

Much to lose, little to gain: Assessing EPAs from the perspective of Malawi, *A brief for Tearfund partners*

This paper is a summary of the Tearfund policy report: *Much to lose, little to gain: Assessing EPAs from the perspective of Malawi*. The policy report was informed by primary research done for Tearfund by Malawi Economic Justice Network (MEJN) but also uses a wide range of secondary data, including a number of studies on the impact of past trade reform on Malawi and a number of other quantitative studies that have been undertaken to assess the possible impacts of the trade liberalisation aspect of EPAs on ACP countries.

For more detail and references, please see the full report which can be found on Tilz

(<http://tilz.tearfund.org/Research/Trade+policy+and+research.htm>) or contact Mari Griffith on mari.griffith@tearfund.org or 00 44 (0) 20 8934 7928.

1. Introduction

The European Union (EU) is negotiating Economic Partnership Agreements (EPAs) with 75 of its former colonies in Africa, the Caribbean and Pacific (ACP). EPAs are Regional Trade Agreements (RTAs) between an economic giant and some of the poorest countries in the world including 39 of the world's 50 Least Developed Countries (LDCs). They mark a fundamental change in ACP-EU trade relations and the stakes for developing countries are extremely high. However, there is a woeful shortage of official and thorough impact studies to assess the real costs of EPAs on livelihoods, development and the environment in ACP countries. Tearfund's report, *Much to lose, little to gain: Assessing EPAs from the perspective of Malawi* looks at the issues Malawi faces in negotiating an EPA, what the impact of an EPA might be on Malawi and whether an EPA would support or hinder Malawi's development strategy.

2. Background to EPAs

Since 1976, the trade, aid and political relationship between the EU and its former colonies, the ACP, has been governed by a series of conventions – called the Lomé Conventions. In recognition of the very different levels of economic development experienced by EU and ACP countries, the Lomé Conventions gave the ACP special access to Europe's markets ('trade preferences'), without having to 'reciprocate' (offer market access to the EU) in return. However, these preferences were increasingly challenged by other countries at the World Trade Organisation (WTO) because they were seen to discriminate against non-ACP developing countries and hence to be incompatible with WTO rules.

The fourth and final Lomé agreement was signed in 1996 and expired in 2000, but under a 'waiver' granted at the WTO, its provisions – ie the trade preferences - will govern trade between ACP countries and the EU until December 2007.

In 2000, a new deal – The Cotonou Partnership Agreement was signed to replace the Lomé Conventions. Its objectives are to reduce and eventually eradicate poverty, consistent with the objectives of sustainable development and the gradual integration of ACP countries into the world economy. It has three pillars: development cooperation (aid), political cooperation and trade. Within the area of economic cooperation and trade, it provides for negotiations of new trade agreements – Economic Partnership Agreements – between the EU and ACP.

In September 2002 talks on EPAs began with the aim of concluding negotiations by 2007 and their coming into force in 2008. EPAs are being negotiated between the EU and six regional groupings of countries: four in Africa, one for the Caribbean and one for the Pacific.

The European Commission (EC) is mandated by the EU Member States to negotiate on behalf of the EU, and Regional Secretariats negotiate on behalf of each ACP grouping.

Free Trade Agreements

A key feature of EPAs is that they are to be compatible with WTO rules. The current WTO provisions governing RTAs say that they should cover 'substantially all trade' (at present most countries agree a working definition of approximately 90 per cent of trade) and should be implemented 'within a reasonable

length of time' (agreed interpretation is 10 years except in exceptional circumstances). However, there is no legal clarity on the interpretation of either 'substantially all trade' or 'a reasonable length of time'.

It's important to note that these rules were principally designed to cover agreements between developed countries and have no provisions to allow special treatment for developing countries (as at the WTO). They are thus highly inappropriate for trade agreements between such economically disparate parties as the EU and ACP.

The EU will allow for what is called an 'asymmetrical' approach to calculating 90 per cent of the total average value of trade. For example, they could liberalise 95 per cent of trade and the ACP 85 per cent, making total average of 90 per cent. Thus Malawi and other ACP countries will be able to select a certain number of products to include on a 'sensitive list' that will be protected from liberalisation. They may also be given a slightly longer time frame in which to liberalise.

The Eastern and Southern Africa Group

Malawi is negotiating an EPA as part of the Eastern and Southern Africa (ESA) grouping that is being coordinated by the COMESA Secretariat. The ESA internal negotiating structure consists of two levels: ministerial and ambassadorial. The bulk of technical work is done by the Regional Negotiating Forum (RNF), which comprises experts from ESA member states and regional organisations and meets every three to four months.

Each ESA country, including Malawi, has established a National Development and Trade Policy Forum (NDTPF) which is tasked with developing national negotiating positions to be used by the country representatives at the RNFs.

3. EPAs: a flawed process

The process of negotiating EPAs is fraught with difficulties. There are fundamental areas of disagreement between the ACP and EU and significant imbalances in power and capacity between the two sides.

Unbalanced negotiations

From the start, the EPA negotiations have been extremely unbalanced. The dependence of Malawi and most other ACP countries on the EU for market access and development assistance makes it difficult for them to resist aspects of EPA negotiations which may be against their interests, let alone be able to promote their own interests. In addition, the EC is not deterred by the fact that the ACP contains some of the poorest countries in the world: it insists on pursuing a tough negotiating approach, putting immense pressure on ACP countries to negotiate on its terms.

Unequal negotiating capacity

Trade negotiations are by nature extremely complex and countries require vast technical and human resource capacity to negotiate adequately. MEJN's research concluded that EPAs have put considerable additional strain on an already stretched Malawian trade negotiating team. Malawi's EPA negotiations are led by the Ministry of Trade and Private Sector Development (MTPSD). The Ministry has only two experienced negotiators responsible for all of Malawi's trade negotiations (EPAs, WTO, COMESA, etc). One full-time officer is assigned to coordinate consultations and input from other key ministries, civil society organisations and private sector forums.

Civil society and private sector organisations interviewed in Malawi expressed concern that the MTPSD has very limited capacity to negotiate a favourable trade agreement for Malawi through EPAs. The workload is simply too vast for the limited resources available. Arguably linked to the issue of capacity, many stakeholders from civil society and the private sector in Malawi felt that there has not been enough debate at the national level, nor has there been enough consideration about what the impact will be on livelihoods, employment and poverty.

Disagreement over 'development'

Both the EU and ACP have said that EPAs are to be ‘tools for development’. However, there is serious disagreement between the parties on the practical implications of what this means. For the EC, the development component of EPAs is a process driven by trade liberalisation, regional integration and more stringent trade and investment rules. These will lead to greater efficiency, attract investment and promote development according to the EC.

However, ACP governments hold that this viewpoint ignores the structural deficiencies and supply-side constraints (eg poor infrastructure and roads, transport costs etc) that they face - the factors that have stopped them from taking advantage of the preferential access to Europe’s markets that they’ve had over the past 30 years. For the ACP, development implies *inter alia* the provision of special and differential treatment (poor countries are given special treatment in trade deals), more effective access to Europe’s markets and binding commitments on EU development support to help them deal with supply-side constraints and adjustment to EPAs.

However, the EC refuses to listen to such arguments and continues to forcefully push forward its agenda for the substantial opening of ACP markets.

Raised hopes of more funding

When asked what gains EPAs were likely to bring to Malawi, many of the Malawian government officials interviewed on Tearfund’s behalf said that the gains would come through increased aid to address supply-side constraints and to help to meet sanitary and phytosanitary SPS standards (health and safety standards that the EU says imports have to meet).

The ACP has been clear from the start on its need for development assistance: its guidelines for the negotiations state that the ‘development component is essential to an EPA... trade liberalisation entails for ACP countries certain economic costs such as the fiscal impact and adjustment costs, and capacity requirements that need to be addressed. Unless these are addressed, the benefits of an EPA for the ACP would be unrealisable and the EU would be the beneficiary of ACP trade liberalisation.’

Europe’s approach to the issue of development assistance, however, has been both contradictory and misleading. While the EC has implied strong links between aid and EPAs, raising the hopes of Malawi and other ACP countries of an increase in much-needed funding, it has gradually become clear that these hopes are misplaced and that the EC will not provide any new funds in the context of EPAs.

Additional development assistance: illusory

The EC has said that the costs of implementing and adjusting to EPAs will come from the 10th European Development Fund (EDF), the EU’s main mechanism for providing development assistance to ACP countries. €22.7 billion has been pledged for the 10th EDF that will begin in 2008. However, it was estimated that €21.3 billion was needed to fund the costs of the existing aid portfolio before consideration of any EPA-related financing (Oxfam International 2006). That means that if the EDF is to provide new funds for EPAs, these are funds that will have to be diverted from other areas such as health and education. In addition to concerns over the amount of EDF funds, there are significant problems with the process of the EDF, not least the time it takes to commit and disburse resources.

4. The EPAs debate: increasing concern

Parliamentarians and civil society from across the EU and ACP, as well as ACP governments themselves are expressing fundamental concerns about EPAs. For example,

- In April 2006, the African Union trade ministers expressed their ‘profound disappointment at the stance taken by negotiators of the European Commission in so far as it does not adequately address the development concerns that must be the basis of relations with Africa. We urge our negotiating partners to clearly demonstrate the development content of the proposed agreements...’
- In March 2006, a statement from civil society groups from across Africa declared that: ‘[EPAs will] expand Europe's access to ACP markets for its goods, services and investments; expose ACP

producers to unfair European competition in domestic and regional markets, and increase the domination and concentration of European firms, goods and services; thereby lead to deeper unemployment, loss of livelihoods, food insecurity and social and gender inequity and inequality, as well as undermine human and social rights; endanger the ongoing but fragile processes of regional integration among the ACP countries; and deepen – and prolong – the socio-economic decline and political fragility that characterises most ACP countries.¹

- In August 2006 the Malawi Farmers Union issued a statement on EPAs ‘urging the government and its partners in the Southern and Eastern African region to seriously reconsider the implications of these new trade deals before signing the deal with the European Union’.²

5. Poverty and vulnerability in Malawi

Malawi is one of the poorest countries in the world, ranking 166 out of 177 countries on the UN’s Human Development Index in 2006. Its Gross Domestic Product (GDP) is approximately €1.43 billion. GDP per capita is merely €112. Many women, men and children in Malawi are extremely poor (see Box 2) and many suffer from food insecurity. Over the last five years, Malawi has faced periodic food shortages, with millions of people needing to rely on food aid. Many men and women lack access to productive assets and opportunities for economic empowerment.

Box 2: Poverty and vulnerability in Malawi

- 65 per cent of Malawi’s 12.6 million inhabitants live below the poverty line.
- Life expectancy at birth is 39.6 years.
- Access to adequate healthcare is a major challenge: there are only two doctors per 100,000 people; one in ten babies dies at birth, two more will die before they are five.
- While primary education is free, class sizes are very large; only 25 per cent of young people enrol in secondary school (far fewer complete their secondary education); 36 per cent of adults are illiterate.
- Almost 30 per cent of people lack sustainable access to an improved water source; 40 per cent lack access to improved sanitation.
- 34 per cent of people are undernourished.
- The HIV and AIDS pandemic is a catastrophic challenge: approximately one in seven people in Malawi is HIV-positive.

Source: Statistics from the UN’s Human Development Report 2006

6. Malawi’s economy and trade

- Malawi’s economy remains heavily dependent on rain-fed agriculture. The sector contributes just less than 40 per cent of GDP and employs 81 per cent of the total labour force (UNCTAD 2006a). It accounts for more than 90 per cent of export earnings (Mbekeani 2005).
- The industrial sector remains small, having shrunk considerably since the 1980s. The share of industry in GDP has declined from 31.5 per cent in 1992 (Mbekeani 2005) to 14.9 per cent in 2003 (UNCTAD 2006a).
- The service sector has grown and is now the main contributor to GDP, accounting for 46.7 per cent (UNCTAD 2006a). However, its contribution to employment remains small with agriculture continuing to be by far the greatest income-earner for most Malawians.

Malawi’s economic growth performance over the last few decades has generally been weak. While recent years have seen a concerted effort by the government to bring about stability in the economy and to stimulate economic growth, Malawi’s economy remains extremely vulnerable on several counts. Its dependence on a small basket of raw agricultural exports (see below) makes it vulnerable to fluctuations in world commodity prices, and its dependence on rain-fed agriculture means that it is also extremely vulnerable to changing climatic conditions. Malawi is highly dependent on Overseas Development Assistance (ODA), receiving €359.17mil in 2004, a quarter of total GDP (UNDP 2006).

¹ *A Global Call for Action to Stop EPAs*, Harare, March 2006 http://www.bilaterals.org/article.php3?id_article=4297

² Quoted in *The Nation* newspaper, 16 August 2006, Malawi

Overview of Malawi's trade

Malawi's exports are dominated by unprocessed, low-value agricultural commodities. The main export crop is tobacco, accounting for around half of Malawi's total goods and services exports (UNCTAD 2006a), followed by sugar, tea and cotton. Manufacturing exports account for only ten per cent of total exports. These include textiles and clothing and, to a lesser extent, furniture and processed food products (Mbekeani 2005). Malawi's main export markets are the EU (40.5 per cent), the USA (15.7 per cent), South Africa (10.4 per cent), Egypt (6.6 per cent) and Japan (5.3 per cent) (UNCTAD 2006b).

Malawi's imports are dominated by manufactured goods and industrial equipment. Again, there is high concentration in a few major goods. Key imports are vehicles (and parts), petroleum fuels, various types of machinery, fertiliser, packaging materials, pharmaceuticals, iron and steel, wheat flour and cement. In terms of imports, Malawi's main trading partner is South Africa (45.2 per cent) followed by the EU (12.8 per cent), India (7.3 per cent), Tanzania (4.6 per cent) and Zambia (4.1 per cent) (UNCTAD 2006a).

It is important to note that the regional market (the Common Market for Eastern and Southern Africa – COMESA) is increasingly becoming an important export and import market for Malawi. Intra-COMESA trade increased by 10% in 2004 and a further 9-10% in 2005, bringing the total such trade to €4.1 billion or 7 per cent of the total global trade of COMESA member states (COMESA 2006). For years, Malawi's imports have exceeded its exports and as such it faces a sustained trade deficit, largely financed by the inflow of donor funds.

Trade with Europe

Trade with Malawi accounts for just 0.01 per cent of EU world trade. However, from Malawi's perspective, the EU is an important trading partner: it is the single largest market for Malawi's exports and a key source of imports. Thus, the stakes in EPAs are much higher for Malawi than for the EU.

Malawi exports predominantly raw agricultural commodities to the EU. In fact, 97 per cent of exports to the EU are made up of just three commodities: tobacco (69 per cent), sugar (16 per cent) and tea (12 per cent). The EU is also the source for a number of key imports for Malawi (13 per cent of total imports come from the EU). These are predominantly higher-value capital goods.

As an LDC Malawi benefits from the EU's Everything But Arms (EBA) initiative, an extension of the EU's Generalised System of Preferences (GSP) (this is a system whereby the EU can give better market access to developing countries than developed countries). Under EBA, Malawi has duty- and quota-free access to Europe's markets for all products except arms and munitions (ie it doesn't have to pay any tax to export to the EU or have any limit on the amount of goods it can export). The only other exceptions are sugar and rice for which LDCs will be given duty- and quota-free access in 2009.

Supply-side challenges

Malawi's ability to trade in a way that will promote development is constrained by crippling supply-side constraints. As a landlocked country, transport costs are extremely high, accounting for up to 40-60 per cent of total production costs. Malawi also suffers from poor infrastructure, unreliable public utilities and production inefficiencies. In addition, exporters struggle to meet the sanitary and phytosanitary (SPS) measures required to export to many countries (health and safety standards).

Malawi's development strategy

The new Malawi Growth and Development Strategy (MGDS) identifies five broad themes: sustainable economic growth, social protection of the most vulnerable people, social development, rehabilitation and development of infrastructure and provision of good governance. Key trade-related components of the strategy include:

- A focus on the following sectors to increase employment and bring about economic growth:
 - Mining – a focus on increased production and value-addition.

- Integrated cotton industry – with the aim of increasing production of garments made from locally woven cotton cloth as opposed to imported synthetic fabrics.
 - Manufacturing – the objective being to lay the foundation for manufacturing to ‘take off’.
 - Agro-processing – with a particular focus on tea, cotton, tobacco and sugar.
 - Private sector growth – with the aim of increasing the number of firms which are producing goods that are competitive in terms of prices and quality in regional and international markets; also, an increase in domestic firms producing for export and the domestic market.
 - Tourism – with the aim of establishing Malawi as a principal and leading eco-tourism destination in Africa and increasing domestic tourism.
- Agricultural activity will be improved to promote food security, and the productivity of rural communities and businesses will increase to boost employment and income.
 - Regional integration is also recognised as a key element in achieving sustainable economic growth.

It is clear that trade, both domestic and international, has a major role to play in Malawi’s development and the right trade policy is critical to Malawi’s economic growth and poverty reduction. Tearfund’s report aimed to assess whether an EPA would help or hinder the Government of Malawi in achieving these aims.

7. Malawi’s experience: lessons to be learnt

Malawi embarked on a path of trade liberalisation in the late 1980s, a route initially imposed by the International Monetary Fund (IMF) and World Bank’s structural adjustment policies, later reinforced by the multilateral trade negotiations at the WTO.

During the 1990s, tariffs (taxes on imports and exports) were reduced and non-tariff barriers (other barriers to trade) were removed. The rationale championed by the international institutions and donor governments was that lower tariffs would lead to increased competition, production and economic growth. Agricultural marketing policies were also liberalised including the removal of price controls and subsidies for farmers.

Various studies have recorded the largely negative impact of these liberalisation reforms forced on Malawi. In terms of the impact of import liberalisation, Malawi’s manufacturing sector suffered a great deal as a result. A study carried out for the UN found that total manufacturing production shrank from an annual average of €404.2 million during the period 1989-1991 to €221.7 million in 1998 (Mbekeani 2005). Exports of manufactured goods halved from €6 million in 1988 to €3 million in 2001. According to the study’s author, ‘This is a reflection of the negative impact of liberalisation on local manufacturers, who failed to compete with imports in the domestic market and did not have enough capacity to produce for exports. Consequently, most of them were forced to close down’.

More than 40 manufacturing companies folded between 1994 and 2002.³ With each factory that closed, many jobs were lost. In the textiles sector, for example, 40,000 people were laid off. Backward linkages affected farmers who produced the raw materials the factories used. Many farmers lost important markets for their crops. Loss of livelihood and employment increased the poverty and vulnerability of those directly affected who were unable to find other sources of income. It is also important to consider the impact that such deindustrialisation had on the wider economy negatively affecting Malawi’s population more broadly.

An argument often used in favour of trade liberalisation is that it leads to cheaper consumer goods such as food products, electronic products and clothes. It has been difficult to assess whether this was the case in Malawi. Mbekeani (2005) suggests that consumers did not benefit because various taxes meant that the final purchase price of imported products either remained the same or increased. One respondent

³ Malawi Confederation of Chamber of Commerce and Industry (2002), cited in Gondwe and Magalasi (2006)

interviewed in Malawi suggested that there may have been price decreases but in terms of the goods affected (electrical products etc) it seems that only the elite benefited from any price cuts.

Since these trade liberalisation reforms were imposed on Malawi most Malawians have become poorer and more vulnerable to food insecurity. The promised increase in production, trade, economic growth and poverty reduction has not materialised. Instead, Malawi has experienced deindustrialisation, unemployment and increased dependence on low-value raw commodities. Even the World Bank (2003) admits that while Malawi carried out its structural reforms during the 1990s ‘the full macroeconomic stability and sustainable growth proved elusive. All the social and education indicators deteriorated. Infant mortality rates, adult illiteracy, malnutrition and poverty remained very high.’

8. Costs of EPAs to livelihoods, jobs and Malawi’s future industrial development

Increased exports from EU

The quantitative studies assessed for the Tearfund report all show that the EU stands to gain significantly in terms of increased exports into Malawi’s market. Increased imports from the EU are likely to have significant impacts on Malawian producers as the more efficient EU producers and exporters supplant producers who have not yet built up their capacity to produce competitively and who are not yet benefiting from economies of scale.

Some studies show that consumers could gain from lower prices from cheaper imports (the so-called welfare gain). However, they conclude that this gain is low when compared with the potential losses in terms of livelihoods, employment and policy space (see below). It is also important to note that in countries such as Malawi where the labour force is mostly agricultural, there is no clear distinction between consumers and producers. The benefit of some cheaper products being available is likely to be negated by lack of purchasing power due to a low earnings or unemployment.

Impact on agriculture

Agriculture is the backbone of Malawi’s economy, with most poor people relying on it as a source of both subsistence and livelihood. Small-scale farmers and farmers’ associations from a cross-section of industries (tea, cotton, coffee, tobacco, sugar) were interviewed for this report. The problems they faced were similar across the board – low selling prices, lack of access to value-adding activities, problems in accessing markets and high costs of inputs (fertilisers and seeds). In terms of exporting, the problems cited by farmers’ associations were high transport costs, poor infrastructure and difficulties in meeting SPS standards (health and safety standards that the EU says imports have to meet).

In terms of agricultural exports to the EU, Malawi is unlikely to benefit from an EPA as it already has duty-free, quota-free market access under EBA. This scenario will only change if the impediments that Malawi currently faces in exporting are addressed. Many exporters in Malawi feel that realistically they do not have the capacity to expand exports into the EU market and that the regional market (COMESA) is a more realistic and achievable goal. They see the regional market as a ‘springboard’ on which to build their capacity before they can take on the EU market competitively. Yet EPAs threaten to harm even these regional markets (see below).

As we’ve seen, Malawi exports predominantly low-cost raw agricultural commodities to the EU and imports much higher-value finished products. To move away from a reliance on commodities whose prices are low and highly volatile, Malawi needs to add significant value to its products before exporting. Yet as we explain below, an EPA is likely to hinder this. Thus, in terms of agriculture, an EPA threatens to reinforce and ‘lock in’ the scenario whereby Malawi exports cheap low-cost commodities to the EU and imports high-value goods.

In addition, Malawi’s agriculture may well be threatened by farm goods (in particular wheat and dairy products) entering from the EU and undercutting local producers. Europe’s farmers benefit greatly from subsidies under the Common Agricultural Policy (CAP), giving them an immensely unfair advantage over

Malawi's farmers. Yet the EC has made it clear that Europe's subsidies cannot be discussed in EPAs. Crucially, an EPA will also further undermine the ability of the government of Malawi to use agricultural tariffs (taxes on imports) to protect livelihoods and food security in the future.

Impact on industry

Above, we've described the decline of Malawi's manufacturing sector since the early 1990s, due in large part to the fast-paced liberalisation policies imposed on the government of Malawi from the late-1980s onwards. We've also seen that the EU exports predominantly manufactured goods into Malawi and thus increases in exports as a result of EPAs are likely to be largely in manufactured goods. This will have a detrimental impact on Malawi's manufacturing sector as its domestic industries struggle to withstand competition from EU imports.

Data for the industry and manufacturing sector in Malawi is scarce, but according to the United Nations Industrial Development Organisation (UNIDO) the sector was employing 82,913 employees in 2001.⁴ Based on an approximate family size of six members per household in Malawi, this translates to around 500,000 Malawians benefiting directly from the sector (four per cent of the population). However, further liberalisation through EPAs puts these jobs at risk. Based on Malawi's past experience of deindustrialisation, many people interviewed in Malawi for this report fear that EPAs will lead to increased unemployment. The Malawi Chamber of Trade Unions (MCTU), for example, expressed grave concern about the threat to jobs if Malawi was to undertake more trade liberalisation on European goods and services.

The impact goes far beyond current employment. Policy space (or freedom to choose the policies that it feels will best serve its population) risks being lost through EPAs. Malawi is trying to revive its manufacturing sector. The MDGS recognises industry and manufacturing as key to the country's development. The aim is for Malawi to move away from exporting raw materials to manufacturing and adding value. To do this a variety of policy measures – including tariffs (taxes on imports) – may need to be adopted to protect and support these industries. Malawi needs to retain the policy space to raise and lower tariffs according to its development strategies and priorities. Yet an EPA would prevent the government from using tariffs in this way and in so doing threatens to hinder Malawi's future industrialisation efforts.

What about asymmetry?

As we explained above, the EU will allow for an asymmetrical approach to calculating 90 per cent of the total average value of trade and the ACP may be given a slightly longer timeframe in which to liberalise. However, Tearfund does not believe that this will provide a pro-development deal for Malawi. Firstly, the government of Malawi will have to determine what it protects from liberalisation and what it includes on its 'sensitive list'. Decisions will have to be based on an assessment of existing production and trading patterns, as it is very difficult to predict how these patterns will change over time. There are a number of factors to consider and difficult choices to be made: Should the main factor be tariff revenue? Should its rationale be food security and the protection of staple foods? Should it try to protect the few industries Malawi has? Or be thinking about future industrial development? Choices in favour of one criteria mean losses in other areas.

The EU may alter the timeframe slightly. However, even if it was extended to 20 years, it is impossible to predict Malawi's situation two decades from now. The extent to which Malawi and other developing countries liberalise their trade should be based on their development needs and be in line with their national development strategies, not determined by imposed timeframes and product coverage.

Secondly, ESA countries may need to agree regional positions on which products to liberalise or protect. Countries in ESA have different priorities for the products they will select for exclusion from liberalisation. One study analysed the regional overlap of products to be exempted between ESA

⁴ This is likely to be an underestimate as much economic activity by the informal sector in Malawi goes unrecorded.

countries and found it to be rare. Major compromises will be necessary if ESA is to reach a common position. In the end, Malawi may have little choice in what it can protect. If, however, ESA decides not to reach a regional position and each country develops its own sensitive list of products to protect, this could have major implications on regional integration as the next section shows.

9. Costs of EPAs to regional integration

Malawi and other African countries have recognised the benefits of regional integration and are in the process of developing Regional Economic Communities (RECs). Regional trade agreements can bring benefits such as promoting the pooling of resources, increased intra-regional trade and investment, enabling countries to add value to products and greater diversification. Regional integration is a key development strategy for Malawi, as highlighted in the MGDS. Private sector respondents interviewed in Malawi for this report also underlined its importance as a means to help them build their capacity to trade competitively and profitably before attempting to compete further afield. For example, Simon Itaye, Chairman of Malawi's National Working Group on Trade Policy, said, 'Logistically alone, we do not see the EU as a profitable market... we would rather concentrate on our neighbours before we can think of anyone else or anywhere else to trade.' This is because Malawi's 'neighbours' are countries at much more comparable levels of development. Opening markets and trading with countries in the region will allow Malawi's industries and agriculture to grow and build up competitiveness in order to compete effectively in global markets.

ACP governments, civil society in the global North and South and the EC all agree that regional integration is a good thing. However, there are significant differences in understanding as to how this can be attained and whether EPAs, as reciprocal FTAs, will contribute to or harm this process. The evidence is increasingly proving the latter.

Trade diverted away from ESA

Above we highlight the major increase in imports from the EU that Malawi is likely to experience as a result of EPAs. A UN study found that this result is common to all countries in the ESA region. Yet a significant proportion of the EU's trade gain comes from trade diversion from other ESA countries. For example, producers in Malawi exporting to Zambia would risk losing their market to European exporters. The study shows that, as with all ESA countries, Malawi's imports from ESA and the rest of the world decrease, while imports from the EU increase significantly. Thus, the ESA EPA is likely to have significantly negative effects on current trade between ESA countries and on their potential to build future regional markets.

Trade barriers between ESA countries reinforced

One research study by a university in the UK shows that EPAs may result in countries having to reinforce rather than eliminate barriers to trade between them (Stevens 2006). The effects for Malawi are dependent on whether ESA will need to create a regional position on which products to protect or whether ESA countries can determine their own sensitive lists. A regional position is likely to prove extremely difficult for ESA to agree. However, if countries determined their own sensitive lists, in order to ensure that cheap European goods weren't coming in via their neighbours, they would have to keep rigorous border controls. This will harm Malawi's current trade with its neighbours and will limit the potential of intra-regional trade to develop in the future.

Existing regional integration processes hindered

Regional integration processes in Africa are complex and many countries are members of more than one economic group. Malawi is a member of both COMESA and SADC, as are a number of countries in the region. The ESA group, which exists only for the purpose of negotiating an EPA, has both COMESA and SADC members and the SADC EPA grouping contains the remaining SADC members. The overlapping membership of various regional integration organisations with diverging integration agendas is clearly a key challenge for countries in the region. It is impossible for a country to be a member of two customs unions at the same time and, as SADC and COMESA move towards becoming CUs, Malawi will have to choose between them.

Regional integration in Africa is important. However, it is complex both economically and politically and Malawi and other countries in the region need time to clarify their integration agenda before entering into regional agreements with the EU. Regional integration should take place at an internally driven pace, not one imposed by the EU. However, EPAs threaten to hinder rather than help regional integration processes by forcing them through at an unrealistic pace.

10. Costs of EPAs to government revenue

Loss of tariff revenue

Trade taxes in the form of import duties contribute about 12 per cent of Malawi's total revenue base (excluding grants) (Imani 2005). Taxes from trade with the EU represent 5 per cent of total tariff revenue (Zgovu and Kweka 2006). The studies show that Malawi is likely to lose around €6.1 million per annum in tariff revenue on the EU imports that were previously taxed.⁵ While at first glance this figure may not seem extortionate, for a country as poor as Malawi, this represents a significant contribution to the revenue base. To put it in context, Malawi's national budget allocations for 'protected pro-poor expenditure on agriculture' (food security initiatives, agricultural extension, technology generation and technical services) for the past three years has been around €5.28 million annually. This sum is in addition to the revenue loss arising from diverted trade towards the EU which is likely to be substantial. One analysis stipulates that such revenue loss could be around €45.3 million.⁶

Malawi is likely to find it difficult to replace the lost revenue. The adjustment costs of undertaking tax policy and administration reforms are significant in terms of both finance and human resources. If Malawi was unable to raise revenue in other ways, there would have to be a reduction in fiscal expenditure with the likely knock-on effects on social spending. It is poor women, men and children in Malawi who will be hardest hit by the loss of government revenue. The government's capacity for spending on education, health, water and sanitation is already woefully inadequate. Any further decrease in its budget will worsen this problem.

Adjustment costs

EPAs also present other significant impacts on government revenue. Research by the Commonwealth Secretariat calculated that it would cost Malawi €135 million to adjust to the negative impacts of EPAs (Milner 2006).

11. Beyond goods tariffs: other areas of negotiation

The EC's vision for EPAs goes far beyond the lowering of goods tariffs. The EC is also pushing for the liberalisation of ACP countries' service sectors, as well as the inclusion of new areas, the so-called 'Singapore issues', which have been rejected by developing countries at the WTO for years.

Services

While under the Cotonou Agreement and WTO rules, EPAs do not have to include services, ESA is negotiating services as part of an EPA. There has been very little analysis of the implications of including services in the EPA negotiations and the Tearfund report does not seek to assess impact in this regard. However, it raises a few points of caution.

Firstly, Malawi needs to maintain flexibility in the policy tools it can choose to use related to services. For example, it may wish to protect its infant services industries as part of a diversification strategy away from reliance on low-cost raw agricultural commodities. Malawian services industries risk collapse if faced with unequal competition before they've had the opportunity to grow and develop. Furthermore, maintaining effective domestic industries is an important tool for promoting competition.

⁵ Imani (2005), Karingi *et al* (2005), Gondwe and Magalasi (2006)

⁶ IMANI (2006) cited in Gondwe and Magalasi (2006)

Secondly, Malawi's 'sensitive service sectors' – essential services such as water and healthcare – are of vital importance. There has been great concern over the pressure on developing countries to liberalise such sectors and increasing evidence to show that governments need to exercise tight control if they are to ensure universal access to these essential services for their populations. Liberalisation of essential services can result in higher prices for consumers and concentration of services in urban areas. The consequence is often that poor people are unable to access them.

For Malawi to reap the benefits of market access opportunities and increased competition from services liberalisation, and to mitigate the potential negative impacts, certain conditions need to be in place. Of critical importance is the existence of adequate supporting regulatory frameworks and institutions to ensure development objectives are met. However, Malawi's regulatory frameworks and institutions need strengthening significantly before such aims can be assured. Other important factors are a supportive physical infrastructure, and sufficient supply capacity and competitiveness. Again, these are areas in which Malawi needs substantial development and without which services liberalisation could have serious repercussions.

The Singapore Issues

At the WTO the EU has tried to force developing countries into negotiations on the so-called Singapore issues of investment, competition policy and transparency in government procurement. Developing countries have consistently rejected this agenda.

Despite this opposition, and the fact that there is no WTO requirement to include them in regional trade agreements, the EC continues to push aggressively for negotiations on the Singapore issues in EPAs. Some of the reasons against the inclusion of such issues in EPAs are outlined below. In addition, there are also concerns that negotiations on these issues would place a large burden on the already over-stretched negotiating capacity of ACP countries and that the implementation costs of any new agreements would be very high.

Investment

The EC is pushing for rules-based investment agreements in EPAs, arguing that such agreements will help developing countries attract more investment, which would in turn lead to increased economic growth. However, much more important in influencing FDI than investment agreements are factors such as weak physical, social and administrative infrastructure; the costs of asset development; vulnerability to shocks; and lack of business support services.

Furthermore, when foreign investment does take place under rules-based agreements, its impacts are by no means automatically developmental. Indeed there are many potential costs and such agreements have in the past limited the ability of developing country governments to manage foreign investment to serve their development interests.

Malawi needs investment – both domestic and foreign. However, the EU's proposals for rules-based investment agreements of the investor protection variety in EPAs would lead to rules that determine the way in which Malawi and other ESA countries can select and regulate foreign investors. The government's control over the entry of foreign investors and types of investment into the country would be curtailed and its ability to give preferential treatment to local firms, or to channel foreign investment in certain directions, would be limited.

Public procurement

The EU is pushing hard for the inclusion of public procurement in EPAs. Given the potential size of the market for EU companies, this is a clear offensive interest of the EU. However, public procurement practices can be used as a tool for development. For example, they can be used to direct expenditure to locally produced materials, or to target certain groups or communities that are marginalised economically. Alternatively where foreign firms are invited to bid, a government may choose to give the award to firms

from particular countries (for example, other developing countries). Liberalisation of public procurement within an EPA would limit and even prohibit the use of this tool by the government of Malawi.

Competition policy

Competition law and policy are necessary and beneficial, for example, to curb the mega-mergers and acquisitions that threaten the competitive position of local firms in developing countries. However, locking competition policy into trade agreements risks curbing the right of governments to provide advantages to local firms and to help them develop and become more competitive. It also risks preventing each country from having the flexibility and choice to select a competition model appropriate to their economic and social development needs which can be adapted through time in response to changing conditions.

12. Has Malawi anything to gain from an EPA?

An EPA threatens to increase Malawi's dependence on the export of low-value raw commodities and result in the inflow of cheap, subsidised European farm goods undercutting local producers. Moreover an EPA poses a real threat to Malawi's weak manufacturing sector and could severely hinder Malawi's future industrialisation efforts. Malawi needs the policy freedom to develop its own self-driven policies that deliver economic growth and poverty reduction: an EPA will significantly reduce this policy space both in terms of tariff policy and other policies to regulate investment and to support domestic industry and firms (through negotiation of the Singapore issues). The ESA EPA is also likely to have significant negative effects on current trade between ESA countries and on their potential to build future regional markets. This undermines a fundamental development strategy that African governments have embarked on in regional integration programmes. An EPA will also result in significant revenue loss for Malawi: through tariff revenue loss on current imports from the EU and on imports diverted to the EU from elsewhere, and through adjustment costs.

Potentially, Malawi faces huge losses. Gains, on the other hand, are hard to find. EPAs will not help Malawi address its supply-side constraints: there will be no binding commitments of additional aid. In terms of market access, Malawi, as an LDC, already has duty-free and quota-free access to the European market through the EBA initiative. An EPA may improve market access in terms of offering better rules of origin and would offer more legal certainty of market access. However, the price to pay in terms of jobs, livelihoods and future development prospects would be very great.

What Malawi and other ACP countries may also see as a gain from an EPA is the avoidance of the political or diplomatic ramifications of *not* signing up to one, most notably the potential loss of development aid. The fact that this is a consideration is a scandal and the EU should make firm commitments to ACP countries that they will not lose aid as a result of rejecting an EPA.

Malawi has much to lose and little to gain from an EPA. The losses outlined above all represent substantial blows to the Malawian economy as a whole, but more importantly the effects will be felt most by poor people: the men and women who will lose livelihoods and employment and those who will remain trapped in the vulnerable position of producing low-cost commodities. Moreover, if Malawi is unable to boost its economy by developing agro-industry and manufacturing, its government will be unable to improve basic services such as hospitals and schools, or provide safe water and sanitation. Here again, it is poor people who will feel the worst effects.

13. What alternative for Malawi?

As an LDC, Malawi can in theory opt out of an EPA and remain with the duty-free, quota-free access it has under the EU's EBA initiative instead. However, as it stands, the EBA is non-contractual and could be amended or withdrawn at any time by the EU without negotiation or notification. It thus offers no legal certainty to Malawi. For the EBA to be a developmental alternative to an EPA it would need to be made contractual at least. It also has onerous rules of origin that act as a restraint to exports: these would need to be addressed. Also, opting for EBA may pose a substantial risk to Malawi's integration in the region: if Malawi decided not to sign an EPA, but its neighbours did, it would still feel the effects of EU

imports entering its markets unless it put in place robust and costly border controls to prevent trans-shipment. This would clearly act as a harmful and costly disincentive to regional trade integration.

ACP governments have called for the EC to provide them with alternatives to EPAs. To date, however, the EC has adamantly refused to explore alternatives. For Malawi and other developing countries to make an informed choice of whether to sign up to an EPA, they need to be able to consider what other options are available. The EU needs to explore all possible alternatives to the current EPAs that are on the table.

14. Conclusion and recommendations

The Cotonou Agreement between the EU and ACP has the principal objectives of reducing poverty and promoting sustainable development of the ACP countries and their gradual integration into the world economy. However, in the grossly unbalanced negotiating dynamic between the EU and the ACP, the EC is using EPAs to force liberalisation commitments onto ACP countries, far beyond what they have committed at the WTO, and to force their agenda on the long-resisted Singapore issues. This report, using Malawi as a casestudy, has shown that while EPAs are cloaked in the language of partnership and development, they will not contribute towards these ends. We have seen that Malawi has little to gain and much to lose from an EPA with the EU.

From the start of the EPA negotiations, ACP governments have raised serious questions and concerns over both process and content, many of which are highlighted in this report. However, negotiations continue while fundamental questions remain unresolved and major concerns are left unaddressed. Given the harm that EPAs pose to development and poverty reduction and the concerns being raised by stakeholders across the ACP, Tearfund makes the following recommendations:

Recommendations to EU member states and the EC

EU member states and the EC should:

- seek a framework for EU-ACP trade that includes:
 - Market access for the ACP to European markets that is no worse than they currently have, with legal certainty and the removal of certain non-tariff barriers.
 - No requirements on ACP countries to open their markets in return. This is in order to protect livelihoods and promote food security. It would also allow ACP governments to use tariffs as part of development policy to promote diversification from low-cost commodities and develop of manufacturing and industry.
 - No requirements to negotiate on the Singapore issues.
- provide increased development assistance to ACP countries to adjust to preference erosion, to address supply-side constraints and to build regional integration. The EU should improve the delivery mechanisms for this aid and should make clear guarantees that this assistance is in no way contingent on the signing of an EPA.
- examine all alternatives to EPAs as a matter of urgency so that developing countries have a genuine choice as to whether or not to sign up to an EPA.
- ensure EPAs are a key priority of the German and Portuguese presidencies of the EU in 2007 to ensure that the ACP-EU trade relationship is one that promotes sustainable development.
- not use the deadline of the WTO waiver expiry to pressure the ACP to sign up to trade agreements that will harm development. Proper time should be allowed in the negotiations for a new ACP-EU trade framework to ensure full consultation of all stakeholders – including civil society and parliamentarians, and to carry out full and thorough impact assessments.
- respect the regional integration processes already underway in Africa and ensure that any future ACP-EU trade framework does not undermine these processes.

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