utility models, patents including bio-technological, industrial designs, geographical indications, trademarks etc. Parties to strengthen co-operation upon request in preparation of laws and regulations, etc. including training</p> | <p>Under Art. 46, Parties shall ensure effective protection of IPRs at highest international standards, applying the WTO TRIPS Agreement and improving, where appropriate, the protection provided for under that Agreement. Where problems arise, urgent consultations to reach satisfactory solutions. Confirms importance of Madrid Protocol, the Inter'l Convention for the Protection of Performers, etc. and the Patent Cooperation Treaty, with South Africa possibly considering accession to these. Parties confirm the importance of several other listed instruments. EU may provide technical assistance in preparing laws and regulations, the prevention of abuse, the establishment of offices and agencies, including the training. There follows a definition of intellectual property similar to Cotonou</p> | <p>Parties agree to cooperate in effective application of IPRs, the prevention of abuses of such rights, counterfeiting and piracy. Technical cooperation may focus on one or more of legislative advice: comments on draft laws relating to copyright, trademarks, geographical indications, etc.; advice on administrative infrastructure; training in general and, specifically, of judges and Customs and Police Officers; awareness building activities</p> |
|--|---|--|--|

| | | | |
|---|---|---|--|
| <p>Standardisation and certification</p> | <p>Under Art. 47 Parties agree to cooperate more closely in standardisation, certification and quality assurance to remove unnecessary technical barriers. They reaffirm their commitment to the WTO TBT Agreement. Cooperation shall aim at promoting compatible systems between Parties and include measures to promote greater use of international technical regulations, standards and conformity assessment procedures in accordance with the level of economic development of ACP countries, cooperation in quality management and assurance in selected sectors of importance to the ACP States, support for capacity building initiatives in the ACP countries, developing links between ACP and European standardisation, conformity assessment and certification institutions. However the Parties undertake to consider, in due course, negotiating mutual recognition agreements in sectors of mutual economic interest.</p> | <p>Article 47 states that Parties will cooperate in standardisation, metrology, certification and quality assurance in order to reduce differences between Parties, and remove technical barriers. Cooperation shall include: measures, in accordance with the WTO TBT Agreement, to promote greater use of international technical regulations, standards and conformity assessment procedures, including sector specific measures; developing agreements on mutual recognition of conformity assessment; cooperation in quality management and assurance in selected sectors of importance to South Africa; technical assistance for southern African capacity building initiatives in accreditation, metrology and standardisation; developing practical links between standardisation, accreditation and certification organisations.</p> | <p>Under Art. 18 cooperation on standards, technical regulations and conformity assessment to avoid and reduce TBTs. Cooperation efforts in regulatory cooperation; compatibility of technical regulations; technical assistance to create a network of conformity assessment bodies. In practice, cooperation shall encourage any measures aimed at bridging the gaps between Parties in conformity assessment and standardisation; provide support between Parties to foster regional networks, and increase coordination of policies to promote a common approach to the use of international and regional standards and similar technical regulations and conformity assessment procedures; and encourage any measure aimed at improving convergence and compatibility, including transparency, good regulatory practices and the promotion of quality standards for products and business practices</p> |
| <p>Data protection</p> | <p>Only mentioned in relation to IPRs: legal protection of data bases and against unfair competition as in</p> | <p>Under Art. 91 the Parties shall cooperate to improve the level of protection to the processing of personal data, taking into account</p> | <p>This only appears in Art. 31 on Public Administration and Interinstitutional Cooperation. The means of cooperation in this area shall include regular</p> |

| | | | |
|--|---|--|--|
| | <p>Article 10a of the Paris Convention for the Protection of Industrial Property.</p> | <p>international standards. Cooperation on personal data protection may include technical assistance in the form of exchanges of information and experts and the establishment of joint programmes and projects.</p> | <p>exchanges of information taking whatever form is appropriate, including the use of computer networks; personal data protection shall be ensured in all areas where data are to be exchanged</p> |
|--|---|--|--|

ANNEX 17: SADC IMBALANCIES

South African Dominance: One of the main aspect of the SADC is that it is dominated by South African economy. Indeed South Africa represents more than 70 percent of the combined sub-regional GDP and about 32 percent of its population. The role of South Africa is also important through trade and transport, in fact neighbouring countries (especially Zimbabwe and Malawi) highly depend from South Africa's railways, highways, airports and other transit facilities.

With respect to trade South Africa dominates the export to other SADC countries by supplying about 77 percent of intra SADC exports in 1999, but it has to be noticed that this was only 11.5 percent of its total export. Whilst for instance Mozambique contributed in 1999 with a non relevant percentage (0.0 percent) but still this weight about 17.4 percent of total Mozambican exports. The clear message is twofold: whilst dominating intra-SADC exports still this is a minimal part of total South African exports, in the opposite situation are the other SADC countries

On the side of imports the picture is consistent with what previously said, whilst most SADC countries are highly dependent on SADC (Malawi, Mozambique, Zambia, Zimbabwe) South Africa is minimally dependent

The fact that South Africa is a large exporter to SADC, but is a minor importer, suggests that complementarity are low between South Africa and the rest of SADC region, as well it can be a result of trade barriers (formal and informal) specific to the South African market (Chauvin and Gaulier, 2002)³⁴. In this second case it seems that this would be a deep source of concern, as well as it would be if the South African gain of market shares on SADC is due to trade diversion thanks to the tariff advantages conferred to South Africa after the apartheid regime ended.

| Source of Intra-SADC exports | 1990 | 1995 | 1999 |
|------------------------------|---------------|---------------|---------------|
| Angola | 0.0 percent | 0.0 percent | 0.9 percent |
| Congo Dem. Rep | 0.1 percent | 2.7 percent | 0.1 percent |
| Malawi | 0.5 percent | 1.9 percent | 2.3 percent |
| Mauritius | 1.4 percent | 0.6 percent | 0.6 percent |
| Mozambique | 0.1 percent | 1.4 percent | 0.0 percent |
| South Africa | 56.0 percent | 76.5 percent | 77.8 percent |
| Seychelles | 0.0 percent | 0.0 percent | 0.1 percent |
| Tanzania | 0.2 percent | 0.3 percent | 1.3 percent |
| Zambia | 1.0 percent | 1.3 percent | 2.0 percent |
| Zimbabwe | 40.7 percent | 15.4 percent | 14.9 percent |
| TOTAL | 100.0 percent | 100.1 percent | 100.0 percent |

| Share of SADC in country | 1990 | 1995 | 1999 |
|--------------------------|------|------|------|
|--------------------------|------|------|------|

³⁴On this issues Kalanga (1999) underlines that there are countries in SADC, which are competitive exporters of certain products to the rest of the world and that South Africa does import these products from the rest of the world as well (food, beverages and tobacco, refined copper, cotton yarn, travel goods, footwear, toys, etc.). Nevertheless, these products had historically attracted a significant level of protection under the SACU trade regime. At the same time this creates an "untapped potential for trade between SADC and SACU" (UNCTAD, 1998)

| exports percent | | | |
|------------------------|--------------|--------------|--------------|
| Angola | 0.0 percent | 0.0 percent | 0.7 percent |
| Congo Dem. Rep | 0.1 percent | 6.0 percent | 0.3 percent |
| Malawi | 1.6 percent | 17.2 percent | 16.9 percent |
| Mauritius | 1.2 percent | 1.4 percent | 1.4 percent |
| Mozambique | 0.2 percent | 32.1 percent | 17.4 percent |
| South Africa | 2.5 percent | 10.7 percent | 11.5 percent |
| Seychelles | 0.4 percent | 1.4 percent | 1.2 percent |
| Tanzania | 0.5 percent | 1.4 percent | 7.4 percent |
| Zambia | 0.8 percent | 3.8 percent | 7.8 percent |
| Zimbabwe | 30.7 percent | 31.7 percent | 28.0 percent |
| Intra-SADC exports | 3.1 percent | 9.9 percent | 10.0 percent |

| Share of SADC in country imports percent | 1990 | 1995 | 1999 |
|---|--------------|--------------|--------------|
| Angola | 0.8 percent | 7.1 percent | 10.0 percent |
| Congo Dem. Rep | 1.1 percent | 18.1 percent | 31.5 percent |
| Malawi | 24.8 percent | 49.2 percent | 64.4 percent |
| Mauritius | 9.9 percent | 11.3 percent | 11.2 percent |
| Mozambique | 7.6 percent | 55.5 percent | 58.6 percent |
| South Africa | 1.8 percent | 2.1 percent | 1.9 percent |
| Seychelles | 14.8 percent | 14.0 percent | 14.3 percent |
| Tanzania | 1.3 percent | 13.9 percent | 13.3 percent |
| Zambia | 7.9 percent | 49.1 percent | 65.5 percent |
| Zimbabwe | 33.1 percent | 51.2 percent | 51.2 percent |
| Intra-SADC imports | 5.1 percent | 9.9 percent | 10.2 percent |

Annex 18: Trade creation and trade diversion

Table 1: Trade diversion and trade creation: \$ 000

| chapter (listed by size of trade creation) | chapter number | total imports | % total imports | trade creation | % total trade creation | trade diversion to EU | % total trade diversion | total incr. in impts. from EU | trade creation (% impts.) | trade diversion (% impts.) |
|--|----------------|---------------|-----------------|----------------|------------------------|-----------------------|-------------------------|-------------------------------|---------------------------|----------------------------|
| Electrical machy., parts | 85 | 73,786 | 9.5 | 9229.8 | 26.8 | 1465.7 | 14.0 | 10695.6 | 12.5 | 2.0 |
| Furniture, bedding etc. | 94 | 14,854 | 1.9 | 5119.8 | 14.9 | 943.9 | 9.0 | 6063.7 | 34.5 | 6.4 |
| Machinery, mech. appl's. | 84 | 90,774 | 11.7 | 3695.5 | 10.7 | 1366.6 | 13.0 | 5062.1 | 4.1 | 1.5 |
| Vehicles | 87 | 101,518 | 13.1 | 2482.9 | 7.2 | 1235.6 | 11.8 | 3718.5 | 2.4 | 1.2 |
| Optical instrument etc. | 90 | 15,936 | 2.0 | 1202.5 | 3.5 | 159.1 | 1.5 | 1361.6 | 7.5 | 1.0 |
| Plastics and articles | 39 | 18,195 | 2.3 | 1165.9 | 3.4 | 292.2 | 2.8 | 1458.1 | 6.4 | 1.6 |
| Footwear | 64 | 6,715 | 0.9 | 1088.2 | 3.2 | 199.3 | 1.9 | 1287.5 | 16.2 | 3.0 |
| Ships, boats | 89 | 17,155 | 2.2 | 987.7 | 2.9 | 23.0 | 0.2 | 1010.7 | 5.8 | 0.1 |
| Beverages, spirits | 22 | 14,662 | 1.9 | 937.9 | 2.7 | 793.2 | 7.6 | 1731.1 | 6.4 | 5.4 |
| Other textile articles | 63 | 14,310 | 1.8 | 913.4 | 2.7 | 788.0 | 7.5 | 1701.5 | 6.4 | 5.5 |
| | | | | | | | | | | |
| other products | | 409,806 | 52.7 | 7565.1 | 22.0 | 3234.4 | 30.8 | 10799.5 | 1.8 | 0.8 |
| | | | | | | | | | | |
| Total | | 777,711 | 100.0 | 34388.8 | 100.0 | 10500.9 | 100.0 | 44889.7 | 4.4 | 1.4 |

Table 2: Trade diversion from SACU; \$ 000

| chapter (listed by size of trade diversion) | chapter number | total imports from SACU | percent total imports from SACU | trade diversion | percent total trade diversion | trade diversion percent imports |
|---|----------------|-------------------------|---------------------------------|-----------------|-------------------------------|---------------------------------|
| Electrical machinery, parts | 85 | 12,311 | 4.6 | 1,213.1 | 15.1 | 9.9 |
| Machinery, mech. appl's. | 84 | 25,450 | 9.5 | 1,123.6 | 13.9 | 4.4 |
| Vehicles | 87 | 33,853 | 12.6 | 947.4 | 11.8 | 2.8 |
| Furniture, bedding etc. | 94 | 9,033 | 3.4 | 849.0 | 10.5 | 9.4 |
| Beverages, spirits | 22 | 5,481 | 2.0 | 792.6 | 9.8 | 14.5 |
| Iron, steel arts. | 73 | 10,110 | 3.8 | 293.7 | 3.6 | 2.9 |
| Plastics and articles | 39 | 5,981 | 2.2 | 243.9 | 3.0 | 4.1 |
| Essential oils etc. | 33 | 5,049 | 1.9 | 195.6 | 2.4 | 3.9 |
| Tanning/dyeing extracts etc. | 32 | 1,268 | 0.5 | 191.6 | 2.4 | 15.1 |
| Paper etc. | 48 | 4,547 | 1.7 | 153.8 | 1.9 | 3.4 |
| | | | | | | |
| others | | 155,412 | 57.9 | 2,054.3 | 25.5 | 1.3 |
| | | | | | | |
| Total | | 268,495 | 100.0 | 8,058.6 | 100.0 | 3.0 |
| | | | | | | |
| Total non-SACU | | 509,216 | | 2,442.3 | | 0.5 |

Table 3: Estimates of trade creation and diversion by 4-digit HS code

| section (listed by trade creation) | section number | total imports | % total imports | trade creation | as % total trade creation | trade diversion | total incr. in impts. from EU | trade creation (% impts.) | trade diversion (% impts.) |
|------------------------------------|----------------|---------------|-----------------|----------------|---------------------------|-----------------|-------------------------------|---------------------------|----------------------------|
| Transmission apparatus | 8525 | 11,445 | 1.5 | 4,015.0 | 11.7 | 230.6 | 4,245.5 | 35.1 | 2.0 |
| Other furniture | 9403 | 9,248 | 1.2 | 3,771.0 | 11.0 | 681.6 | 4,452.6 | 40.8 | 7.4 |
| Telephonic equipment | 8517 | 10,209 | 1.3 | 1,573.9 | 4.6 | 159.8 | 1,733.7 | 15.4 | 1.6 |
| Data processing equipment | 8471 | 8,297 | 1.1 | 1,142.7 | 3.3 | 165.8 | 1,308.6 | 13.8 | 2.0 |
| Motor cars | 8703 | 2,147 | 0.3 | 1,052.6 | 3.1 | 585.1 | 1,637.7 | 49.0 | 27.3 |
| Seats | 9401 | 1,977 | 0.3 | 907.1 | 2.6 | 119.9 | 1,027.0 | 45.9 | 6.1 |
| Footwear, rubber soles | 6403 | 1,598 | 0.2 | 798.2 | 2.3 | 124.8 | 923.1 | 49.9 | 7.8 |
| Office mach., and parts | 8473 | 7,450 | 1.0 | 783.9 | 2.3 | 157.7 | 941.6 | 10.5 | 2.1 |
| Fishing vessels | 8902 | 7,720 | 1.0 | 742.5 | 2.2 | 0.1 | 742.6 | 9.6 | 0.0 |
| Worn clothing | 6309 | 9,415 | 1.2 | 720.6 | 2.1 | 669.5 | 1,390.2 | 7.7 | 7.1 |
| | | | | | | | | | |
| Sub-total | | 69,506 | 8.9 | 15,508.0 | 45.1 | 2,895.0 | 18,402.0 | 22.3 | 4.2 |
| | | | | | | | | | |
| Others | | 708,205 | 91.1 | 18,881.0 | 54.9 | 7,623.0 | 26,504.0 | 2.7 | 1.1 |
| | | | | | | | | | |
| Total | | 777,711 | 100.0 | 34,388.9 | 100.0 | 10,517.5 | 44,906.4 | 4.4 | 1.4 |

Table 4: Estimates of trade diversion from SACU, by 4-digit HS code

| section (listed by size of trade creation) | section number | total imports, \$ '000 | percent total imports | trade diversion to EU | as percent total trade diversion | trade diversion (percent impts.) |
|--|----------------|------------------------|-----------------------|-----------------------|----------------------------------|----------------------------------|
| Other furniture | 9403 | 3,519 | 0.8 | 610.8 | 7.6 | 17.4 |
| Motor cars | 8703 | 4,559 | 1.0 | 456.8 | 5.7 | 10.0 |
| Ethyl alcohol | 2208 | 321 | 0.1 | 326.8 | 4.1 | 101.8 |
| Wine | 2204 | 148 | 0.0 | 312.8 | 3.9 | 211.3 |
| Air pumps | 8418 | 719 | 0.2 | 259.4 | 3.2 | 36.1 |
| Transmission apparatus | 8525 | 435 | 0.1 | 188.6 | 2.3 | 43.4 |
| Vehicle parts | 8708 | 2,851 | 0.6 | 151.4 | 1.9 | 5.3 |
| Telephonic eqt. | 8517 | 5,197 | 1.2 | 143.8 | 1.8 | 2.8 |
| Paints, aqueous medium | 3209 | 503 | 0.1 | 138.8 | 1.7 | 27.6 |
| Insulated wire | 8544 | 2,301 | 0.5 | 131.7 | 1.6 | 5.7 |
| | | | | | | |
| Sub-total | | 20,553 | 4.7 | 2,720.9 | 33.8 | 13.2 |
| | | | | | | |
| Others | | 420,603 | 95.3 | 5,337.7 | 66.2 | 1.3 |
| | | | | | | |
| Total | | 441,156 | 100.0 | 8,058.6 | 100.0 | 1.8 |

Table 5: Estimates of trade creation and diversion: sensitivity analysis (% of total imports 2001)

| Elasticity of demand | Trade creation | Elasticity of substitution | Trade diversion |
|----------------------------|--|----------------------------|-----------------|
| default *0.75 | 3.4 | 1.0 | 0.9 |
| default | 4.4 | 1.5 (default) | 1.4 |
| default *1.5 | 6.7 | 2.0 | 3.1 |
| | | | |
| | Total trade effect (creation plus diversion) | | |
| Elasticity of substitution | 1.0 | 1.5 (default) | 2.8 |
| Elasticity of demand | | | |
| default *0.75 | 4.3 | 4.8 | 6.5 |
| default | 5.3 | 5.8 | 7.5 |
| default *1.5 | 7.6 | 8.1 | 9.8 |

Note: average default elasticities of demand were as follows: Chs. 0-24 1.02, Chs. 25-97 2.34