

**MULTILATERALISM VERSUS REGIONALISM: AN APPRAISAL OF
ETHIOPIA'S FOREIGN TRADE POLICY OPTIONS**

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Law at the School of Law, Addis Ababa University

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SCHOOL OF GRADUATE STUDIES
SCHOOL OF LAW

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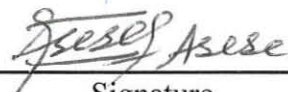
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DECLARATION

I declare that "Multilateralism versus Regionalism: An Appraisal of Ethiopia's Foreign Trade Policy Options" is my own work and has never been presented before for any degree or examination in any other university and that all sources of materials used have been duly acknowledged.

Name: Henok Birhanu Asmelash

Signature:  _____

Date: February 2010

To my late mother Fikirte Debela

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Acronyms and Abbreviations

ACP	African, Caribbean and Pacific
ADLI	Agricultural Development Led Industrialization
AEC	African Economic Community
AGOA	African Growth Opportunity Act
AU	African Union
CET	Common External Tariff
COMESA	Common Market for Eastern and Southern Africa
CRTA	Committee on Regional Trade Agreement
CU	Customs Union
DTIS	Diagnostic Trade and Integration Study
EAC	East African Community
EBA	Everything But Arms
EPA	Economic Partnership Agreement
EPDRF	Ethiopian People Democratic Revolutionary Front
EU	European Union
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
IEPA	Interim Economic Partnership Agreement
IF	Integrated Framework
IGAD	Intergovernmental Authority on Development
IMF	International Monetary Fund
LDC	Least Developed Country
MFN	Most Favoured Nation
MFTR	Memorandum of Foreign Trade Regime
MOFED	Ministry of Finance and Economic Development
MOTI	Ministry of Trade and Industry
NAFTA	North American Free Trade Area
NBE	National Bank of Ethiopia

PASDEP	Plan for Accelerated and Sustainable Development to End Poverty
PTA	Preferential Trade Agreement
RTA	Regional Trade Agreement
SADC	Southern Africa Development Cooperation
SDPRP	Sustainable Development and Poverty Reduction Programme
SDT	Special and Differential Treatment
SFC	Sana'a Forum for Cooperation
TGE	Transitional Government of Ethiopia
TRIPs	Trade Related Intellectual Property Rights
UNCTAD	United Nations Committee on Trade and Development
WTO	World Trade Organization

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Chapter One

Introduction

1.1. Background of the Study

Trade liberalization can be accomplished in a number of ways. Unilateral, bilateral, regional and multilateral strategies have all been employed by different countries at different times. However, for the last fifty years, it has been economic orthodoxy that the best route to trade liberalization is through multilateral negotiations within the structure formerly provided by the General Agreement on Tariffs and Trade (GATT) and then by the World Trade Organization (WTO).¹

Several countries wishing to promote trade have liberalized their trade regime, albeit in varying degrees, multilaterally based on the cardinal principle of non discrimination. But, as membership in the multilateral trading system grew from the original 23 countries to more than 100, and as it began to address more complex and difficult issues, such as non tariff barriers, intellectual property rights, services and agricultural trade, the difficulty of negotiating reductions in trade barriers at the multilateral level increased. This increased difficulty led the traditional wisdom regarding multilateralism as the first best route to trade liberalization to be called in to question.

Regional Trade Agreements (RTAs) have therefore been put forward as being a more practical and feasible route to reach broad liberalization. Accordingly, they proliferated all over the world within a short period of time to become one of the two pillars of the international economic order, together with the multilateral trading system. Their proliferation has continued unabated since the early 1990s, and some 474 RTAs had been notified to the WTO up to September 2010.²

Countries wishing to integrate their economy with the global economy through reciprocal trade liberalization are therefore faced with the strategic question of whether to opt for the regional or the multilateral route. The impact of integrating through the regional and multilateral system as well as the interplay between the two trading systems is however a subject of an ongoing debate.

¹ Kim HeeMin and Smith Dale (1997), *Blocks or Rounds? An Analysis of Two Approaches to Trade Liberalization*, Canadian Journal of Political Science, Vol. 30, No. 3, P. 427

² WTO, *Regional Trade Agreements*, available at http://www.wto.org/english/tratop_e/region_e/region_e.htm, last visited on 20 September, 2010

1.2. Statement of the Problem

Since the early 1990s, Ethiopia has embarked up on comprehensive socio-economic and structural reforms, aimed at stabilizing and transforming the economy from a command economy to a market-oriented one. Trade policy reform has been one of the key components of these reforms and the country has undertaken far reaching unilateral trade liberalization measures over the last twenty years. However, its participation in the global economy has been very limited.

Cognizant of this fact and in a bid to boost economic growth and eradicating poverty, the country has initiated a process of integration in to the global economy through two different types of avenues. At the multilateral level, Ethiopia has applied for membership in the WTO in 2003 and is still negotiating its way in to the organization. At the regional level, the country is currently involved in a process to join the Common Market for Eastern and Southern Africa (COMESA) Free Trade Area (FTA), negotiations to establish a FTA among the members of the Intergovernmental Authority for Development (IGAD), negotiations to establish a FTA with the European Union (EU) under the Economic Partnership Agreement (EPA) framework and in the study to establish a FTA among the members of the Sana'a Forum for Cooperation (SFC).

All these trade integration initiatives are being pursued simultaneously without any clear priority and sequence. The country's major development policies and strategies clearly underlined the importance attached to exports and the commensurate necessity of integrating the domestic economy with the global economy.³ However, neither of them set priority between the multilateral and regional trading arrangements for the attainment of these policy objectives.

This fact, among other things, raises two fundamental questions. First, which trading arrangement (i.e. the multilateral or regional) is best suited to bring larger benefits to Ethiopia? Second, whether or not sequencing the multilateral and regional integration process is essential for Ethiopia? And what is the appropriate sequence? This study craves to answer these questions.

³ MOFED (2005), Ethiopia: Building on Progress A Plan for Accelerated and Sustained Development to End Poverty (PADEP) 2005-2010, Addis Ababa, Ethiopia

1.3. Objective of the Study

The overall objective of this study is to assess the implications of Ethiopia's foreign trade policy options as reflected in the country's bid for membership in the multilateral trading system and different regional trade agreements. Assessing their general implications, relative merits, and the right sequence between the multilateral and regional integration initiatives are the central themes of this study. In so doing, the study seeks to address the following specific areas

- To explore the notion of trade liberalization
- To provide a brief discussion of WTO rules on RTAs
- To review the trade policy regime of Ethiopia
- To assess the general implications of Ethiopia's membership in the multilateral trading system and regional trade agreements
- To investigate the relative merits of multilateralism and regionalism
- To analyze the appropriate sequence between the multilateral and regional integration

1.4. Significance of the Study

Ethiopia is pursuing membership in the multilateral trading system and regional trade agreements with a view to integrate its economy with the global economy and thereby promote its twin development objectives of economic growth and poverty reduction. Although integration in to the global economy may serve as an engine of economic growth, it is almost a universal wisdom that trade liberalization presents both opportunities and challenges. Unlike the challenges, the opportunities are not automatic and depend on several other factors. Therefore, mechanisms to maximize the opportunities and mitigate the challenges always have a paramount importance.

In this context, identifying the particular trade integration route that serves the interest of the liberalizing country (i.e. Ethiopia) best and analyzing the appropriate sequence between the different trade integration initiatives the country is heading for, has a paramount significance.

1.5. Limitation and Scope of the Study

Discussion on multilateralism versus regionalism is inherently wide and extensive subject. Hence, a detailed assessment of the relative prospects and challenges of these two trading

systems can hardly be achieved under this study. The study is therefore limited to assessing the general implications of Ethiopia's multilateral and regional trade integration initiatives. In doing so, it briefly discusses the nature and other important features of these two trading arrangements and examines the implications of Ethiopia's multilateral and regional trade integration initiatives from trade in goods perspective, therefore, excluding trade in services and in intellectual property rights mainly because such issues are not adequately addressed at the regional level.

Regarding Ethiopia's regional trade integration initiatives, the scope of the study is limited to the country's aspiration to join the COMESA FTA, negotiations to join the proposed FTAs under IGAD and EPA framework and preparation to negotiate the establishment of a FTA under SFC.

Finally, the study does not discuss the political motivations of the country's multilateral and regional integration initiatives, mainly to accentuate on the economic and legal implications.

1.6. Methodology of the Study

This study is basically a theoretical based analysis of Ethiopia's foreign trade policy options with complete emphasis on the country's multilateral and regional integration initiatives. A combination of approaches (i.e. descriptive, analytical and comparative) has been employed to address the problems and achieve the objective mentioned earlier. The study uses; a descriptive approach to review the existing literature on the subject, an analytical approach to investigate the possible implications of the multilateral and regional integration initiatives, and a comparative approach to evaluate the relative merits of the multilateral and regional integration initiatives.

With regard to data sources both primary and secondary sources have been considered. Primary information was gathered from relevant government officials at MOTI and MOFED. The quantitative data are mainly collected from NBE, MOFED, COMESA, WTO, and UNCTAD.

As far as secondary sources are concerned, books, journal articles, working and discussion papers as well as annual reports from leading organizations/research centers such as the World Bank, IMF, WTO and UNCTAD and which are relevant to the study have been consulted. In this respect, the overwhelming majority of such sources used under this study are electronic copies.

1.7. Outline of the Study

The study is divided into five chapters. Chapter one, introduces the background of the study, the study problem, objective and significance as well as the scope and delimitations of the study.

Chapter two describes the trade policies of developing countries, the notion and the different forms of trade liberalization, and the nexus between trade liberalization and economic growth.

Chapter three explores the two pillars of the international economic order, multilateralism and regionalism. Particularly, it reviews the fundamental features of the multilateral and regional trading arrangements, and the interaction between the two. Furthermore, the chapter examines the legal provisions of the World Trade Organization governing Regional Trade Agreements.

Chapter four appraises the trade policies and regime of Ethiopia, mainly in the context of the trade liberalization measures that have been undertaken over the last two decades. The chapter will also describe the composition and direction of trade through the merchandise trade data.

Chapter five presents the assessment of the Ethiopian multilateral and regional trade integration initiatives, their possible implications, and relative merits. It will also accentuate the need for implementing the right sequence between the multilateral and regional trade integration initiatives, and examines the appropriate sequence between these two trade integration tracks.

Finally, the study draws together the overall discussions and examinations of Ethiopia's multilateral and regional integration initiatives and present its conclusion and recommendations.

Chapter Two

Trade Liberalization and Developing Countries

2.1. Developing Countries' Trade Policy: From Import Substitution to Export Promotion

Central to the free trade theory is the notion that international trade serves as an engine of economic growth as it promotes efficient allocation of resource through specialization and comparative advantage. According to this theory a policy of free trade would guide a nation to an efficient utilization of this trade opportunity.¹ The initial wave of such free trade argument traced back to the classical economic thought that started with Adam Smith and was subsequently enriched by the work of David Ricardo, Torrens, James Mill and Stuart Mill in the first half of the 19th century.² Since then, the justification for free trade and the potential benefits it brings to the productivity of nations have widely been discussed in the international economic discourse.

Faith in these benefits of free trade has encouraged many countries to adopt economic policies that promote greater trade and investment. However, that had not been the case for developing countries during the large part of the post World War period. Beginning in the 1950s and particularly, in the 1960s and 1970s the role of trade as an engine of economic growth was less felt by many developing countries.³ The free trade philosophy of the classical trade theory was viewed irrelevant and even an impediment to the economic prosperity of developing countries.⁴

During these periods, most developing countries were heavily specialized in the production and export of primary commodities and imported most of their manufactured goods.⁵ The export prices of primary commodities, however, tended to fluctuate heavily and lagged behind the price of manufactured trade goods.⁶ As a major cause of Balance of Payment (BOP) problems, the

¹ Bhagwati Jagdish (1989), *Is Free Trade Passé After All?*, Weltwirtschaftliches Archiv, Vol. 125, No. 1, P. 21

² Medina-Smith Emilio J. (2001), *Is the Export Led-Growth Hypothesis Valid for Developing Countries? A Case Study of Costa Rica*, Study Series No.7, United Nations, New York and Geneva, P.7

³ Krueger Anne O. (2009), *Trade Liberalization and Growth in Developing Countries*, Paper Prepared for Presentation at American Economic Association Meeting, January 4-6, New Orleans, p. 5

⁴ Dunn Robert M and Mutti John H. (2004), *International Economics*, 6th Edition, London and New York, Routledge Taylor and Francis Group, 236

⁵ Krueger, Anne O. (1997), *Trade Policy and Economic Development: How We Learn*, the American economic review, Vol. 87, No. 1, PP.1-22

⁶ Mailink Hank A. (1982), *The Effect of Import-Substitution: The Case of Kenya's Manufacturing Sector*, Discussion Paper No. 276, Institute for Development Studies University of Nairobi, p. 2

fluctuation and deterioration of the primary commodities' price was a major concern for most developing countries. Accordingly, it was insistently argued in the economic literature of the time that developing countries had to reduce their over reliance on primary exports, through diversifying their economic structure, if they were to achieve significant economic growth.

Encouraged by such arguments, policy makers in many developing countries concluded that the key to reduce such over reliance and ensure economic growth, was creation of a strong manufacturing sector, and that the best way to create that manufacturing sector was by protecting domestic manufacturers from international competition.⁷ The intellectual underpinning of this argument was rested in the "infant industry argument" of the nineteenth century. According to which, new industries in developing countries could not effectively compete with their established counterparts in the developed world. Hence, such industries need to be protected during their initial phase so as to gain a breathing space to grow up over time and become internationally competitive.⁸ To this end, reducing the role of trade by substituting domestic goods for previously imported goods with the help of high tariffs, a number of non tariff barriers and exchange rate policies was perceived as an optimal policy option for developing countries.⁹

Consequently, many developing countries in the 1950s and 1960s adopted a policy of import substitution industrialization, which, encouraged these countries to build up their own domestic manufacturing capacity, and substitute domestically produced goods for imports.¹⁰ According to the proponents of this strategy, if substitutes for most imports could be produced, declining primary product prices would be less threatening because large export revenues were no longer needed to pay for imports.¹¹ Moreover, the implementation of this strategy was propagated to help enhance technological advancement, employment opportunity and economic development.¹²

The adoption of import substitution strategies in many developing countries however resulted in a protectionist structure that only allowed those goods without domestic counterparts or need to

⁷ Krugman Paul and Obstfeld Maurice (2003), International Economics: Theory and Policy, 6th edition, P. 255-256

⁸ Park Dongyuhun and Hur Jung, (2002), Exports Under an Import Substitution Trade Regime: An Alternative View, Economics Bulletin, Vol. 6, No. 5 p. 1

⁹ Dunn Robert M and Mutti John H. (2004), *Supra note 4*

¹⁰ Thomas I. Palley (2003), Export-Led Growth: Evidence of Developing Country Crowding-out, in Baddeley and McCombie (eds.), Economic Integration, Regionalism, and Globalization, Cheltenham: Edward Elgar.

¹¹ Dunn Robert and Mutti John (2004), *Supra note 4*, p. 23

¹² Chanthunga L. and Murinde V. (1988), Trade Regime and Economic Growth, P. 33

cover eventual over demand to enter the country.¹³ It has also created trade regimes heavily biased against trade, characterized by an overvalued exchange rates and extensive use of trade policy instruments to favour import substitution. Such restrictions imposed on manufacturing imports had significantly contributed to the growth of the domestic manufacturing sector in many developing countries.¹⁴ However, the growth was concentrated mainly in activities related to processing of primary products.¹⁵ The manufacturing sector was unable to advance to the production of capital goods as implied by the second stage of the import substitution strategy. Developing countries were therefore forced to finance their imports of capital goods with a low level of exports, which drastically deteriorated their foreign exchange reserve. Import substitution strategies accordingly led many developing countries to a series of balance of payment crisis, crisis that were supposedly going to be prevented by their implementation.¹⁶

There are several reasons why import substitution strategies failed as early as the late 1970s. The argument most often used to explain the crisis in import substitution strategies, however, is probably the poor productivity of the new enterprises.¹⁷ The purpose of protection was to help enterprises in developing countries overcome their productivity differential in relation to competitors in developed countries. That implied that this new enterprises would use the protection provided by import substitution strategies in order to make the needed investment to increase productivity and become more competitive. However, only on rare occasions did protection prompt the enterprises to invest and modernize their production capacity.¹⁸ In most cases quite the opposite happened and rent seeking become the norm as enterprises took advantage of the lack of competition. As a result, import substitution strategy yielded very little improvement in the productivity of local enterprises and the competitiveness of developing economies.¹⁹ Besides, by creating barriers to free trade and preventing specialization, import

¹³ Krueger Anne (1997), *supra note 5*

¹⁴ Krugman Paul and Obstfeld Maurice (2003), *Supra note 7*, P. 259

¹⁵ *Ibid*

¹⁶ Sapelli Claudio (2002), The Political Economics of Import Substitution Industrialization: Some Reflections on the Political Economics of Liberalization, the Role of External Shocks and of Donor Agencies, Instituto de Economía Pontificia Universidad Católica de Chile, p. 8

¹⁷ Hammouda Hakim Ben (2004), Trade Liberalization and Development: Lessons for Africa, ATPC, p. 10

¹⁸ *Ibid*

¹⁹ *Ibid*

substitution strategies have; reduced incentives to local firms to cut costs and increase productivity, lead monopolistic structures, distort price and misallocate scarce resources.²⁰

From the mid 1970s on wards, import substitution strategies had begun to sweep aside by outward oriented trade strategies commonly referred to as "export promotion". This shift away from import substitution toward export promotion is often attributed to three factors; the disappointment about the result of import substitution, the favourable experience of some East Asian countries,²¹ and the pressure from international financial institutions who stipulated economic reforms as a prerequisite for financial assistance.²² As a result of these factors, many developing countries shifted their policy stance towards export promotion in the early 1980s.

2.2 Understanding Trade Liberalization

Over the past two decades or so, trade policies across the world and developing countries' trade policies in particular have changed their character and complexion. The traditional protectionist strategies of the post WWII period have been changed and replaced by more open and outward oriented trade strategies. Trade liberalization was a critical component of these changes.

Despite the controversy as to its impact on welfare and economic growth, trade liberalization has been the primary policy choice of many developing countries since the 1980s. It is worthwhile, therefore, to explore the constituents and notion of this frequently used crucial trade terminology.

The term "trade liberalization", however, has no an agreed up on definition. Different researchers define trade liberalization in different ways. In most cases it has been equated with becoming more outward oriented.²³ However, for some economists such as Anne Krueger, trade liberalization is far from being synonymous with outward orientation. According to her, while trade liberalization is simply the action of making ones trade regime less restrictive, moving towards outward oriented trade regime is moving to a very small or even zero deviation.²⁴ In the

²⁰ Turan Subasat (2003), Does Simultaneous Implementation of Import-Substitution and Export-Promotion Neutralize Each Other?, University of Bath, UK and Izmir University of Economics, Turkey, pp. 46-63

²¹ See, World Bank (1993), The East Asian Miracle: Economic Growth and Public Policy, Oxford University Press.

²² Thomas I. Palley (2003), *Supra* note 10

²³ *Ibid*

²⁴ Krueger Anne (1998), Why Trade Liberalization is Good for Growth, The Economic Journal, Vol. 108, No. 450, P.1521

classic National Bureau of Economic Research (NBER) studies directed by her (Anne Krueger) and another ardent free trader Jagdish Bhagwati; trade liberalization was defined as "any policy that reduces the degree of anti export bias".²⁵ Pursuant to this definition a measure as simple as reduction in import license premium constitutes a fundamental step in a trade liberalization process and more interestingly it does not require a zero or even a very low import tariffs.

With time, however, the definition of trade liberalization has evolved in to a sharper concept, almost becoming synonymous with free trade. For instance, some authors have argued that trade liberalization policies should not aim at reducing their degree of anti export bias, and generating a neutral trade regime, but should rather strive to produce a liberal trade system where all trade distortions, including import tariffs and export subsidies, are completely eliminated.²⁶ On the basis of this argument they try to assimilate trade liberalization with *laissez fair*. However, such position is strongly criticized by those scholars who doubt the existence of firm evidence linking liberal trade regime with improved economic performance. In particular, Cooper has argued that, it is necessary to distinguish between different types of trade liberalization to make clear that liberalization can be viewed as a process rather than as a state and to disassociate liberalization from *laissez fair*.²⁷ According to him trade liberalization is only a means of achieving *laissez fair*, not a *laissez fair* by itself. In similar vein, Michaely *et al.* defines trade liberalization as:

Any change which leads a country's trade system toward neutrality in the sense of bringing its economy closer to the situation which would prevail if there were no governmental interference....²⁸

On the other hand, based on the review of measures taken by those countries which implemented trade policy reforms, and the conditions set by the World Bank to extend Structural Adjustment Lending to the reformers, Greenway *et al* defines trade liberalization as import liberalization and/or a move towards neutrality in the structure of relative prices and/or the substitution of less

²⁵ Bhagwati, Jagdish (1978), Anatomy and consequences of exchange control regimes. Cambridge, MA: Ballinger Pub. Co. for NBER, as sighted in Edwards Sebastian (1993), Openness, Trade Liberalization, and Growth in Developing Countries, Journal of Economic Literature, Vol. 31, No. 3, P. 1364

²⁶ *Ibid*

²⁷ Cooper Richard (1987), Industrial Policy and Trade Distortion, in Dominick Salvatore (ed.), The New Protectionist Threats to World Welfare, Amsterdam and London, North Holland, *Ibid*

²⁸ Michaely *et al.* (1989), Liberalizing Foreign Trade, Lessons of Experience in the Developing World, Vol.7, Oxford and Cambridge, MA: Basil Blackwell, P. xx

distorting for more distorting forms of intervention.²⁹ This definition, like the one noted above disassociates trade liberalization from laissez fair and regard trade liberalization only as a move towards free trade. But, none of these definitions describe what constitutes trade liberalization.

Because of the different opinions on the meaning of liberalization, what constitutes trade liberalization is ambiguous and subject to debate.³⁰ In particular, whether to consider devaluation as a component of trade liberalization or not is an issues widely debated in the literature.³¹ Nevertheless, the experience of developing countries which undertook trade reforms through the Structural Adjustment Programme show that exchange rate policies were part and parcel of their trade reform measures.³² When devaluation is combined with a change in the mechanism of allocating scarce foreign exchange, and import of final good will be no longer discriminated against through non-issuance of licenses, this clearly qualifies as a move towards free trade.³³ This implies that even though devaluation is an exchange rate policy, in countries characterized by high restriction on foreign trade, it should be considered as part of the trade reform measures.

Generally, as one can observe from the above discussion, the literature on the definition of trade liberalization is far from unequivocal. While some of the definitions associate trade liberalization with free trade, most others consider it only as a process towards free trade. Whereas the trade reforms measures taken during the 1980s and 1990s in most developing countries simply involve; removing non tariff barriers, reducing import tariffs, reforming exchange rate regimes and eliminating export restriction³⁴ and hence hardly fall under the first set of definitions. For the purpose of this paper, trade liberalization shall be understood in the context of the second set of definitions, as a move towards freer trade through the reduction of tariff and other barriers.

Countries can take such measure either unilaterally or jointly with other countries based on reciprocity. Trade liberalization can be considered as "unilateral" if it is taken independently,

²⁹ Greenway *et al.* (1993), A Methodology for the Study of Trade Liberalization, Paper Prepared for the African Economic Research Consortium in Nairobi, Dec 1-3.

³⁰ Metzel Jeffrey and Phillips Lucie (1998), Bringing Down Barriers to Trade: The Experience of Trade Policy Reform, A Paper Prepared for Equity and Growth Through Economic Research Workshop, South Africa, P. 3

³¹ See for example, *Ibid*, and Edwards Sebastian (1993), *supra* note 25

³² Meltz Jeffrey and Philips Lucie (1998), *Supra*

³³ Reinikka (1994), How to Identify Trade Liberalization Episodes: An Empirical Study on Kenya, Centre for the Study of African Economies, University of Oxford Working Papers Series No.94/10

³⁴ Meltz Jeffrey and Philips Lucie (1998), *Supra*, P. 4

without the expectation of reciprocal actions, or *quid pro quo*, from other countries.³⁵ The British led the way with unilateral trade liberalization, by repealing its Corn Laws unilaterally in 1846.³⁶

Since then, many countries have liberalized their trade regime without seeking reciprocal concessions. According to the World Bank, two-third of developing countries' tariff liberalization since the early 1980s has been done unilaterally.³⁷ However, such liberalization was not genuinely 'unilateral' as there were reciprocities in terms of financial assistance under the adjustment and stabilization programs of the Bretton Woods institutions.³⁸ Nevertheless, there are notable cases in which developing countries have liberalized their trade regime without being subject to such pressure and without any obvious reciprocity. For example, the unilateral liberalization of many East Asian countries in the 1980s and 1990s was neither part of reciprocal negotiations nor a result of conditionality imposed by the Bretton Woods institutions.³⁹ The main drive for the liberalization of these countries was competition to attract Japanese investment.⁴⁰

The case for unilateral trade liberalization is built on the same reasoning as the case for free trade; any country can improve its welfare by lowering its own barriers to trade and this holds irrespective of what its partner does.⁴¹ This is essentially because of the increase in welfare generated by competitive goods imported at lower cost to replace inefficient local production. In other words, even if there are tariffs in the rest of the world, a country can increase its own welfare by cutting tariffs unilaterally without the need for reciprocity. Moreover, unilateral liberalization is believed to lower the political stakes associated with trade liberalization in foreign countries, thereby lowering the overall political cost of reaching and implementing trade agreements.⁴² It also gives governments the flexibility to initiate policies and emulate better

³⁵ Bhagwati Jagdish (2002), Introduction: The Unilateral Freeing of Trade versus Reciprocity, In Bhagwati Jagdish (ed.) Going Alone: The Case for relaxed Reciprocity in Freeing Trade, MIT Press: Cambridge.

³⁶ *Ibid*

³⁷ World Bank (2004), Global Economic Prospects 2005: Trade, Regionalism and Development, World Bank, Washington, DC, as sighted in, Sally Razeen (2008), Trade Policy, New Century: The WTO, FTAs and Asia Rising, The institute of economic affairs, Profiles Book Ltd. London, P. 83

³⁸ Bhagwati Jagdish (2002), *Supra*, P. 17

³⁹ Sally Razeen (2008), *Supra*, P. 165,

⁴⁰ *Ibid*

⁴¹ Narlikar Amrita, (2005), The World Trade Organization: A Very Short Introduction, New York, Oxford University Press Inc., P. 3

⁴² Coates Daniel E. and Ludema Rodney D. (1997), Unilateral Trade Liberalization As Leadership in Trade Negotiations, P. 31

practice abroad in experimental, trial and error, fashion tailored to specific local conditions.⁴³ The latter aspect is even more important for developing countries, as it enables them to determine the pace and sequence of their liberalization measure in accordance with their particular needs.

However, unilateral trade liberalization has its own limitations as well. First, rather than being implemented as part of an agreement with trading partners; it is implemented independently by the liberalizing country and therefore cannot bring access to foreign markets. Second, government commitments to unilateral liberalization are not binding and thus can be reneged at any time, causing uncertainty and unpredictability. Third, unilateral trade liberalization is politically difficult in democratic countries where interest group lobbying influence government decisions.⁴⁴ In such countries, relatively powerful interest groups can oppose and block liberalization measures which are against their individual interests. In contrast, reciprocal liberalization help governments resist such opposition by mobilizing the support of domestic exporters that may benefit from the ensuing foreign market access. Finally, unilateral trade liberalization wastes the bargaining chip of access to the domestic market that could be parlayed, in a bilateral or multilateral deal into access to others' markets.⁴⁵ A country which has already liberalized its trade regime unilaterally would obviously have less to offer to its trading partners in terms of market access concessions.

Generally, however, the realities of modern politics— interest group lobbying for protection, the perception that trade liberalization hurts the poor and vulnerable – make sustained unilateral trade liberalization very hard to achieve, except in situations of political and economic crisis.⁴⁶

The other form of trade liberalization is reciprocal trade liberalization, which implies the reduction of barriers to trade based on "reciprocity". According to the Oxford English Dictionary the term "reciprocity" refers to "the principle or practice of mutual exchange, especially of giving advantages or privileges in return for advantages or privileges received".⁴⁷ A trade liberalization

⁴³ Sally Razeen (2008), *Supra note 3*, 7 P. 198-199

⁴⁴ *Ibid*, P. 84

⁴⁵ Richardson Martin (2001), Unilateral Liberalization in a Multilateral World, University of Otago, Economics Discussion Papers, No. 0120, P. 9

⁴⁶ Haggard S. and Williamson J. (1995), The political preconditions for economic reform, in J. Williamson (ed.) *The Political Economy of Policy Reform*, Washington: Institute for International Economics.

⁴⁷ Oxford Advanced Learner's Dictionary, Oxford University Press, 1995, P.973

measure can, therefore, be understood as "reciprocal" if it is made in response to an equivalent measure taken by other countries. The balance of concessions cannot, however, necessarily be "equivalent". That is, as long as an agreement is reached and trade restrictions are lifted accordingly, such measure can validly be regarded as "reciprocal" despite the exact value of restrictions lifted by each country. In fact, as famously remarked by former Director General of GATT, Arthur Dunkel reciprocity cannot be determined exactly, it can only be agreed upon.⁴⁸ The experience of multilateral trade negotiations also demonstrate that it is difficult, if not impossible, to exactly determine the market access concessions exchanges between countries.

Policy makers and politicians believe that lowering trade barriers is expensive rather than gainful and must be offset by concessions for one's exports.⁴⁹ Accordingly, instead of going alone, many countries prefer to liberalize their international trade regime only if other countries do likewise. The development of the reciprocal approach to trade liberalization is, however, largely attributable to the "Smoot-Hawley Tariff Act" of the United States. The Act raised duties on more than 100 articles that were imported to the US market.⁵⁰ However, by the end of 1931, 26 foreign nations had raised their tariff against US products in retaliation.⁵¹ The resulting harm led the US congress to pass the "Reciprocal Trade Agreements Act" in 1934, which reserved the prohibitive Smoot-Hawley Tariff of the 1930 and authorize the executive to negotiate reductions in American trade barriers in return for reciprocal reduction by other countries.⁵² As a result, United States and its major trade partners embark on reciprocal international trade liberalization through the bilateral and multilateral tracks. Especially, they engaged in worldwide reciprocal trade liberalization under the auspices of the General Agreement on Tariffs and Trade (GATT).

From that time onwards and in the second half of the twentieth century in particular, reciprocal trade liberalization has become the main route through which trade restrictions are reduced across the world. The ever mounting membership in the World Trade Organization and the proliferation of regional and bilateral trade agreements over the past few decades are good

⁴⁸ Finger J Michael and Winters L. Alan (200), Reciprocity in the WTO, in Bernard M. Hoekman Aaditya Mattoo, and Philip English (eds.) Development, Trade, and the WTO, The World Bank, Washington, DC, P. 51

⁴⁹ Bhagwati Jagdish (2002), *Supra note 35*, P. 9

⁵⁰ Barton John (1986), International Trade and Investment: Regulating International Business, 1st Ed., Little Brown and Company, P. 9

⁵¹ *Ibid*

⁵² Drezner Daniel W., (2006), U.S. Trade Strategy: Free Versus Fair, Council of Foreign Relations Inc., P. 13

accounts as to the rising enthusiasm toward reciprocal liberalization. Indeed, reciprocal trade liberalization has several political and economic gains that can inspire countries across the world.

First, mutuality of concessions suggests fairness and makes adjustment to trade liberalization politically more acceptable by the domestic losers from the change.⁵³ Reciprocal trade liberalization entails a reduction in foreign trade barriers as a quid pro quo for the liberalization of domestic import restrictions. Second, foreign concessions to one's exporters create new interests that can counterbalance the interests that oppose one's own trade liberalization.⁵⁴ That is, in a democratic system, it may help government mobilize export oriented lobbies that would profit from expanding foreign markets to countervail the import competing lobbies that profit instead from reducing trade.⁵⁵ Third, the gains from trade liberalization can be increased by twofold if countries secure the liberalization of their trading partners market while liberalizing theirs. Unlike unilateral liberalization, reciprocal trade liberalization brings gains to a country not merely from its own liberalization but the liberalization of its partners as well. Fourth, the mutuality of liberalization helps to alleviate short term challenges associated with the opening of the domestic market for foreign competition such as Balance of Payment (BOP) difficulties.

Inspired by these and other potential benefits many countries around the world have been liberalizing their trade regime through the bilateral, regional and multilateral tracks of reciprocal trade liberalization since the turn to the second half of the twentieth century. But, despite the ever growing enthusiasm toward reciprocity, most economists and free traders in particular, still favour unilateral instead of reciprocal liberalization, especially for developing countries.⁵⁶

2.3 Trade Liberalization and Economic Growth

The doctrine that trade enhances welfare and economic growth has a long and distinguished ancestry dating back at least to Adam Smith. Smith, in his famous book, *an inquiry to the nature and causes of the wealth of nations* stressed the importance of trade as a vent for surplus production and as a means of widening the market thereby improving the division of labor and

⁵³ Bhagwati Jagdish (2002) *Supra note* 35, P. 10

⁵⁴ *Ibid*

⁵⁵ *Ibid*

⁵⁶ *Ibid*

the level of productivity.⁵⁷ Likewise, the other prominent classical economist, David Ricardo, showed rigorously through his theory of comparative advantage that countries can reap welfare gains by specializing in the production of those goods with the lowest opportunity cost ratio.⁵⁸

According to this classical theory, trade affects economic growth through efficiency gains from specialization and economies of scale. Specialization permits increased attainment of economies of scale, especially for countries with relatively small domestic markets.⁵⁹ On the basis of these assumptions the classical theory contends that reduction of trade barriers forces domestic businesses to improve their efficiency because of the ensuing competition from high quality and cheaper imports. Whereas increased economic integration with the outside world encourages technological innovation through the diffusion of new technologies from advanced countries.⁶⁰

In similar vein, neoclassical economists insist that trade liberalization enhances economic growth through increased productivity and efficiency. In accordance with the fundamentals of the classical theory, neoclassical economists argue that trade liberalization and integration in to the world economy can enhance economic growth because;⁶¹ firstly, residents of a country that is integrated into world markets are likely to enjoy access to a larger technical knowledge base than those living in relative isolation, secondly, exposure to international competition may significantly enhance the competitive capacity of the domestic businesses, and thirdly, the competitive pressures exerted by imports prevent the emergence of welfare-reducing domestic monopolies and induce domestic businesses to improve quality and reduce costs.

However, the positive correlation between trade liberalization and economic growth has no constant supports across all economic theories. As has already been noted, during the period 1950-1970, the positive interaction between trade liberalization and economic growth was questioned in the context of developing countries. The main critics was from the structural economists who argued that international trade brought on negative consequences in the long-

⁵⁷ Smith Adam (1776) An Inquiry into the Nature and Causes of the Wealth of Nations, Chicago: University of Chicago Press, as sighted in Thirlwall Anthony P.(2000), Trade, Trade Liberalization and Economic Growth: Theory and Evidence, The African Development Bank, Economic Research Papers No. 63, P. 6

⁵⁸ David Ricardo (1817), The Principles of Political Economy and Taxation, as sighted in *Ibid*

⁵⁹ UNECA (2010), Assessing Regional Integration in Africa IV: Enhancing Intra-African Trade, UN, P. 40

⁶⁰ *Ibid*

⁶¹ Grossman, G. M. and E. Helpman (1990), Comparative Advantage and Long-Run Growth, American Economic Review, Vol. 80, No. 1, P. 796-815

term for the developing countries because of their specialization in low demand income elastic products (i.e. primary agricultural products).⁶² Whereas institutional economists sustained that even if free trade had some positive effect of diffusion on the developing countries, in the long term, the negative effects remained because it stimulated a production of primary products.⁶³

Skeptics also argue that trade liberalization induces negative fiscal costs. First, the decrease in import duties might reduce custom revenues so that the government's public receipt may be cut and public transfer may shrink. Second, cutting trade barriers increases import competition, which implies reallocation of factors of production and entails adjustment costs and short term risk.⁶⁴

Considering the ambiguities in the theoretical literature a number of empirical studies have been and continues to be undertaken to examine the correlation between trade liberalization and economic growth. However, like the theoretical literature the results of the empirical studies are not conclusive. Some studies find a positive correlation between the two, while others conclude that the impact of reducing trade barriers has a negative effect.⁶⁵ Indeed, a close study of the empirical literature shows that many empirical analyses estimate positive growth effects of trade liberalization, but the size of these effects is often rather small, and the empirical methods used to estimate the effects have been subject to substantial criticism. The fundamental criticism, in this respect, is lack of concrete evidence to support the relationship between trade liberalization and economic growth. Explaining the difficulty of giving concrete evidence on the relationship between the two, one of the prominent skeptics, Francisco Rodriguez, noted that;

One of the main reasons why it is so hard to reach definitive conclusions regarding the trade-growth link is the complex web of interrelationship that is involved in the

⁶² Afonso Oscar (2001), The Impact of International Trade on Economic Growth, Universidad Do Porto, Working Paper No. 106, P. 7

⁶³ *Ibid*

⁶⁴ Bouet Antoine (2008), Trade Liberalization for World Income and Development: Opening the "Black Box" of Global Trade Modeling, Food Policy Review, International Food Policy Research Institute, Washington D.C., P. 4

⁶⁵ Some of the empirical studies which concluded in favour of a positive interaction between trade liberalization and economic growth included; Greenway et al. (2002), Levine and Renelt (1992), Melchior (2007) Sachs and Warner (1995). Whereas the studies which conclude as to the existence of negative or no interaction include; Dollar (1992), Ben David (1993), Frankel and Romer (1999), and Rodriguez and Rodrik (2001)

determination of nation's income. Trade can have a significant impact on GDP, but so can many other factors that can be related to trade.⁶⁶

To sum up, the effect of trade liberalization on economic growth is ambiguous and is a subject of ongoing debate both at the theoretical and empirical level. While classical and neoclassical economists strongly argue in favour of a positive correlation, a growing body of empirical studies cast doubts against the validity of this argument. Indeed, one might argue that the fault line in the recent trade liberalization-economic growth nexus debate is not as such about whether trade liberalization has a positive or negative effect, but, whether trade liberalization can be considered as a sole reason for economic growth and it is especially between those who advocate deep liberalization to take advantage of globalization and those who advocate more cautious policy stance which takes in to account the distributional consequence of such liberalization.

Moreover, it is worthwhile to note that trade policies does not operate in vacuum and hence other policies in the areas of exchange rate, agriculture, industrial, labour, tax and others, supporting trade liberalization, are necessary to reap any of the potential benefits of trade liberalization, not to mention economic growth. In the context of developing countries, such policies also need to focus on improving supply side capacity so that they can take advantage of trade opportunities.

⁶⁶ Rodriguez Francisco (2006), Openness and Growth: What have We Learned?, Wesleyan University, A paper Prepared as a background note for the United Nation's 2006 World Economic and Social Survey, p. 12

Chapter Three

The Multilateral and Regional Paths to Trade Liberalization

In the preceding chapter, it has been described inter alia that trade liberalization can be accomplished either unilaterally or reciprocally. Reciprocal trade liberalization on the other hand can be effected bilaterally, regionally or multilaterally. All these reciprocal approaches to trade liberalization have long been and still employed by different countries around the world.¹ In accordance with the central theme of the paper, this chapter examines the main characteristics as well as the interplay between the multilateral and regional paths to reciprocal trade liberalization.

3.1 The Multilateral Path to Trade Liberalization

The multilateral path to trade liberalization, which is rather shortly referred to as, Multilateralism, refers to the process of reducing trade barriers multilaterally based on the principle of non discrimination.² During the last half a century, Multilateralism has been pursued through multilateral trade negotiation based on the fundamental Most Favoured Nation (MFN) Principle underlying the GATT and its successor the WTO. From Geneva in 1947 to the conclusion of the Uruguay Round, eight successive multilateral trade negotiations have considerably liberalized world trade. It is these multilateral trade negotiations that have reduced developed country tariffs on industrial goods from more than 40 per cent to less than 5 percent.³

Multilateralism, however, lost some momentum because of frustrations growing out of the protracted length and complexity of the Uruguay Round, concluded in April 1994 after years of negotiations. The Uruguay Round was an intensive effort to update the multilateral trading system, and make it more effective forum for enhanced interstate economic relation, since the relations have become more intense, more complex and more wide-ranging than ever before. Accordingly, following the conclusion of the Uruguay Round, the GATT was subsumed within the WTO, whose domain includes areas which had been beyond the reach of the GATT, such as trade in services, agricultural products, trade-related intellectual property rights, textile and

¹ Kim HeeMin and Smith Dale (1997), Blocks or Rounds? An Analysis of Two Approaches to Trade Liberalization, Canadian Journal of Political Science, Vol. 30, No. 3, P. 427-449

² WTO (2001), Trading in to the Future, 2nd Edition,

³ WTO (2005), Understanding the WTO, 3rd Edition, World Trade Organization, P. 14

clothing and investment measures. The transformation from the GATT to the WTO has strengthened the institutional aspect of the multilateral trading system and resulted in a fully fledged multilateral institution with a much stronger dispute settlement mechanism. All the same, it has also increased the difficulty and complexity of negotiating and reaching an agreement at the multilateral level. This in turn has led many to question the validity of the traditional wisdom that multilateralism is the most appropriate path to a more liberal trading system.

3.1.1 The Main Features of the World Trade Organization

The WTO was established in January 1995 as a successor to the GATT that governed the rules of the multilateral trading system for almost half a century without any institutional basis to speak of. This organization is now the only multilateral organization that deals with the global rules of trade between nations by helping trade to flow as smoothly, freely, and predictably as possible.⁴

According to the preamble of the Marrakech Agreement establishing the WTO (herein after the Marrakech agreement), the WTO stands inter alia to promote, economic growth, sustainable development, improved living standard, and full employment. The organization also aims to ensure the "substantial reduction of tariffs and other barriers to trade and the elimination of discriminatory treatment in international trade relations".⁵ However, although it is often referred as a "free trade organization" none of its major agreements calls for total free trade; instead allow tariffs, safeguards, waivers, and other exceptions involving developing countries in particular.⁶

In order to promote and attain these and other objectives, the WTO contains a set of specific legal obligations regulating trade policies of member countries, which are embodied under its various agreements including the GATT, the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Aspect of Intellectual Property Rights (TRIPS).⁷ The Most Favored Nation (MFN) and Reciprocity are two of the most fundamental principles that underlie all WTO agreements. The former requires that a product made in one member country be treated

⁴ Kiggundu, Moses N. (2002), Managing Globalization in Developing Countries and Transition Economies: Building Capacities for a Changing World, Greenwood Publishing Group Inc., P. 170

⁵ WTO, Agreement Establishing the World Trade Organization: Preamble: Paragraph 3

⁶ Dunkley Graham (2004), Free Trade: Myth, Reality and Alternatives, Zed Books, London & New York, P. 191

⁷ Hoekman Bernard,(2002), The WTO: Functions and Basic Principles, In Bernard M. Hoekman Aaditya Mattoo, and Philip English (eds.) Development, Trade, and the WTO, The World Bank, Washington, DC, P. 42

no less favorably than a like product that originates in any other country.⁸ It dictates that concessions granted by any one country to another in the WTO must be multilateralized to all other member countries unconditionally. Whereas, the principle of Reciprocity requires that trade concessions be exchanged on mutually advantageous basis.⁹ It reflects both a desire to limit the scope of free riding that may arise because of the MFN Principle and a desire to obtain payment for trade liberalization in the form of better access to foreign markets.¹⁰ Despite being the most fundamental principles of the WTO, the MFN and Reciprocity principles are actually mutually contradictory. To resolve this contradiction the Reciprocity principle is made to apply only during negotiations; once negotiations are over the MFN principle comes to picture and extend all concessions negotiated between two parties to the rest of the membership unconditionally.¹¹ Besides these two key principles the multilateral trading system also relies on other fundamental principles such as National Treatment, Transparency, and Predictability.¹²

The WTO has inter alia three broad functions; facilitating the implementation and operation of the multilateral trade agreements, serving as a forum for ongoing trade negotiations and resolving disputes between its member countries.¹³ The first deals with administering the rules and principles negotiated and signed by its members. These rules or agreements are essentially contracts binding governments to keep their trade policies within agreed limits. The second function of the WTO is providing a forum for trade negotiations. Negotiations are the driving force of the multilateral trading system. They are used to agree on rules and procedures, to periodically reduce trade barriers, in instances when new countries want to join the club and to resolve trade conflicts.¹⁴ Therefore, by following the footsteps of its predecessor the WTO serves as a permanent negotiating forum in which trade issues may be discussed and agreed upon against the background of the provisions of the various agreements already concluded.¹⁵ The

⁸ The MFN enshrined under Article I of GATT, Article II of the GATS and Article IV of the Agreement on TRIPS

⁹ The General Agreement on Tariffs and Trade Paragraph 3 and Article XXVII bis

¹⁰ Narlikar Amrita, (2005), The World Trade Organization: A Very Short Introduction, Oxford University Press Inc., P. 10, New York, P. 29

¹¹ *Ibid*, P. 52

¹² See, Article III of GATT, Article XVII of GATS and Article III of TRIPS for National Treatment, Article X of GATT and Article III of GATS for Transparency and Article II and XI of GATT for predictability

¹³ WTO, *Supra* note 5, Article III

¹⁴ Hoekman Bernard and Kostecki, M.(1995), The Political Economy of the World Trading System: From GATT to WTO, Oxford University Press Inc., New York, P.56

¹⁵ *Ibid*

preamble of the Marrakech agreement requires such negotiations to be conducted on a reciprocal and mutually advantageous basis. And concessions negotiated under these rules become binding and applies to all member countries on MFN basis. Finally, WTO serves as a forum whereby trade conflicts between and among its member countries are resolved. Indeed, dispute settlement is one of the central pillars of the multilateral trading system and a unique contribution of the system to the stability of the global economy.¹⁶ In contrast to the informal, ad hoc and voluntary dispute settlement mechanism of the GATT 1947, the WTO has a formalized, legalistic and enforceable dispute settlement mechanism with a fully-fledge appellate body.¹⁷

Unlike most other multilateral organizations, which carry out their activities through their own staff, the WTO is a member driven organization with a relatively small staff size.¹⁸ It is headed by a Ministerial Conference of all members that meets at least once every two years.¹⁹ All decisions in the organization are reached by consultation and consensus. Voting is a last resort and it is applied only when there is no consensus, based on "one member one vote" principle.²⁰ The secretariat of the organization has no decision making authority and its function is limited to the provision of technical assistance to developing countries, analyzing world trade and explaining WTO affairs to the public. The onus of negotiating agreements, implementing them, enforcing them as well as settling disputes concerning them, falls on the members themselves.²¹

In sum, WTO is a rules based, member driven and a fully-fledge multilateral trade organization with expanded membership, several responsibilities and binding dispute settlement mechanism.

3.1.2 The WTO Accession Process

The process of accession to the WTO is demanding and has been very lengthy for most of the twenty five countries that have joined the organization since 1995.²² According to Article XII of the Marrakech Agreement any state or separate customs territory having full autonomy

¹⁶ WTO (2005), *Supra note 3*, P. 59

¹⁷ Ahearn Raymond J. and Fergusson Ian F., (2010), World Trade Organization (WTO): Issues in the Debate on Continued U.S. Participation, Congressional Research Service , P. 7

¹⁸ Narlikar Amrita, (2005), *Supra note 10*, P. 34

¹⁹ Agreement Establishing the World Trade Organization: Article IV(1)

²⁰ *Ibid*: Article IX

²¹ Narlikar Amrita, (2005), *Supra 3*, P. 17

²² WTO, Members, http://www.wt.org/english/thewto_e/acc_e/completeacc_e.htm, last visited on 30 July 2010

concerning its external trade relations may join the organization on terms to be agreed between it and the WTO. The terms to be agreed are nowhere defined and thus the process is essentially a negotiation course whereby each acceding state ends up assuming its own unique set of terms.

The process commences with the formal written request of the applicant state expressing its intention to join the organization.²³ Then the General Council establishes a Working Party to examine the application. This will be followed by the submission of Memorandum of Foreign Trade Regime (MFTR) by the applicant, describing the nature of its trade and investment policies, the extent to which they have been liberalized and the legislative system in effect. The submission of the MFTR will trigger the written questions and answers session whereby Working Party members scrutinize the applicant's trade and legal regime with the view of identifying areas of inconsistencies with the WTO Agreements. The examination and clarification of the applicant's trade regime will be accompanied by Working Party meetings either simultaneously or following the conclusion of the written question and answer process.

Once the examination and clarification of the MFTR session is over, intensive negotiations both in the bilateral and multilateral fronts will be launched. The applicant country will set the motion by submitting an offer on the maximum tariffs it intends to impose on imports from WTO member countries and an offer on the extent to which it intends to open its services sector. Such offer will be distributed by the Secretariat to the member countries who can then engage in bilateral trade negotiations. Such negotiations will determine the market access commitments the acceding country will assume as part of its membership obligation. Whereas the multilateral negotiations will be conducted at the Working Party level and focus on issues such as ensuring the compatibility of the applicant country's trade regime with WTO rules and agreements.

Following the conclusion of these negotiations both at the bilateral and multilateral front, the working party will prepare a protocol of accession that among other things consist market access concessions made by the applicant during the negotiations. Then the protocol of accession will be submitted to the General Council for adoption. Once this protocol is adopted by the General

²³ The discussion on the process of accession herein under is essentially based on, WTO (2005), *Supra note 3* and UNCTAD (2001), WTO Accession and Development Policies, New York and Geneva, United Nations.

Council on a two-thirds majority vote, the applicant country becomes a full WTO member 30 days after it notifies that the accession package has been ratified as per its national legislation.

3.1.3 Developing Countries and the WTO

Developing countries have been an integral part of the multilateral trading system since the establishment of the GATT in 1947. They constituted nearly half of the original GATT and about two thirds of the current WTO membership.²⁴ Although there is no official definition as to what constitute a "developing country", the WTO simply categorizes them as "developing" and "least developed".²⁵ While the former is labeled on a self selective basis, those 49 countries which are designated as least developed by the United Nations are recognized likewise in the WTO.²⁶

Up until the mid 1960s, the participation of developing countries in the multilateral trading system was regulated on a similar basis with that of the developed countries, as there was no GATT provision which accord them any special rights or privileges. However, with the expansion of import substitution strategies in the 1950s and 1960s, developing countries demanded more flexibility in their trade policy stance to give protection to their infant industries and more favourable treatment from developed countries to strengthen their capacity to trade.²⁷

Eventually, they succeeded in incorporating provisions that accord them special rights and privileges in to the multilateral trading system. These special rights and privileges are collectively referred to as "Special and Differential Treatment" (SDT) for developing countries.

The first of such provisions was introduced when Part VI consisting three Articles²⁸ was added to the GATT 1947 in February 1965.²⁹ This part simply sought developed countries to take in to account the special situations and needs of developing countries while taking trade measures. Apart from its failure to impose legal obligations up on developed countries to comply with such request, it is however reckoned for introducing the first formal statement in the GATT legal text

²⁴ See, WTO, Members, *Supra* note 22

²⁵ WTO, Who Are the Developing Countries in the WTO? Available at http://www.wto.org/english/tratop_e/devel_e/dlwho_e.htm, last visited on November 23, 2010.

²⁶ *Ibid*

²⁷ Michalopoulos Constantine (2001), Developing Countries in the WTO, Palgrave Macmillan (UK), P. 23

²⁸ Article XXXVI, XXXVII and XXXVIII of GATT 1947

²⁹ Gillies Peter and Moens Gabriel (1998), International Trade and Business: Law, Policy and Ethics, Cavendish Publishing, Sydney and London, P. 469

about the principle of non reciprocity. Article XXXVI: 8 explicitly urge developed countries not to expect reciprocal concessions from developing countries. Whereas Article XXXVI: 5 stressed the need for increased access in the largest possible measure to markets under favourable conditions for products of particular export interest to developing country Contracting Parties.

Such Special and Differential Treatments were made a permanent element of the multilateral trading system in 1979 through the Tokyo Round decision, commonly referred to as the "Enabling Clause". This Clause provided a permanent legal cover for the General System of Preference (GSP), restated the principle of non reciprocity and identified the Least Developed Countries (LDCs) as a separate category of GATT Contracting Parties meriting more favorable treatment than other developing countries.³⁰ At the same time, it has also codified the principle of graduation as a quid pro quo for the special treatments, whereby developing countries would return to the game of multilateral reciprocity once they have moved up the development ladder.

Developing countries' trade policy stance has been changed significantly towards the Uruguay Round when outward-oriented export promotion strategies became the priority of the day, substituting the inward-oriented import substitutions strategies of the 1950-1970s. This Round accordingly marked three substantial changes in the ways developing countries participate in the multilateral trading system. First, as opposed to the pre Uruguay Round, the principle of Single Undertaking has been incorporated in to the multilateral trading system and developing countries required to undertake commitments in all the Uruguay Round Agreements. Second, this Round brought sectors of particular interest to developing countries, such as agriculture and textiles, to the multilateral trading system for the first time. Third, a major shift occurred in terms of the approach towards SDT. That is, as opposed to the pre Uruguay period developing countries will not be accorded exemptions from any of the multilateral agreements, but longer time period, commitment of lesser threshold than industrial countries and technical assistance and capacity building support to enhance their capacity of implementing the commitments they undertake.³¹

³⁰ Oyejide T. Ademola (2002), Special and Differential Treatment, In Bernard M. Hoekman Aaditya Mattoo, and Philip English (eds.), Development, Trade, and the WTO, the World Bank, Washington, DC, P. 505

³¹ *Ibid*

However, although they have been designed to promote the interests of developing countries and to help them take advantage of new trade opportunities, the SDT provisions of both the pre and post Uruguay Round Agreements are simply a set of best endeavor clauses with no legal force.

3.1.4 The Possible Benefits and Costs of WTO Membership

Accession to the WTO entails outward-oriented policy changes in a wide range of areas including but not limited to in market access, competition policy, price controls, and privatization, before membership can be granted and to promise to do more within a certain timeframe after the start of membership.³² The benefits and costs of accession are therefore determined essentially by the implications of undertaking these changes. Acceding countries will enjoy the benefits and/or suffer the costs of the policy changes they will undertake as part of their accession deal. While many countries have already acceded, a number of others including Ethiopia are still waiting in the wings to accede, hoping the benefits will prevail over the costs.

The forthcoming two subsections attempt to examine the possible benefits and costs of WTO membership from acceding countries perspective. However, it should be noted at this juncture that both the benefits and costs of WTO accession are unique to each acceding country owing to differences in economic potential, export capacity, terms of accession and some other factors.

3.1.4.1 The Benefits of WTO Membership

The WTO has provided countries a forum in which to discuss and negotiate their terms of engagement in the multilateral trading system. The outcome of their engagement among other things depends on their ability to negotiate and exploit the opportunities thereof. Nevertheless, countries are generally expected to enjoy the following potential benefits by joining the WTO.

The first and foremost benefit may come from the ensuing changes in domestic policies. The non discriminatory reduction of trade barriers may induce specialization and efficient allocation of resources and enhances productivity. In this respect, it is worthwhile to note that identifying areas of comparative advantage and reallocating factors of production before accession is of paramount importance for countries such as Ethiopia that lack the necessary competitive edge

³² Tang Man-Keung and Wei Shang-Jin (2006), Does WTO Accession Raise Income? When External Commitments Create Value, IMF Research Department

even in the areas of their comparative advantage. Since accession may narrow down their policy space, it is imperative for them to strengthen their comparatively advantageous sectors beforehand, in order to reap the full benefits of integration in to the multilateral trading system.

Owing to its principle of non discrimination and vastly expanded membership as well as broad sectoral coverage, accession to the WTO may also provide a transparent, predictable and unconditional market access in a wide range of products and countries. But, this does not mean that accession will alter the MFN tariff of the incumbent members. Acceding countries most probably face the same trade barriers in their export destinations after accession, as most WTO members usually maintain the same MFN tariffs to all their trading partners regardless of WTO membership.³³ However, since the MFN obligation prohibits discrimination between member countries only, member countries are in a position to apply discriminatory treatment against non members, (i.e. they can impose tariffs above their MFN tariff against non members). By joining the WTO countries will avoid such uncertainty and therefore enhance the credibility and predictability of the foreign market access opportunities they may have been enjoying already.

The other potential benefit of WTO membership is enhancing the transparency and predictability of acceding countries' trade policy regime.³⁴ Adherence to the rules and binding agreements of the WTO as well as the careful scrutiny countries undergo while acceding and periodically thereafter through the trade policy review mechanism will substantially enhance the transparency and predictability of their policy regime. WTO membership will also increase the credibility of the domestic policy regime, in particular because, reneging commitments undertaken at the WTO requires complex negotiations with interested member countries and paying compensation.³⁵ The enhanced transparency, predictability and credibility could play a key role in promoting foreign investment, especially by sending a credible signal to foreign investors to boost their confidence.

Access to the WTO's Dispute Settlement Body (DSB) is another point usually considered as a potential benefit of joining the WTO.³⁶ The possibility of resolving disputes through an impartial

³³ Derk Bienen (2009), Preparedness of the Ethiopian private Sector to Benefit from WTO Accession, Trade and Development Discussion Paper no02/2009, P. 4

³⁴ UNCTAD (2001), *Supra note 23*, P. 119

³⁵ See, Art. XXVIII of the GATT for Modification of Schedules

³⁶ Michalopoulos Constantine (2001), *Supra note 27*, P. 62

and binding DSB, the decision of which has a significant chance of being enforced, is in fact an important potential benefit. However, the cost of pursuing an action under the DSB in terms of time, finance, technical/legal expertise is often beyond the means of most LDCs. The fact that only a single LDC has been able to bring a case before the WTO's DSB throughout the entire history of the multilateral trading system³⁷ implies that access to the binding dispute settlement mechanism of the WTO is a benefit practically less available to acceding LDCs such as Ethiopia.

Finally, WTO accession is considered as a potent tool to attract Foreign Direct Investment (FDI). The trade reform measures taken and their transparency and predictability as well as the improved foreign market access expected to be gained from accession are believed to attract a robust amount of foreign investment to acceding countries.³⁸ There is no doubt that any acceding country will benefit from the inflow of foreign capital and technology. But all incoming investments may not be considered as beneficial for acceding countries. In particular, those investments solely aimed at exploiting the domestic market or those which are invested in areas where the country has no comparative advantage will have a lesser contribution.³⁹ For example for acceding LDCs like Ethiopia capital intensive investments are of lesser value at least in the short and medium term, since their comparative advantage lies in labour intensive industries.

3.1.4.2 The Costs of WTO Membership

Membership in the rules based multilateral trading system entails binding commitments in a wide range of areas. The Uruguay Round Agreements not only take the WTO wider, with broader sectoral coverage; but also go much deeper into domestic regulations, all underpinned by much stronger dispute settlement mechanism. Accession to this organization entails ensuring compliance with a broad array of rules, procedures and Agreements. The first and foremost challenge of membership therefore stems from both negotiating and implementing commitments and concessions thereof. This would constitute a huge cost for those acceding LDCs like Ethiopia due to their limited financial, technical and institutional resources. Employing high-skilled personnel, enacting and amending a number of trade related legislations, and building

³⁷ A detailed statistics on the exploitation of the dispute settlement mechanism, is available on the WTO website, http://www.wto.org/english/tratop_e/dispu_e/stats_e.htm#fntext6,

³⁸ Michalopoulos Constantine (2001), *Supra note 27*

³⁹ Seetanah, B. and Khadaroo, A. J. (2007), Foreign Direct Investment and Growth: New Evidences from Sub-Saharan African countries, Paper prepared for the 2007 CSAE conference

and running administrative infrastructures for the effective implementations of commitments consumes a huge amount of capital that otherwise have been spent on developmental projects.

On the other hand, a more liberal trade regime encouraged by WTO membership may expose domestic industries to stiff competition from abroad.⁴⁰ As has been noted earlier, one of the fundamental objectives of the WTO is to promote the dismantling of trade barriers by member countries. But, such dismantling pierces the domestic industries' shelter and exposes them for an equal level competition with foreign firms, in which they seldom come out as a winner. This may result in short term deterioration of a country's current account, since higher imports due to market opening materializes faster than higher exports due to improved market access abroad.⁴¹ This is particularly true for most developing and least developed countries that are capable neither to compete with foreign firms nor to take advantage of new market access opportunities. It should be noted however that even if they affect the domestic industries by taking their market share, the increased imports will benefit consumers both in terms of price and wider choice.

The other possible challenge of membership in the multilateral trading system is the fiscal cost of tariff reduction.⁴² By acceding to the WTO countries will be required to cut their tariff in a wide range of areas. This is, however, onerous for developing and least developing countries owing to their heavy reliance on taxes on international transaction for their fiscal revenues. Indeed, this may constitute less of an issue during the early stages of trade liberalization when non tariffs barriers are tariffed, prohibitive tariffs are lowered and imports increase due to the liberalization measures.⁴³ In the long term, however, it would have a considerable impact on fiscal revenues.

3.2 The Regional Path to Trade Liberalization

Regional Trade Agreements (RTAs) have become the prominent feature of the international trading system and their proliferation has been one of the most visible trends in inter-state relation of the last two decades. The so called second best options to trade liberalization have become one of the two pillars of the international economic order together with the multilateral

⁴⁰ Fikremarkos Merso (2005), Ethiopia's Accession to the WTO: A Strenuous Step for a Poor Nation Seeking Economic Prosperity, Action Aid Ethiopia, P. 42

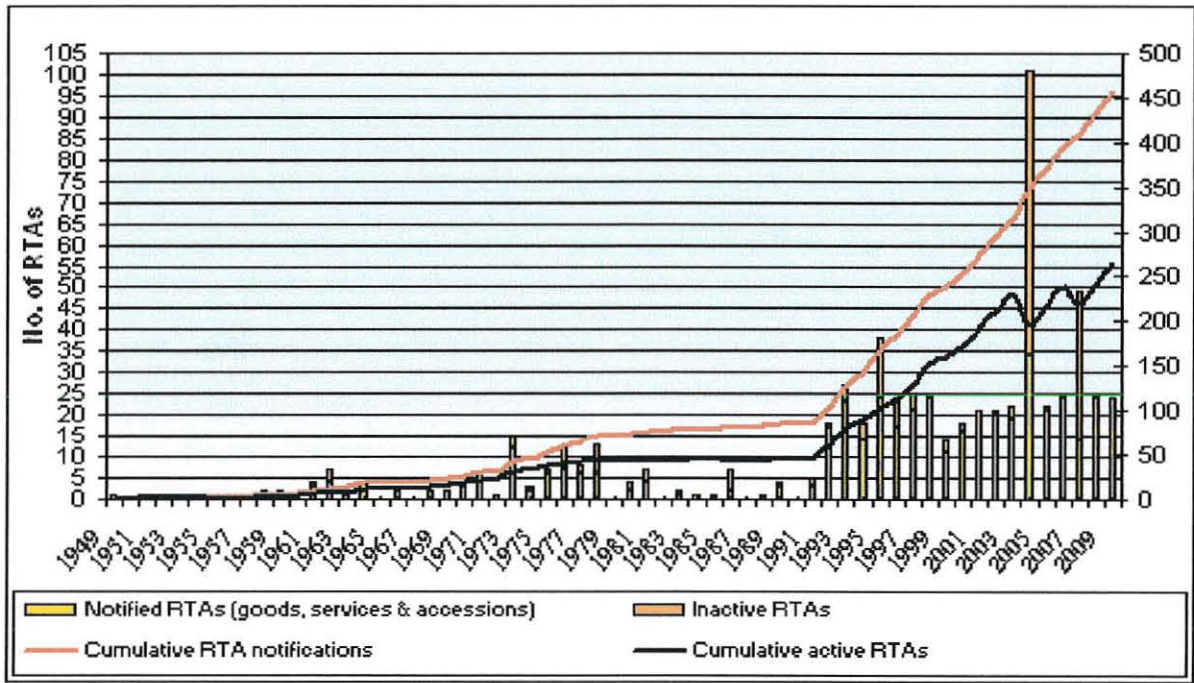
⁴¹ *Ibid*

⁴² *Ibid*

⁴³ *Ibid*

trading system and attracted the attention of all countries around the world including those longstanding and ardent supporters of multilateralism like the United States. Their proliferation has continued unabated since the 1990s and some 474 RTAs have been notified to the WTO as of September 2010.⁴⁴ Of these RTAs, only 123 of them were notified during the GATT 1947 and all the remaining 351 RTAs have been notified to the WTO since its establishment in 1995.⁴⁵ According to the WTO virtually all countries around the world including WTO members are now members of at least one RTA and some countries even belong to twenty or more RTAs.⁴⁶

Figure 3.1: RTAs Notified to the GATT/WTO (1948-2009)



Source: WTO, *Regional Trade Agreements: Facts and Figures* (www.wto.org)

The term regional trade agreement is generally defined as a grouping of countries, which is formed with the objective of reducing barriers to trade between member countries.⁴⁷ Contrary to what the name suggests, these groupings or unions may be concluded between countries not

⁴⁴ WTO, *Regional Trade Agreements*, available at http://www.wto.org/english/tratop_e/region_e/region_e.htm, last visited on 20 September, 2010

⁴⁵ *Ibid*

⁴⁶ *Ibid*

⁴⁷ Neumann Ildiko Virag (2009), *Regional Trade Agreements and the WTO*, 7th International Conference on Management, Enterprise and Benchmarking, Budapest, Hungary, P.382

necessarily belonging to the same geographical region, as illustrated by the current EU-ACP Economic Partnership Agreements (EPAs). In the literature, regional trade agreements/arrangements, regional integration agreements/arrangements, preferential trade agreements/arrangements and trade blocs, are used interchangeably and sometimes differently. Nevertheless, despite some differences all these terms represents a discriminatory or preferential treatment among a sub set of countries. Therefore, unless otherwise stated, the term Regional Trade Agreement (RTA) in this paper shall represent all bilateral, regional and plurilateral trade agreements of a preferential reciprocal nature that have been notified to the GATT or the WTO.

3.2.1 The Evolution of Regional Trade Agreements

Regional Trade Agreements are not a recent phenomenon. They have been in existence long before the establishment of the multilateral trading system. Besides the well known German Zollverein, the Austrian States had established a Customs Union in 1850, as did Switzerland in 1848, Denmark in 1853, and Italy in 1860s.⁴⁸ Since then, the world had witnessed the emergence and reemergence of different waves of regionalism, particularly after the Second World War

The first wave of regionalism took place from the late 1950s through the 1970s and was marked by the establishment of the European Economic Community (EEC), European Free Trade Agreement (EFTA), and the Council for Mutual Economic Assistance (CMEA).⁴⁹ Inspired by the success of the EEC and the desire to consolidate import substitution industries within large economic space, many developing countries had also formed a plethora of regional trade agreements during this period.⁵⁰ Most of them were, however, protectionist and interventionist. Besides, many of them were beset by considerable conflicts over how to distribute the costs and benefits stemming from regional integration, how to compensate distributional integration losers, and how to allocate industries among members.⁵¹ As a result, despite their marginal contribution in terms of industrialization, most of them became ineffective and hence collapsed along with the

⁴⁸ D. Edward, *et al* (1999), The New Wave of Regionalism, International Organization, Vol. 53, No. 3, P. 596

⁴⁹ *Ibid*, P. 600

⁵⁰ Schiff Maurice and Winters L. Alan (2003), Regional Integration and Development, World Bank, P. 5

⁵¹ D. Edward, *et al* (1999), *Supra*,

import substitution industrialization strategies in the late 1970s. Yet, European regionalism (under a series of names) founded on the ideas of trade creation, have survived and succeeded.⁵²

The second wave of regionalism, often referred to as "new regionalism", has arisen in the late 1980s in an utterly different context than its predecessor.⁵³ It emerged in the wake of the conclusion of the cold war, a shift in the trade policy direction of most developing countries and a change in the attitude of the United States toward regionalism.⁵⁴ United States was strongly committed to multilateralism and its founding principle of non discrimination and hence had long opposed regionalism.⁵⁵ Its long-standing opposition to regionalism was, however, abandoned following the failure of its effort to pursue Contracting Parties, the EU in particular, to launch the eighth Round of multilateral trade negotiations at the GATT Ministerial in 1982.⁵⁶ Recognizing that regionalism is the only means left for keeping the process of trade liberalization afloat, the United States went on to conclude an FTA with Israel in 1985 and Canada in 1989.⁵⁷

The momentum of regionalism peaked with the participation of the United States and then with the European Communities' (EC) single market program intensified with the conclusion of the North American Free Trade Agreement (NAFTA) in 1994 between the United State, Canada and Mexico.⁵⁸ Unlike the old regionalism, which was hardly stretched beyond Western Europe, the new regionalism has thus involved all countries around the world including those in African.

Generally, two distinct waves of regionalism have occurred since the entry in to force of the General Agreement on Tariffs and Trade (GATT) in 1948. While the first wave was predominantly a European phenomenon characterized by immense failure in other parts of the world owing to its association with import substitution industrialization strategies, the second one is a worldwide phenomenon accompanied by export oriented and trade focused strategies.

⁵² Porfilio Amelio, Regionalism and multilateralism, from coexistence to collision?, P. 5

⁵³ D. Edward, *et al* (1999), *Supra note* 48, P. 601

⁵⁴ *Ibid*

⁵⁵ Krueger Anne O., (1999), Are Preferential Trading Arrangement Trade-Liberalizing or Protectionist?, Journal of Economic Perspective, Vol. 13, No. 4, P. 107

⁵⁶ Panagariya Arvind (1998), The Regionalism Debate: An Overview, Mimeo, University of Maryland, P. 7

⁵⁷ *Ibid*

⁵⁸ Pomfret Richard (2005), Regional Trade Agreements, University of Adelaide, Working Paper 2005-15, P.3

3.2.2 Rationales for the Proliferation of Regional Trade Agreements

The multilateral trading system has been in existence for more than half a century now. Through the eight successive multilateral trade negotiations it had sponsored, it has successfully and significantly reduced tariffs and promoted the development of liberal trade across the world. During its nearly sixty years of existence, the system has served as the principal forum for reciprocal trade liberalization. In the mean time, it had also raised its membership from merely two digits to a three digit number to become almost a universal system. Parallel to this development, the world had also witnessed the development of another trading system. As illustrated in the preceding section, regional trade agreements had emerged and reemerged during the second half of the twentieth century. Given their inherent discriminatory nature, the development of regional trade agreements in the so called "multilateral world" is, however, quite astonishing. This section dwells on the main rationales behind the recent proliferation of regional trade agreements, in the presence of a rules-based and well organized multilateral trading system.

Many factors lay behind the recent surge in regionalism. In particular economic, political and security considerations explains why countries pursue regionalism in the presence of multilateralism. Starting with the economic considerations, countries' enthusiasm towards regionalism can be explained through their desire to secure more favourable access to their trading partners' markets.⁵⁹ Regionalism as opposed to multilateralism most often entails elimination of trade barriers and thus accords more favourable access to the markets of countries within the Agreement or region. Besides, its discriminatory nature means that exports from member counties will have additional competitive advantage compared to exports from non members which will continue to comply with the regular MFN requirements. This rationale has often been explicitly mentioned in the constituting Agreements or Protocols of many RTAs.⁶⁰

The proliferation of RTA may also be explained through non economic, political considerations. Countries may establish RTAs in order to consolidate Peace, political stability and increase regional security. This has been the case for many RTAs especially in Africa. For example, Article 3 (d) of the Agreement establishing the Common Market for Eastern and Southern Africa

⁵⁹ Schiff Maurice and Winters L. Alan (2003), *Supra note 50*, P. 16

⁶⁰ *Ibid*, P.6-10

(COMESA) has explicitly provided that one of the main objectives of the Common Market is to ensure cooperation in the promotion of peace, security and stability among the member countries. The same provision has also been stipulated under Article 6A (d) of the Agreement establishing the Intergovernmental Authority on Development (IGAD). Moreover, developing countries may also conclude RTAs in order to strengthen their bargaining power at the international fora.

Another important motive for the formation of RTAs that has gained prominence in recent times is the sluggish progress in the multilateral trade negotiations. Krugman, for instance, is of the opinion that countries find regionalism an easier alternative because large number of participants in multilateral trade negotiations increases the cost of cooperation and creates rigidity in the system.⁶¹ Indeed, the vastly expanded membership of the WTO and its consensus based decision making procedure may complicate the process of reaching an agreement. This can easily be observed from the period of time required to conclude a single round of multilateral negotiations.

Finally, the recent proliferation of regional trade agreements may also be explained through Baldwin's famous "Domino Theory of Regionalism". According to this theory the main rationale for the proliferation of RTAs during the last two decades is the fear of those countries that are outside the RTAs that they would be disadvantaged once the RTAs become operational.⁶² This prompts a defensive reaction to conclude RTAs. Baldwin, through his domino theory went on further and concludes that a new agreement or the extension of an existing agreement leads to added association or accession.⁶³ To prove his case he presents the experience of Latin American Countries' rush to forge regional trade agreements in the wake of the rejection of their request to join NAFTA and that of the Eastern European countries rush to claim membership in the EU following the launching of the formers' single market program in the early 1990s.⁶⁴ Likewise, it is argued that as new regional trading arrangements are formed or existing ones are expanded the opportunity cost of remaining outside an agreement increases and therefore inspire countries to

⁶¹ *Ibid*

⁶² Schiff Maurice and Winters L. Alan (2003), *Supra note 50*

⁶³ *Ibid*

⁶⁴ *Ibid*

join regional trade agreements.⁶⁵ Whereas, its cousin, the competitive liberalization theory, holds that countries compete in forming RTAs as tools to compete for attracting foreign investment.⁶⁶

3.2.3 Types of Regional Trade Agreements

As has been mentioned earlier, "regional trade agreement," as used in this paper, is a general term that refers to a range of discriminatory or preferential trade arrangements. These various forms of trade agreements are often categorized in the literature according to their scope, intensity and deepness. In this context five main types of trade agreements can be identified.

At the first level are *Preferential Trade Agreements* (PTAs), in which member countries lower tariffs selectively on an item by item basis.⁶⁷ These are trade agreements under which a country accords preferential treatment to other member countries only for those goods and services that appear in the positive list. Many agreements between developing countries belong to this category. Nevertheless, such agreements appear to be trade diverting and hence the drafters of the GATT 1947 aimed particularly at outing them from the scope of Article XXIV of the GATT.

At the second level are *Free Trade Agreements* (FTAs), in which member countries remove all tariffs and non tariff barriers among themselves, but retain their own national trade policy and tariff schedule against non member countries.⁶⁸ It is normally assumed that FTAs would cover all tradable products in the member countries. In reality, however, most FTAs often tend to exclude so called "sensitive" sectors such as; agriculture, services, textiles and clothing.⁶⁹

Although they are the most common forms of RTAs, FTAs are criticized for causing a phenomenon known as "trade deflection". That is, due to different tariff levels that may exist among FTA members, imports may shift to enter the countries of the FTA through the lowest-

⁶⁵ Carbaugh Robert J. (2005), *International Economics*, 10th Ed., Thomson South-Western, P. 229, P. 255

⁶⁶ Estevadeordal Antoni and Suominen Kati (2009), *The Sovereign Remedy? Trade Agreements in a Globalizing World*, Oxford University Press, New York, P. 58

⁶⁷ Kettunen Erja (2004), *Regionalism and the Geography of Trade Policies in EU-ASEAN Trade*, Helsinki School of Economics, Dissertation A-245, P. 31

⁶⁸ Carbaugh Robert J. (2005), *Supra*, P. 254

⁶⁹ Sally Razeen (2008), *Trade Policy, New Century: The WTO, FTAs and Asia Rising*, ICA, London, P. 128

tariff FTA member.⁷⁰ Such trade deflection drastically affects members of the FTA with higher tariff rates. To avoid the occurrence of trade deflection, virtually all FTAs impose rules of origin.

At the third level are *Customs Unions* (CUs), in which all tariffs among member countries are eliminated, while external tariffs are adjusted to a common level.⁷¹ As it will be discussed in the forthcoming sections, WTO Rules require that the Common External Tariff (CET) must on average be no higher than the pre union tariff, and “compensation” is negotiated by nonmember countries when accession of a member “harms” the nonmember. The United States, for example, received compensation when Spain joined the European Union on such ground.⁷² The essential difference between a customs union and a free trade agreement is that in a free trade agreement, member countries may differ in the trade barriers that they impose on those outside the agreement. Accordingly, it is argued that customs union provides deep integration than FTAs.

All these three regional trade agreements are, however, generally referred as shallow integrations. While, the remaining two agreements, namely *Common Markets* and *Economic Unions* referred as deep integrations. A Common Market is a customs union which, in addition, permits free movement of factors of production, like labour and capital, among the member countries.⁷³ Beyond common markets is Economic Union, which is a common market that additionally has common economic laws covering issues such as standards across members.⁷⁴

3.2.4 The Proliferation of Regional Trade Agreements in Africa

The wildfire-like spread of RTAs around the globe has stroked the African Continent as early as its first wave. Those African countries inspired by the flattering experience of their counterparts in Europe have embarked on the establishment of RTAs immediately after their independence. The post colonial Africa has accordingly witnessed the formation of more than thirty RTAs.⁷⁵

⁷⁰ Krueger Anne O., (1999), *Supra note 55*, P. 112

⁷¹ *Ibid*

⁷² *Ibid*

⁷³ *Ibid*

⁷⁴ *Ibid*

⁷⁵ Yang Yongzheng and Gupta Sanjeev (2005), Regional Trade Arrangements in Africa: Past Performance and the Way Forward, IMF Working Paper, WP/05/36, P. 6

Self centered development has always been the underlying ideology behind most post colonial African States' economic policies. This ideology has induced African Head of States to adopt the Lagos Plan of Action in 1980 at an Extraordinary Summit of the OAU as the first step toward increased integration on the African continent.⁷⁶ These objectives were put into action with the adoption of the Treaty establishing the African Economic Community (AEC) in 1991. The AEC Treaty, which is commonly referred to as the Abuja Treaty, particularly aims to promote economic, social and cultural development in Africa to ensure higher standards of living, economic stability and peaceful relations between member states.⁷⁷ The Treaty further acknowledges that the development of the continent is hindered by the lack of cooperation and integration between Member States and accordingly pledges to promote intra-African trade and improve market access for local Community products. However, since the continent is made up of 53 countries with large variations in terms of national output and development, the integration process is designed to begin with the formation of sub regional blocs, which could form the cornerstone of a future integrated Africa. This call has led to the proliferation, on the continent, of RTAs with overlapping Membership, which has not in any way helped the original intension of promoting the process of African integration. After calls for the dissolution of some of the irrelevant RTAs was unheeded, the African Union conducted a process of rationalization of RTAs and recognized only eight of them as forming the building blocks of an integrated Africa.⁷⁸ These RTAs include the following: The Arab Maghreb Union (AMU), Economic Community of Central African States (ECCAS), Common Market for Eastern and Southern Africa (COMESA), Southern Africa Development Community (SADC), Economic Community of West African States (ECOWAS), Eastern Africa Community (EAC), Intergovernmental Authority for Development (IGAD) and the Community of Sahel Saharan States (CEN-SAD).

RTAs in Africa are characterized by their overlapping membership. According to World Bank on average, each African country belongs to four RTAs,⁷⁹ while a study by the United Nations Economic Commission for Africa (UNECA) and the African Union Commission (AUC) revealed, in 2006, that an average of 95 per cent of the members of a given RTA were also

⁷⁶ Cord Jakobei, *et al.* (2005), Overlapping Membership in COMESA, EAC, SACU and SADC: Trade Policy Options for the Region and for EPA Negotiations, A Research Commissioned by GTZ, P. 5

⁷⁷ OAU (1991), The Treaty establishing the African Economic Community: Article 4, Abuja Nigeria

⁷⁸ AEC, South African Department of Foreign Affairs <http://www.dfa.gov.za/foreign/Multilateral/africa/aec.htm>

⁷⁹ World Bank (2004), Global Economic Prospects 2005, World Bank, Washington, D.C

members of another.⁸⁰ According to the latter study, the multiplicity of memberships was largely due to strategic, political, and economic consideration. Such multiplicity of membership, however, has constituted a major challenge for the continent's deep integration objective. Furthermore, African RTAs can be reckoned for their "multi-prong approach to regional integration".⁸¹ That is, apart from trade issues, they pursue numerous other agendas such as socio economic development, peace and security, agriculture and environmental conservation.

The function of RTAs in Africa, as is in other parts of the world, is at best controversial. Most RTAs in Africa aim to "promote economic prosperity through regional integration and enhancing growth by exploring economies of scale; enlarging local markets and encouraging investment; facilitating trade liberalization; harmonizing economic policies; enhancing economic convergence; and accelerating economic diversification".⁸² The attainment of such broad objectives is, however, a tough challenge for most of African RTAs. In particular, they need to successfully tackle the following five major challenges in order to prove their worthiness and attain at least some of the above mentioned and often expressed as "over ambitious" objectives.

First, the major challenge for all African RTAs is to ensure the implementation of agreements signed by their member countries. Regional integration initiatives in Africa are mainly recognized for their lack of strong political commitment and policy reversals in implementing harmonization provisions.⁸³ They are known for their solemn declarations and lengthy protocols than for firm implementation of agreed policies and proven economic impact on the ground.⁸⁴ Enforcement mechanisms to compel countries to comply with agreed positions such as on tariff phase-down schedules are generally weak in Africa. Therefore, it is paramount importance for most African RTAs to establish and strengthen regional judicial institution such as SADC Tribunal and the COMESA Court of Justice to perform enforcer roles for their respective protocols and agreements. When there are strong and efficient enforcement mechanisms they can

⁸⁰ United Nations Economic Commission for Africa (UNECA) & African Union Commission (AUC) (2006), Assessing Regional Integration in Africa II, Rationalizing Regional Economic Communities, UNECA, Addis Ababa

⁸¹ Chiumya Chiza Charles N. (2009), Regional Trade Agreements: An African Perspective of Challenges for Customs Policies and Future Strategies, World Customs Journal, Vol. 3, No. 2, P. 86

⁸² Yang Yongzheng and Gupta Sanjeev (2005), *Supra note 75*, P. 12

⁸³ Khandelwal Padamja (2004), COMESA and SADC: Prospects and Challenges for Regional Trade Integration, IMF Working Paper, WP/04/227, P. 6

⁸⁴ Cord Jakobei, *et al.* (2005), *Supra note 76*, P.IX

help address concerns over policy transparency and credibility by locking in unilaterally undertaken trade liberalization measures and functioning as an agency of restraint.⁸⁵

Second, overlapping membership poses an enormous challenge for African RTAs. Membership in different RTAs tends to absorb much-needed and limited human, institutional and financial resources. Along with a lack of strong political determination, multiple-membership has already complicated, if not thwarted, the regional integration process in Africa. A study conducted by IMF in 2004, likewise concluded that overlapping membership in SADC and COMESA has led to conflicting goals and limited progress in both organizations.⁸⁶ Since several of the RTAs are in different stages of forming customs unions, resolving current conflicts of membership is of paramount importance for their well functioning. Furthermore, due to the ensuing complex rules of origin, overlapping membership will impose significant administrative burden on customs.

Third, Revenue losses are important concerns in RTA design and implementation in Africa. Trade taxes generate almost one-third of all government revenues in African countries and trade liberalization will deprive them of this long standing source of revenue.⁸⁷ It is not surprising, then, that a discussion on trade liberalization, despite its type, also provokes a discussion of its potential consequences for government revenues. Thus, in order to ease the integration process and attain their objectives the RTAs need to develop compensatory mechanisms for those countries that will lose fiscal revenues from trade liberalization, though difficult. Otherwise, the current lack of political determination does not seem to be averted in the recent future.

Finally, there are inadequate resources to support regional integration in Africa. The region's ability to raise resources for sustainability of the region's integration process remains a challenge.⁸⁸ Inadequate capacity limits the ability to innovate, diversify and to produce non-traditional goods in order to access new markets in the region and beyond.⁸⁹ Strengthening the RTAs with adequate technical, institutional and financial resources are fundamental components in deepening the regional integration process and ought to be carried out expeditiously.

⁸⁵ *Ibid*, P. 19

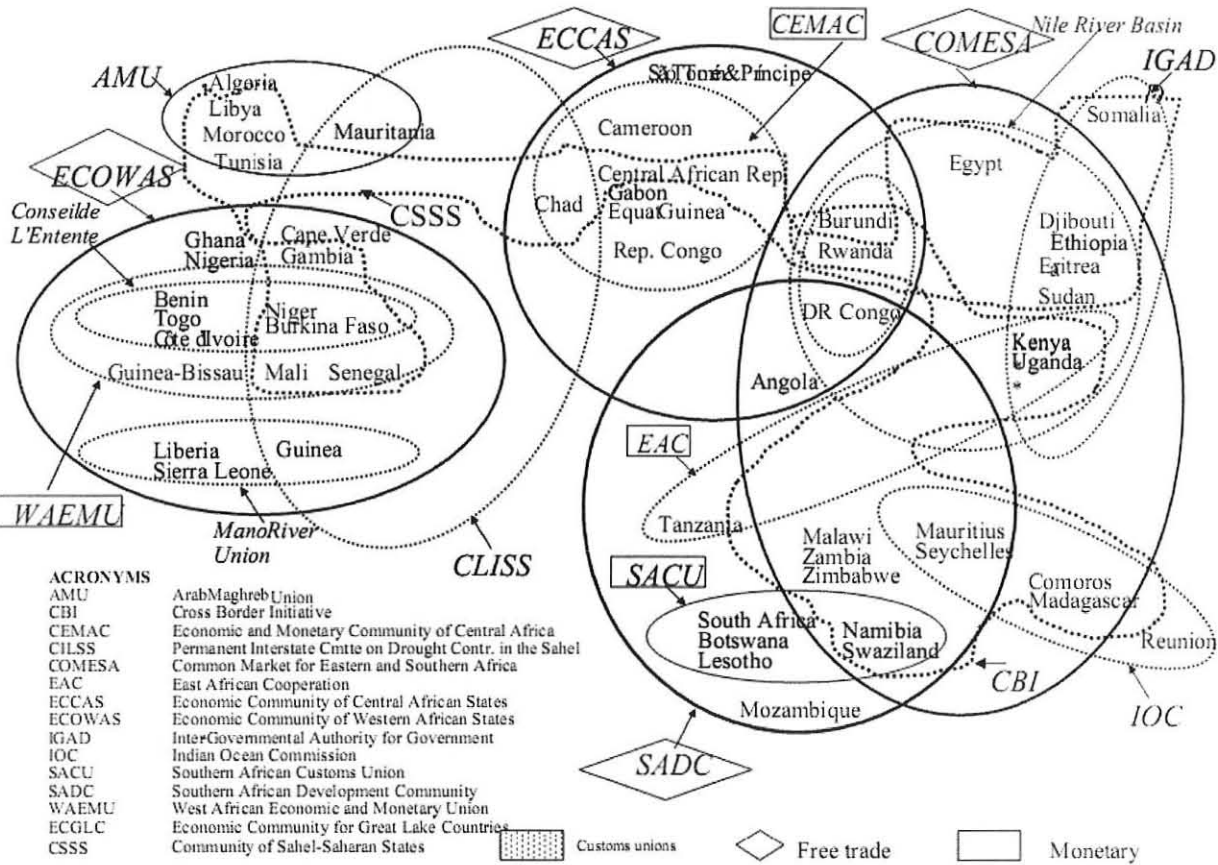
⁸⁶ *Ibid*

⁸⁷ *Ibid*

⁸⁸ Mfunwa Mzwanele G. (2008), Achieving Free Trade Area and Customs Union: Emerging Challenges and Opportunities for Southern Africa, 4th Meeting of ICE, Feature Article

⁸⁹ *Ibid*

Figure 3.2: The Spaghetti Bowl of RTAs in Africa
African Union



Source: Yang and Gupta (2005)

3.3 Regional Trade Agreements and the WTO Law

Non discrimination is the cornerstone of the multilateral trading system. As embodied in Article one of the GATT, Article two of the GATS, and Article four of the TRIPs Agreement, the MFN principle requires that each member grants to all members the same advantage, privilege, favours or immunity that it grants to any other country. In other word, members are forbidden to grant special trade preferences or privilege to any country without giving the same to the rest of the membership. However, as there are no rules without exceptions, there are also exceptions to this principle. RTAs are the most significant and far-reaching exceptions to the MFN principle.

From a critical legal standpoint the tendency to establish preferential trade agreements with some countries excluding the others apparently conflicts against the principle of non discrimination.

And hence RTAs are in clear contradiction to the long standing principle of the multilateral trading system. They have nevertheless, been accommodated in to the multilateral trading system in order to preserve the prerogatives of those countries wishing to trade with their neighbours. During the course of drafting the provisions of the GATT 1947, it was recognized that a number of the founding GATT Contracting Parties were members of different RTAs, while some others were still negotiating to forge similar arrangements.⁹⁰ It thus became apparent that some exceptions were required to preserve the prerogative of such Contracting Parties.

Accordingly, two rules of particular importance for the formation of regional agreements were incorporated in to the GATT 1947. These rules were predominantly entrenched under Article I: 2 and Article XXIV of GATT 1947. The former "explicitly exempts in perpetuity from the MFN requirement certain preferential arrangements existing at the time the GATT came into force".⁹¹ The latter, perhaps the most important one, allows contracting parties to forge such agreements provided that they meet certain requirements to be verified through a notification procedure.

At present, the provisions of GATT Article XXIV complemented by its Understanding on the, the Enabling Clause negotiated during the Tokyo Round and the provisions of GATS Article V provide the legal foundation for the formation of RTAs in the area of trade in goods and services. Of the 474 RTAs notified to the GATT/WTO as of September 2010, 351 RTAs were notified under GATT Article XXIV, 31 under the Enabling Clause, and 92 under GATS Article V.⁹² These rules are essentially meant to minimize the trade diverting and maximize the trade creating effects of RTAs. All the same, they have been widely criticized for being, too vague and inadequate to regulate the formation of RTAs. Despite being too vague or ambiguous they have not been applied successfully so far for different reasons that will be discussed *infra*.

The forthcoming sub sections discuss those criteria stipulated under the so called preferential trade agreement exception Articles of the WTO. However, since the RTAs which are the subjects of this study hardly address trade in services, this section confines itself in to discussing the requirements stipulated under GATT Article XXIV and the Enabling Clause.

⁹⁰ Onguglo Bonapas (2005), Issues Regarding Notifications to the WTO of a Regional Trade Agreement, In Mina Mashayekhi and Taisuke Ito (Eds.), Multilateralism and Regionalism: The New Interface, United Nations, New York and Geneva, P. 34

⁹¹ *Ibid*

⁹² WTO, *Supra* note 46

3.3.1 GATT Article XXIV

When the drafters of the GATT 1947 worked on Article XXIV they could not have imagined that in sixty years time more than half of world trade would be taking place within actual or prospective RTAs such as free trade agreements and customs unions.⁹³

GATT Article XXIV being an exception to the cardinal MFN principle of non discrimination permits departure from this principle and allows the formation of Customs Unions and Free Trade Agreements. Indeed, in the early multilateral trade negotiations that resulted in to GATT 1947, it was envisaged that the only exemptions from the multilateral trade regime would be Customs Unions.⁹⁴ Nevertheless, such decision was reversed and free trade agreements were permitted. While some suggests that the secret negotiation between the United States and Canada to forge free trade area was the main *raison d'être* for the reversal of the original decision, others believe that it is the proposal of Syria and Lebanon for the exemption of free trade area that resulted in the reversal of the original decision.⁹⁵ Regardless of such historical controversies, Article XXIV was made to permit the formation of customs unions and free trade agreements as well as any interim trade agreements that would lead to the formation of customs union or free trade agreement within a reasonable period of time provided that they met certain requirements.

The general function attributed to RTAs as provided under Para.4 of Article XXIV is to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories. The argument that the WTO rules on RTAs are meant to minimize the trade diversion and maximize the trade creation effect of RTAs stems from this provision.

The substantive and perhaps the most important requirements for the formation of Free Trade Areas and Customs Unions are essentially furnished under Para.5 and 8 of GATT Article XXIV.

Para.5 of Article XXIV is specifically aimed at protecting the interest of GATT/WTO members remaining outside a newly formed free trade area or customs union or an interim agreement leading toward the formation of any of the two. The provision in its relevant part reads

⁹³ UNESCAP (2005), Multilateralizing Regionalism: Towards an Integrated and Outward-Oriented Asia-Pacific Economic Area, Trade and Investment Division, P. 2

⁹⁴ Krueger Anne O., (1999), *Supra note 57*, P. 106

⁹⁵ *Ibid*

the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be.

According to this provision, for those countries not included in the union or free trade area or not parties to such agreement that leads to the formation of any of these two, the duties and other regulation of commerce imposed after the formation of such RTAs shall not be higher than before. In the case of the formation of free trade area or an interim agreement leading to the formation of free trade area the comparison refers to the duties and other regulations of commerce imposed by each individual member of the free trade agreement. This provision however, has been and still the source of controversies and long standing debate. First of all, critics argue that it is not clear whether the applicable or applied tariff should be compared.⁹⁶ In recognition of this ambiguity, the Understanding on the Interpretation of GATT Article XXIV has clarified that for the assessment of customs unions the applied tariffs are relevant. In particular, Para.2 of the Understanding states "for this purpose, the duties and charges to be taken into consideration shall be the applied rates of duty". However, nothing has been said concerning free trade areas either under Article XXIV or under its Understanding and hence the ambiguity still persists. Similar issue concerning Para.5 of Article XXIV that has been clarified by the Understanding was the way general incidence of the duties and other regulations of commerce applicable before and after the formation of customs union should be calculated. Para.2 of the Understanding clarified that the calculation of such comparison shall be based up on an overall assessment of weighted average tariff rates and of customs duties collected.

The other important issue concerning Para.5 of Article XXIV relates to which barriers to trade are not to be raised following the formation of customs union or free trade area against third parties. The term other regulations of commerce has never been used anywhere in the entire GATT legal text except under Para.8 of the same Article which uses apparently similar term, other restrictive regulations of commerce. The main issue as regards the interpretation of this term relates to the definition and measurement of non tariff barriers. As no definition of these

⁹⁶ Hilpold Peter (2003), Regional Integration According to Article XXIV GATT: Between Law and Politics, In Bogdandy A. Von and Wolfrum R.(eds.), Max Planck Yearbook of United Nations Law, Vol. 7, P. 234

terms is provided, some members have argued that what matters is not whether some specific measures fall under the umbrella of other restrictive regulations of commerce, but rather if their application among regional trade agreement members leads to a restriction on the trade of third parties.⁹⁷ However, owing to the absence of consensus as to which of the various trade policy instruments should be regarded as other regulations of commerce such issue remains to be the major problem both in relation to barriers raised against third parties and to be eliminated among member countries. Some members, however, argue that non tariff trade barriers such as antidumping duties, preferential rules of origin, technical standards, subsidies and countervailing measures can legally be maintained within regional trade agreements.⁹⁸ The measurement of non tariff barriers, on the other hand, is a very difficult task to be accomplished, especially in the absence of any clear methodology to do so. This has been well recognized in the Understanding where it states that "for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows may be required".⁹⁹

The most important requirement of all for the formation of RTAs is, however, stipulated under Para.8 of GATT Article XXIV. This provision requires free trade areas and customs unions to comprise substantially all the trade of the member countries. However, neither GATT Article XXIV nor its Understanding defines what exactly meant by "substantially all the trade".

Efforts to define the term substantially all the trade requirement have followed two main approaches, which are not mutually exclusive.¹⁰⁰ The first is a quantitative approach which favours the definition of a statistical benchmark, such as a certain percentage of trade between the parties.¹⁰¹ The second approach is more qualitative and requires that no sector (or at least no major sector) be excluded from intra-regional trade agreement trade liberalization.¹⁰² Some regional trade agreement members have tend to interpret it as referring to the whole (horizontal)

⁹⁷ Crawford Jo -Ann and Laird Sam (2000), Regional Trade Agreements and the WTO, CREDIT Research Paper No. 00/3, P. 12

⁹⁸ *Ibid*, P. 13

⁹⁹ Understanding on the Interpretation of Article XXIV of the GATT 1994: Para.2

¹⁰⁰ Crawford Jo -Ann and Laird Sam (2000), *Supra note* 99, P. 11

¹⁰¹ *Ibid*

¹⁰² *Ibid*

trade coverage and no to specific sectors in line with first approach.¹⁰³ This interpretation provides some flexibility to exclude certain product sectors, as is often done by most regional trade agreements with respect to agricultural products or so called sensitive sectors, in general. Proponents of the second approach, on the other hand, argue that the substantially all the trade requirement can only be satisfied when no major sector of economic activity is excluded from the coverage of the free trade area or customs union. Generally, even if Article XXIV seems to rule out RTAs that cover only some goods or reduce tariff only partially, such agreements have been and still continues to be established by WTO members. The simplest example here is COMESA, where some members including Ethiopia, trade only on a limited preferential basis.

Besides such substantive requirements, Article XXIV has also contained some procedural requirements, notification being the major one. Para.7 (a) of GATT Article XXIV states that

Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the Contracting Parties and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

This notification requirement is essentially meant to promote one of the multilateral trading system's fundamental principles, (i.e. transparency), which can lead to reduction in transaction costs. Because of this provision, WTO members which are not members of a proposed RTA would have adequate information about arrangements that may have an effect on their interests.

Compatibility of RTAs has been examined by individual Working Parties that have no central WTO body. Such system, however, proved inefficient as it hardly perform its functions.¹⁰⁴ To address such problems and streamline the examination process, the WTO General Council has established the Committee on Regional Trade Agreements (CRTA) in February 1996.¹⁰⁵ According to its term of reference, the main functions of the CRTA are; to carry out the

¹⁰³ Onguglo Bonapas (2005), *Supra* note 92, P. 37

¹⁰⁴ *Ibid*, P. 42

¹⁰⁵ *Ibid*

examination of RTAs that have been notified to the WTO, develop procedure to improve the examination process, and to receive the biennial reports of existing regional trade agreements.¹⁰⁶

In general, despite their role in reducing the trade diverting effects of RTAs by requiring them to cover substantially all the trade between the constituent parties and prohibiting them to raise trade barriers against non members, the provisions of GATT Article XXIV are full of ambiguities. As a result of disagreements leaded by such ambiguities the CRTA has been unable to perform its functions effectively and deliver its reports on the compatibility of the RTA notified to it since its establishment. As observed by the quote at the beginning of this section, part of the explanation for the ambiguities might goes to the fact that Article XXIV has been drafted at the period where the momentum of regionalism was submissive.

3.3.2 The Enabling Clause

Before the Tokyo Round, the only provision in the GATT legal text dealing with future RTAs was Article XXIV of GATT 1947. However, this Article was viewed inconsistent with the development status of most developing countries and hence replaced by the provisions of the so called Enabling Clause in 1979 with respect to developing countries.¹⁰⁷ By virtue of these provisions while developed countries were allowed to extend differential and more favourable treatment to developing countries without according such treatment to other WTO members, and thus deviating from the MFN principle of non discrimination, developing countries were also allowed to undertake a mutual exchange of trade preferences between themselves. Pursuant to this Clause developing countries can establish a RTA of any kind as far as trade in goods concerned. However, for any RTA to be notified under this Clause all the constituent parties must be developing counties and the inclusion of even a single developed country is not allowed

The substantive requirements for the formation of regional trade agreements under the purview of the Enabling Clause are stipulated under Para.3 of the Clause. According to this provision regional trade agreements among developing countries;

¹⁰⁶ Sampson Gary P. (1996), Compatibility of Regional and Multilateral Trading Agreements: Reforming the WTO Process, The American Economic Review, Vol. 86, No. 2, pp. 88-92

¹⁰⁷ Onguglo Bonapas (2005), *Supra* note 92, P. 39

- Shall be designed to facilitate and promote trade of members and not to raise barriers or create undue difficulties for the trade of third parties;
- Shall not constitute an impediment to the reductions or elimination of tariffs and other restrictions to trade on an MFN basis;

These requirements offer more flexibility and are less demanding than the requirements furnished under GATT Article XXIV, discussed in the preceding section. Under the provisions of the Enabling Clause, there is no obligation to conduct an assessment of the ex ante and ex post level of protection of the regional trade agreement participants against third countries, to verify whether the regional trade agreement conforms to the test of not raising barriers against trade of non participants. Further, there is no obligation in respect of substantially all the trade criteria, as it only requires "mutual reduction or elimination of tariffs".¹⁰⁸ No time limitation specified for interim agreements, and biennial reports are not required of regional trade agreements constituted among developing countries under the purview of this Clause. The only significant obligation imposed by the Enabling Clause on developing countries that constituted regional trade agreements, is to notify to the Committee on Trade and Development (CTD) about the creation (signed and ratified), modification or withdrawal of such agreements.¹⁰⁹

So far, a range of RTAs consisting exclusively of developing countries including the most prominent ones such as the MERCUSOR, ASEAN, SADC, and COMESA have been notified under the Enabling Clause provisions.¹¹⁰ However, it is worthwhile to note that there is no provision either in the Enabling Clause or in GATT Article XXIV that prevents developing countries from notifying or seeking the examination of an RTA under GATT Article XXIV.

3.4 The Regionalism versus Multilateralism Debate

The proliferation of RTAs over the last twenty years has generated an extensive debate as regards to the interrelationship between regional agreements and the multilateral trading system. This debate mainly pertains to the following two broad lines: (i) the relative trade and welfare

¹⁰⁸ Differential and more favorable treatment, reciprocity and fuller participation of developing countries, Decision of 28 November 1979: Para.2 (c)

¹⁰⁹ *Ibid*, Para.4 (a)

¹¹⁰ WTO, *Supra* note 44

effect of multilateral versus regional trade liberalization; and (ii) the impact of regional agreements on the multilateral trading system and in particular on multilateral trade negotiations.

The first question presumes that countries will reap efficiency gains by liberalizing trade and asks which approach to trade liberalization brings more efficiency gains for the liberalizing country. The main argument, based on the free market paradigm, has asserted that multilateral liberalization unequivocally provide these gains, while regional liberalization will not necessarily do so.¹¹¹ According to this view, when trade liberalization is undertaken on a non discriminatory basis the efficiency gains are ensured because the increased imports will come from the most efficient international source.¹¹² Nevertheless, since regional agreements are unlikely to include the most competitive suppliers of all goods and services in their membership the increased imports could come from a less efficient source within the regional agreement.¹¹³ This is, in fact, is likely to be true of regional agreements involving small group of countries. For example, a regional agreement between least developed countries is least likely to comprise the most efficient suppliers of most, let alone all goods and services within its membership.

Advocates of regional agreements on the other hand contend that regional agreements do enable members to enjoy similar efficiency gains.¹¹⁴ They argue that members of regional agreements will increase imports of commodities which their partner can produce more efficiently and increase their own exports of commodities which they themselves can produce more efficiently than their partner. This increase in trade confers efficiency gains in the same way as the increase in trade resulting from multilateral trade liberalization.¹¹⁵

However, the efficiency gains that are supposed to accrue from regional liberalization are subject to a phenomenon called trade diversion, which does not arise in the case of multilateral trade liberalization. Trade diversion occurs when the preference created under the regional agreement diverts trade away from a more efficient supplier outside the agreement, towards a less efficient

¹¹¹ Scollay Robert (2001), Regional Trade Agreements and Developing Countries: The Case of the Pacific Island's Proposed Free Trade Agreement, UNCTAD, Study Series No. 10, New York and Geneva, P. 14

¹¹² *Ibid*

¹¹³ *Ibid*

¹¹⁴ See for example, Summers (1991), Lawrence (1996), Wonnacott, R.J. (1996) and Mansfield (1998)

¹¹⁵ *Ibid*

supplier within the agreement.¹¹⁶ This can happen of course because the higher-cost goods from the partner country enter free of duty and other restrictions under the regional trade agreement, which may allow them to be sold to customers at a relatively lower price than the lower-cost imports from the non-partner, to which duties and other restrictions continue to be applied.

The other issue of particular importance in the regionalism versus multilateralism debate is whether regional agreements constitute a building or stumbling block for multilateral trade liberalization. While some scholars argue that regional trade agreements are impediments to multilateral trade liberalization and thus constitutes a stumbling block, some others believes that regional agreements are building blocks for further trade liberalization at the multilateral level.

Those who consider regional agreements as building blocks argue that these agreements would enable participating countries to move closer and quicker to freer trade over a wider range of goods and services than could be attained at the multilateral level.¹¹⁷ Owing to the limited number of countries they involve, regional agreements are considered as a better forum than the multilateral trading system to deal, especially with complex issues such as agriculture, competition policies, investment and others.¹¹⁸ According to this view the liberalization undertaken in those areas at the regional level will lead to further momentum for multilateral liberalization. That is mainly because; first the trade efficiency gains accrued from regional liberalization may lead countries to soften their resistant to multilateral liberalization; and second consumer may recognize the advantages of cheaper imports and therefore may become more open minded with respect to multilateral liberalization.¹¹⁹

An alternative building block argument is to recognize regional agreements as testing grounds for international policies in new areas. The operating experience of regional agreements in those areas is believed to provide the basis for future multilateral trade negotiations for developing rules for application at the multilateral level.¹²⁰ In these respect, some argue that the dispute

¹¹⁶ Viner Jacob (1950), The Customs Union Issue, as sighted in Ketunnen Erja (2004), Supra note 67, P.30-31

¹¹⁷ Mina Mashayekhi et al. (2005), Multilateralism and Regionalism: The New Interface, in Mina Mashayekhi and Taisuke Ito (Eds.), Multilateralism and Regionalism: The New Interface , United Nations, NY and Geneva, P. 5

¹¹⁸ *Ibid*

¹¹⁹ Glania Guido and Matthes Jurgen (2005), Multilateralism or Regionalism?: Trade Policy Options for the European Union, Centre for European Policy Studies, Brussels, P. 42-44

¹²⁰ Mina Mashayekhi et al. (2005), *Supra*

settlement mechanism of the WTO was taken out from the Canada-U.S. Free Trade Agreement (CUSFTA) model and the WTO approach to technical barriers was inspired by the EU.¹²¹

On the contrary, those who consider regional agreements as a stumbling block argue that the spread of regional agreements is likely to damage the multilateral system. The first argument in this line is that regional agreements are more likely to increase protection against non members.¹²² As one of the most outspoken critics of regionalism, Bhagwati regards regional agreements as inferior to multilateral agreements because, by definition, they deny access trading opportunities to non-members.¹²³ He also asserts that regional agreements are inherently unhealthy even for the member countries themselves because it forces them to engage in discriminatory trade practices rather than trading induced by healthy market preferences.

Another line of argument points to the fact that resources are scares and; the more resources are used to negotiate regional agreements, the less they are available for multilateral trade liberalization process.¹²⁴ This argument, in fact, fits to situations in most developing and least developed countries where financial, human and institutional capacity constraints are very apparent. However the scope of the argument is not limited to the case of developing and least developing countries as it seems, Panagariya for instance pointed out that;

If the President of the United States and his Trade Representative are preoccupied with cutting deals in Latin America, they will have less time and motivation for multilateral negotiations. Furthermore, even if they had the time and motivation, it may become difficult to persuade the U.S. Congress to go along with a multilateral round with negotiating capital having been used up for regional deals.¹²⁵

According to this line of argument countries may lose interest in the multilateral system when they engage actively in regional initiatives, stalling the evolution of the former. In support of this argument many raise the protracted multilateral negotiations during the Uruguay Round and now under the Doha Development Agenda (DDA), which has been launched some eight years before.

¹²¹ Woocock S. (1996), Regional Integration and the Multilateral trading System, as sighted in Porfilio Amelio, *Supra note 52*

¹²² Krueger Anne O., (1999), *supra note 55*

¹²³ Jagdish Bhagwati (1999), Multilateralism and Regionalism in the Post Uruguay Round Era: What Role for the US?, P. 34

¹²⁴ *Ibid*

¹²⁵ Panagariya Arvind (1998), *Supra note 56*

To summarize, the theoretical debate as regards to regionalism versus multilateralism is far from being exclusive and there is no general consensus with respect to both lines of the debate reviewed in this section. Some see regionalism as a step towards multilateral free trade, other as hindrance. Regardless of which opinion one holds, the proliferation of regional trade agreements have become the prominent features of the international economic order, whereby almost all countries in the world have subscribed themselves at least in one regional trade agreement.

Chapter Four

Ethiopia's Trade Policy and Foreign Trade Developments

4.1 General

Ethiopia, a land-locked country with a population of over 76 million in 2008/09¹, is one of the poorest countries in the world. Like many other countries in Africa, agriculture is the mainstay of its national economy. The sector accounts for; *forty five* per cent of the national GDP, *eighty five* per cent of total exports, and generates *ninety* per cent of the country's employment opportunity.² Despite its leading role in the economy, the sector suffers from recurring draught and poor cultivation practices and is mainly dominated by small scale farmers who are accustomed to low input, rain-fed, mixed farming with traditional technologies.³ The other major sectors of the economy namely, services and the industrial sector, are equally weak and inefficient. Although, the share of the service sector to the national GDP has been steadily increasing over the past few years, the share of the industrial sector has been stagnant during the last decade and is still trivial.

Table 4.1: Sectoral Contribution to GDP (2001/02-2008/09)

Year	Share of Major Sectors in GDP (in %)		
	Agriculture and Allied Activities	Industry	Services
2001/2002	48.9	12.8	38.3
2002/2003	44.9	14.0	41.7
2003/2004	47.0	14.0	39.7
2004/2005	47.4	13.6	39.7
2005/2006	47.1	13.4	40.4
2006/2007	46.1	13.2	47.1
2007/2008	44.6	13.0	43.5
2008/2009	43.2	13.0	45.1
Average	45.9	13.3	41.2

Source: Computed from, NBE Annual Report (2008/2009, 2007/2008)

The Ethiopian economy has been state controlled through a series of industrial development plans since the first five year development plan was introduced during the Imperial regime in the

¹ NBE (2009), *Annual Report of 2008/2009*, Addis Ababa, Ethiopia, P.I

² United Nations (2007), *United Nations Development Assistance Framework in Ethiopia 2007-2011*, UN, P. 4

³ Yusuf Bacry, et al.(2008), *How to Optimize Advantages of Accession to the WTO and Measures to be Taken to Meet Possible Challenges*, PSD-Hub Publication No.1, P.24

1950s.⁴ The economic policy of the country, however, drastically changed following the ascent to power of the Ethiopian People Revolutionary Democratic Front (EPRDF) in 1991. The new regime, which is still in power, adopted market oriented economic policies and accordingly embarked on the implementation of far reaching unilateral trade liberalization measures. For nearly two decades before the coming in to power of the EPRDF, the trade policy of Ethiopia was predominantly characterized by controlled foreign exchange allocation, high tariffs, export prohibitions, import quotas, export taxes, and export subsidies.⁵ All these tariff and non tariff trade barriers, however, substantially reduced or eliminated as part of the trade liberalization program that has been implemented since 1991/1992 in line with the Structural Adjustment Program (SAP) of the Bretton Woods institutions.

The purpose of this chapter is to review and analyze the trade strategies of Ethiopia Vis a Vis their impact on the country's external trade regime and to identify the policy objectives and trade interests of the country as explained through its external trade direction and product composition.

4.2 Overview of the Ethiopian Trade Policies

Trade has always been an important component of the Ethiopian economy. The country is regarded as an ancient trading nation.⁶ However, compared to other countries, Ethiopia does not have a strong trading position in the world. The country is one of the least trading nations both in terms of export per capita and export per person.⁷ The main focus of the trade policies of the country has been and still is to improve the balance of payment deficit, which has been and still continues to deteriorate as a result of low export earnings and rising merchandize imports.⁸ However, it is worthwhile to note that currently Ethiopia has no comprehensive and autonomous trade policy. The trade policies of the country are sprinkled throughout various government policy and strategy documents. In particular, they are enshrined under the overall development

⁴ Kiyota Kozo et al. (2007), The Case of Financial Sector Liberalization in Ethiopia, The University of Michigan, Discussion Paper No. 565, P.3

⁵ Derrese Degefa (2001), The Parallel Foreign Exchange Market and Macroeconomic Performance in Ethiopia, African Economic Research Consortium (AERC), Research Paper 107, P. 11

⁶ Pankhurst, R. (1999), A Brief History of Trade and Business in Ethiopia from Ancient to Modern Times, Addis Tribune, 4 June 1999, As Sighted in Amdissa Teshome (2007), The Compatibility of Trade Policy with Domestic Policy Interventions in Ethiopia, Paper Prepared at FAO Workshop , Rome, P.5

⁷ Amdissa Teshome (2007), *Supra*

⁸ Ayele Kuris (2006), The Ethiopian Economy: Principles and Practices, 2nd Ed., Commercial Printing Enterprise

plan of the country, formally referred to as A Plan for Accelerated and Sustainable Development to End Poverty (PASDEP), as well as in the agricultural and industrial policies of the country.

Over the past half a century, Ethiopia has pursued diverse economic policies culminating in major changes in trade policy with profound consequence on expansion of trade and economic development. The three governments that took power ever since the turn to the second half of the twentieth century have designed and implemented diverse socio-economic and political policies. These policies have caused the trade policy of the country to swing between high protectionism and more liberal stance in line with the socio-economic and political ideologies pursued by each government. Tariffs have at various times been used to raise fiscal revenue, limit imports to safeguard foreign exchange or even protect the domestic industries from competition. In addition, various forms of non-tariff barriers such as quotas, prohibitions and licensing schemes have on various occasions been extensively used to limit imports of particular items. This, however, significantly changed following the ascent to power of EPDRF and the accompanied adoption of Structural Adjustment Program in collaboration with the Bretton Woods institutions.

Since the current trade regime is the repercussion of existing as well as past policies and with a view that understanding the patterns of the past can provide insight into things present, the trade policies of the past two regimes have been generally reviewed in the forthcoming sub sections in addition to the trade policies and strategies of the existing regime.

4.2.1 The Imperial Regime [1930-1974]

Although the history of Ethiopia dates back to many centuries before the ascent to power of the Imperial regime it was only during this regime that Ethiopia has obtained its first comprehensive and long term development plan.⁹ The first of the three successive five-year plans was introduced in 1957 and covered the years from 1958 to 1962. The plan was mainly destined to; promote the development of physical infrastructure, accelerate the modernization of agriculture, and raise industrial production based on locally available raw materials.¹⁰ Foreign trade was slightly addressed in the context of strengthening the domestic industries and improving export capacity. While one of the objectives sought to be achieved through the modernization of the

⁹ Ayele Kuris (2006), *Supra*

¹⁰ Imperial Government of Ethiopia (1957), The First Five-Year Development Plan 1958-1962, Addis Ababa

agricultural sector was the enhancement of the export capacity of the country, "much of the physical infrastructure, especially the expansion of the road network was related to the growth of foreign trade"¹¹. On the other hand the strengthening of the domestic industries was mainly destined to substitute foreign goods with locally produced goods that use domestic raw materials.¹²

The second five year plan (1963-1967) was subsequently launched on the basis of the experiences obtained from the first five year plan.¹³ This plan constitutes a logical continuation of the first and marks the beginning of a new 20 year perspective plan. The overall objective of the plan was to bring about a structural transformation of the economy from a predominant agricultural base to an agro-industrial one.¹⁴ The plan envisages the agricultural sector to lead the economy through the provision of food for the growing population, raw materials for the industrial sector and goods for exports to bolster the foreign exchange earnings of the country.¹⁵

As regards exports, the plan stated that the sector would continue to rely on traditional export products such as coffee, hides and skins, oil seed and pulses. But, it also envisages an important role to be played by new export products of industrial origin and mining products.¹⁶ Toward the implementation of the plan a multitude of measures were taken including; the provision of tax incentives, simplification of export trade licensing procedure, and establishment of trade attaches in Ethiopian Embassies and Missions all over the world.¹⁷ Such measures were believed to facilitate the expansion of the country's exports through strengthening their world market acceptance and competitiveness and enhance the terms of trade and balance of payment position.

The third five year plan (1969-1974) was endorsed in 1969. This plan gave much emphasis to the attainment of higher standard of living through a 6% average rate of growth in the GDP which was projected to increase from about 3.6 billion birr to about 4.8 billion birr by the end of its

¹¹ Ayele Kuris (2006), *Supra note 8*, P. 7

¹² Imperial Government of Ethiopia (1957), *Supra*

¹³ Imperial Government of Ethiopia (1962), The Second Five-Year Development Plan 1962-1967, Addis Ababa.

¹⁴ *Ibid*

¹⁵ *Ibid*

¹⁶ *Ibid*

¹⁷ Debele Gemechu (2002), Exports and Economic Growth in Ethiopia: An Empirical Investigation, MSC Thesis, Addis Ababa University, Addis Ababa, Ethiopia, P. 24

implementation period.¹⁸ In contrast to the first two five-year plans, it gave a great deal of attention for external trade in general and for the development of the export sub sector in particular. Its overall objective with regard to foreign trade was to diversify the country's export base as far as possible and improve the consistently deteriorating balance of payment status. To implement this plan, the then existing system of duty draw back on direct raw materials and other components of export product was revised and fiscal as well as monetary incentives were offered for both domestic and foreign investors who were engaged in export-goods production.¹⁹

In sum, this regime pursued a trade strategy that resembles more to import substitution but which equally encompass some important elements of export promotion such as export tax incentives and duty drawbacks. In fact, as elucidated under chapter two of this paper, the period from 1950s to early 1980s was characterized by import substitution throughout developing countries including those in Africa and hence the case of Ethiopia could not be considered as an exception. It is, however, worthwhile to note that integrating the Ethiopian economy with the rest of the world had not been mentioned under any of the three five-year development plans. Moreover, the regime had wasted the opportunity to join the GATT as an original Contracting Party when it was established in the 1940s. As a member of the United Nations Ethiopia was invited to participate in the Havana Charter that was convened *inter alia* to establish the stillborn ITO, but the Imperial government of Ethiopia rejected the invitation for a reason yet to be known.²⁰

4.2.2 The Derg Regime [1974-1991]

The ascent to power of the Derg regime was accompanied by the nationalization of land and other private properties in Ethiopia.²¹ The regime adopted a socialist ideology and accordingly changed the market based economic policy of the Imperial regime with a centrally planned command economic system, which dictates a state control of virtually all economic activities.

The first long term development plan of the regime was launched in 1984. This ten year perspective plan gave much emphasis to the diversification of the country's export structure and

¹⁸ Imperial Government of Ethiopia (1969), Third Five Year Plan 1968/69-1972/73, Addis Ababa

¹⁹ Debele Gemechu (2002), *Supra note 17*

²⁰ Melaku Gebeye Desta (2008), Ethiopia's Reluctance Move to Join the WTO: A Preliminary Look At Legal and Institutional Implications of Accession, Journal of Ethiopian Law, Vol.22 No.1 (2008) P. 23

²¹ Alemayehu Geda (2005), Explaining African Growth Performance: The Case of Ethiopia, Final Report, P. 6

envisages improvement in the export earnings of the country.²² To this effect, the plan set the share of traditional exports to decrease from 73.5 per cent in 1985/86 to 53.2 per cent in 1994/95, while the share of other export products to rise from 26.5 to 46.8 per cent in the plan period.²³

In terms of trade policy the regime overtly pursued an inward looking import substitution industrialization. And hence, fixed exchange rate, high implicit and explicit export taxation, subsidies and rationing of foreign exchange were often used to discourage imports and enhance the capacity of domestic industries to enable them produce goods for the domestic market.²⁴

Of all the trade barriers, however, the overvaluation of the Birr had caused a far-reaching negative impact on the country's foreign trade. The Birr was pegged to US dollar at the rate of 2.07 Birr per dollar throughout the life span of the regime.²⁵ This however, made importing cheaper resulting in low incentive for local production of intermediate goods and raw materials, causing high import dependency of local manufacturing activities and consequently a big pressure on the current account. On the other hand, it created an anti-export bias, where exporters procure their inputs at domestic price which in many cases is inflated for various reasons, but export their output at Birr equivalent of world price, which is very low due to overvalued currency. This situation alongside the severe restrictions imposed on imports forced exporters to sell their products in domestic markets rather than exporting.

Import substitution policies accompanied by a centrally planned command economic system placed strains on the balance of payments, local industrialization stagnated, that by the mid 1980s the manufacturing sector has become unable to meet the limited domestic demand, contrary to what was envisaged by the adoption of such policies.²⁶ The overall situation forced the regime to avert its longstanding socialist oriented economic policy and endorse what it called "mixed economy" system in the late 1980s. However, none of the policies implemented during this regime had improved either the product composition or trade direction of the Ethiopian foreign trade. While the dependency on coffee and some other agricultural raw materials for

²² Military Government of Ethiopia (1984), *Ten Year Perspective Plan 1984/85-1993/94*, Addis Ababa.

²³ *Ibid*

²⁴ Shewangizaw Sileshi (2003), *The Role of Diversification in Reducing Impacts of Export Instability on Ethiopian Economic Growth: An Empirical Investigation*, MSC thesis, Addis Ababa University, Addis Ababa, P. 40

²⁵ Derrese Degefa (2001), *Supra note 5*, P.10

²⁶ Alemayehu Geda (2005), *Supra note 21*, P.7

export earnings continued unabated, Germany and United State remained to be the major export destinations of Ethiopian products throughout the nearly two decades of military administration.

4.2.3 The EPRDF Regime [1991- Present]

The EPRDF ousted the Derg and established the Transitional Government of Ethiopia (TGE) in May 1991. Soon after its ascent to power, the new government led by the EFPRF embarked on fundamental socio-economic and political reforms. One of the glaring features of these reforms was the adoption of structural adjustment policies in collaboration with international financial institutions. These policies have significantly liberalized the country's trade regime and marked the "drastic turn away from a centrally managed economy to a liberalized free market system".²⁷

The overall development policy of the EPRDF government gives due recognition to the overwhelming role agriculture has in the socio-economic and political set up of the Ethiopian population. The government believes that as an agrarian economy, Ethiopia does not have the necessary capital for an outright industrial development.²⁸ Accordingly, it argued that the most appropriate strategy to reduce poverty and promote industrialization and economic growth is to pursue agricultural development that ultimately leads to industrial development.²⁹ This policy is formally known as Agricultural Development Led Industrialization (ADLI) and has been "the flagship of the Ethiopian government since the early 1990s".³⁰ According to the government ADLI is a strategy in which agriculture and industry are brought into a single framework, wherein the development of agriculture is viewed as an important vehicle for industrialization by providing raw material, a market base, surplus labour and capital accumulation.³¹

Subsequent to the inaugural of ADLI as the "overarching policy dictum" of the regime, the government has initiated several relatively short-term development and poverty reduction Strategic plans in line with the main pillars of the former. Among these strategy plans the most comprehensive and recent ones are the Sustainable Development and Poverty Reduction Programme (SDPRP) and A Plan for Accelerated and Sustainable Development to End Poverty

²⁷ MOTI (1997), Trade, Industry and Investment Policies and Performances of Ethiopia, Addis Ababa, P. 6

²⁸ Amdissa Teshome (2006), Agriculture, Growth and Poverty Reduction in Ethiopia: Policy Processes Around the New PRSP(PASDEP), A paper for the Future Agriculture Consortium workshop, 20-22 March 2006, P. 23

²⁹ *Ibid*

³⁰ *Ibid*

³¹ MOFED (2002), Ethiopia: Sustainable Development and Poverty Reduction Program, MOFED, Addis Ababa,

(PASDEP).³² These plans are considered as a national plan for guiding all development activities during their implementation period and pinpoint the overall socio-economic policy and strategy directions of the government. Hence, they are reviewed as follows from trade-policy perspective.

According to the SDPRP the overarching objective of the government's poverty reduction strategy is to reduce poverty through enhancing rapid economic growth while at the same time maintaining macroeconomic stability.³³ To this effect the SDPRP *inter alia* gives recognition to the critical role of exports both in terms of growth of income and foreign exchange.³⁴ Exports are considered as necessity under this strategy not only because of the extremely small ratio of urbanization and the resultant inadequacy of demand for large quantity of agricultural products, but also for some other important reasons. In explaining these reasons the SDPRP has stated that

The enhancement of exports plays an important role in availing foreign exchange for the procurement of new technology and to achieve competitiveness in the international market. The availability of more foreign currency enables increased processing of agricultural raw materials for export enabling a higher number of people to live on off-farm activities. This will in turn lead to freeing land for fewer and more efficient users who can increase the rate of production.³⁵

Furthermore, rapid export growth through production of high value agricultural products and increased support to export oriented manufacturing sectors is provided as one of the eight broad thrusts of the SDPRP. The promotion of high-value agricultural products export was envisaged to "bring about diversification in the peasant private sector, increase household income, expand the market for both excess agricultural production and local manufactures and create more urban-rural integration and commercialization of the agricultural sector in the longer term".³⁶

Following the end of the SDPRP period in 2005, the second development and poverty reduction strategy, dubbed, 'Ethiopia, Building on Progress: Plan for Accelerated and Sustained Development to End Poverty 2005-2010', or shortly PASDEP, was adopted on the basis of the development policies and strategies pursued during SDPRP. The PASDEP pledges to carry forward important strategic directions pursued under the SDPRP, but also embodies some bold

³² Although, the government has recently initiated a new five-year development plan dubbed, the Transformation and Growth Plan (TGP), it is yet to be officially released.

³³ MOFED (2002), *Supra* note 31, P.I

³⁴ *Ibid*, P. 46

³⁵ *Ibid*, P. 114

³⁶ MOFED (2002), *Supra* note 31

new directions.³⁷ Foremost among them is a major focus on growth during its five-year implementation period with a particular emphasis on greater commercialization of agriculture and a scaling up of efforts to achieve the Millennium Development Goals (MDGs).³⁸ Furthermore, the strategy reaffirms the fact that poverty reduction and its ultimate eradication in its entire dimension continues to be the overriding development agenda of the Ethiopian government.³⁹ According to this strategy such objective is to be achieved through an accelerated and sustainable economic growth.

For the attainment of the growth acceleration initiative, PASDEP heavily relies on the diversification and commercialization of agriculture. Reducing reliance on coffee and sustaining the rate of growth of exports that have been witnessed during the final years of SDPRP as well as encouraging traditional exports and enhancing the contribution of nontraditional exports are the other main elements of the strategy.⁴⁰ In similar vein to ADLI and SDPRP, the PASDEP also gives utmost emphasis to promote exports and envisages an ambitious export trade growth of 20-25 per cent per annum during its five years of implementation period (2005/06-2009/10).⁴¹

Unlike previous development plans, however, the PASDEP for the first time demonstrates the government's strong aspiration to integrate the Ethiopian economy with the international trading system. Indeed, several statements were contained in the SDPRP expressing the government's desire to integrate Ethiopian exports with the international trading system, but none of them were direct and specific as it is stipulated under the PASDEP. The latter unambiguously stated that

The Government of Ethiopia has recently initiated the process of Ethiopia's accession to the WTO, which facilitates the integration of the Ethiopian economy with the international trading system through developing skills in bilateral and multilateral trade negotiations.⁴²

According to this statement the policy rationale behind Ethiopia's accession to the WTO is to pave the way for the integration of its economy with the international trading system. Although,

³⁷ MOFED (2005), Ethiopia: Building on Progress A Plan for Accelerated and Sustained Development to End Poverty 2005-2010, Addis Ababa, P. 1

³⁸ *Ibid*

³⁹ *Ibid*, P. 18

⁴⁰ *Ibid*, P. 59

⁴¹ *Ibid*, P. 157

⁴² *Ibid*, P. 156

it is not clear whether the bilateral and multilateral negotiations referred herein are those undertaken during the accession negotiations or the bilateral and multilateral negotiations in which member countries undertake during multilateral trade negotiation rounds, the statement also implies the fact that the government recognizes its lack of trade negotiation skills. Such statement has also been contained in all PASDEP Annual Progress Reports, in the same manner.⁴³

Furthermore, the PASDEP clearly underlined that trade agreements will be reviewed in line with the country's development strategies and policies.⁴⁴ That is those trade agreements which are not in line with the development strategies and policies of the country will not be pursued, as it is unlikely for the development policies of the country to be altered in favour of trade agreements.

The PASDEP, as in the case of SDPRP, also stressed the government's desire to strengthen its effort to gain maximum benefit out of unilateral preferential trade opportunities under the AGOA and EBA initiatives.⁴⁵ However, nowhere in PASDEP or in SDPRP, regional trade integration or efforts to gain maximum benefit out of COMESA membership or EPA negotiations, is considered as export promotion mechanism. The only major policy document wherein regional trade integration is recognized as an instrument of promoting Ethiopian exports is the development framework plan of action dubbed, 'Ethiopia: Development Framework and Plan of Action 2001-2010'. Even under this policy document it is only stated that the government will give "increasing attention to regional cooperation in promoting trade and development".⁴⁶

In sum, the present government pursues a market oriented economic system in which export promotion plays a critical role. In line with this policy, the government has implemented a plethora of unilateral trade liberalization measures, which are the subject of discussion in the forthcoming sections. However, despite membership in COMESA PTA and ongoing Accession process to join the WTO and COMESA FTA as well participating in EPA negotiation, no clear policy was maintained both under SDPRP and PASDEP as regards reciprocal trade

⁴³ See, MOFED (2006), PASDEP: Annual Progress Report 2005/2006, P. 81, and MOFED (2007), PASDEP: Annual Progress Report 2006/2007, P. 101

⁴⁴ MOFED (2005), *Supra note 37*

⁴⁵ *Ibid*

⁴⁶ MOFED (2001), Ethiopia: Development Framework and Plan of Action 2001-2010, Country Presentation by the Government of Ethiopia, 3rd UN Conference on the LDCs, P. 56

liberalization. Indeed, these are general policy guidelines and details are to be found in sector-specific policy documents. Nevertheless, since the country has no autonomous trade policy, it is difficult, if not impossible, to understand the precise policy objective and direction of the government in relation to integrating the Ethiopian economy with the global economy from policy perspective. Yet, it is worthwhile to note that the government's long-term development plan i.e. ADLI is located within the context of progressive integration into the global economy.⁴⁷

4.3 Trade Reform Measures and Indicators

As has been discussed under chapter two of this paper trade liberalization is one of the key elements of economic structural adjustment packages sold to developing countries by the international financial institutions during the import substitution crisis of the 1980s. Import substitution strategies have *inter alia* adversely affected the balance of payment position of most developing countries, making foreign exchanges even scarcer. This led many developing countries around the world to undertake whatever they have been instructed to, by the World Bank and the International Monetary Fund in order to obtain the much needed foreign exchange.

Likewise, the foreign exchange reserve of Ethiopia has been diminished during the 1980s owing to the export bias of the inward-looking import substitution strategies pursued by the military government. As a result, the new government which came in to power in the early 1990s has been forced to inherit "a shattered socialist economy with no foreign exchange reserve to speak of".⁴⁸ This situation, according to Alemayehu, has influenced the government's decision to adopt the Structural Adjustment Program (SAP) of the Bretton Woods Institutions.⁴⁹ Within the context of this program, the government "embarked on a comprehensive trade reform program aimed at dismantling quantitative restrictions and gradually reducing the level and dispersion of tariff rates" since 1991/92.⁵⁰ These reforms have considerably liberalized the trade regime, which was characterized by a plethora of tariffs and non tariff barriers throughout the 1970s and 1980s.

⁴⁷ MOFED (2002), *Supra note 31*, P. 46

⁴⁸ Alemayehu Geda (2005), *Supra note 21*, P. 9

⁴⁹ *Ibid*

⁵⁰ DTIS (2004), *Ethiopia Trade and Transformation: Summary and Recommendations; Diagnostic Trade and Integration Study*, Volume 1, Final Version, P. 20

Nevertheless, such unilateral trade liberalization measures have not yet been accompanied by significant reciprocal trade liberalization, as in the case of most other countries. Despite, joining the COMESA PTA and concluding a "Preferential Trade Agreement" with the neighbour country of Sudan, Ethiopia is yet to undertake any significant reciprocal trade liberalizations, which can lock in the existing trade reforms. Therefore, the recent trade liberalization initiatives launched both through the multilateral and regional fronts may present a novel challenge to the country.

In order to examine the possible implication of the reciprocal trade liberalizations the country is going to undertake in the years to come, it is essential, if not mandatory, to discuss the extent of the trade liberalization measures unilaterally taken by the country so far. The unilateral trade liberalization measures and the extent to which the trade regime is liberalized among other things imply the scope of the challenges the country will face as a result of reciprocal liberalizations. The major trade liberalization measures taken since 1991/1992, i.e. tariff reduction, export promotion and exchange rate policy reforms are accordingly revised as follows with a view to examine whether they facilitates the country's multilateral and regional integration initiatives.

4.3.1 Tariff Structure

Tariff was and still continues to be the major instrument for trade policy implementation. It has traditionally been used for the twin objectives of revenue generation and protection of domestic industry. During the military regime, where inward-looking import substitution strategy was the order of the day, the Ethiopian tariff structure was heavily characterized by high tariff level and tariff dispersion.⁵¹ During this period the Ethiopian tariff structure exhibits that out of the total imports 73 per cent of the goods were subject to an ad-valorem rate ranging from 5 per cent to 230 per cent, 9 per cent of the goods were subject to specific tax, while the remaining 18 per cent were allowed to be imported duty free.⁵² Furthermore, there were more than 23 tariff bands.

The present government, has since the early 1990s adopted a liberal tariff policy which has lead to a simplification of the tariff structure and a massive reduction in tariff levels. Six successive custom tariff reforms were implemented between 1993 and 2003. In the first round (august 1993)

⁵¹ Alemayehu Kuma (2002), Manufacturing Sector and Trade Liberalization in Ethiopia, MSC Thesis, AAU, P. 52

⁵² *Ibid*

the maximum tariff was reduced from 230 per cent to 80 percent.⁵³ It was then gradually reduced and reached 35 per cent in the sixth reform round in 2003. During the same period the average weighted tariff rate has been reduced from 41.6 per cent to 17.5 per cent, and the number of tariff bands has fallen from 23 to 6 including the zero-rate band.⁵⁴ The six tariff rates range from 0 per cent to 35 per cent and are consists of; 0, 5, 10, 20, 30 and 35 per cent. Within the 5 and 10 per cent bands are raw materials and machineries, which are used by manufacturing industries.⁵⁵ Items within the 20 per cent band include organic chemicals, carton, boxes, envelopes, sacks and bags, thread, synthetic filaments, artificial filaments, yarn and synthetic monofilament staple fibers.⁵⁶ Items within the 30 and 35 per cent bands include perfumes, soaps, tiles, transmission belts, ornaments, silk, cotton, jewellery, footwear, motor vehicles, textiles products and toys.⁵⁷

Accordingly, the successive tariff reform measures have reduced the maximum and simple average tariffs of the country from 230 to 35 per cent and from 41.6 to 17.5 per cent, respectively.⁵⁸ However, in order to find out whether such tariff structure facilitates the country's trade integration initiatives, it is imperative to see the tariff structure of other countries as well. In this respect, as can be observed from Table 4.2 below, the Ethiopian tariff structure is one of the most liberalized, especially compared with the bound tariff rate of other countries. In particular, the comparison with the bound tariff rates of Cambodia, Nepal and Vietnam, countries that have joined the WTO through the formal accession negotiations, reveals that Ethiopia will face little challenge in its accession negotiations as regards tariffs.⁵⁹ These three countries have bound their maximum tariff rate at 80, 200 and 2000 per cent respectively, compared to Ethiopia's current maximum tariff rate of 35 per cent.⁶⁰ Therefore, it can be concluded that Ethiopia has liberalized its trade regime even beyond what it is required by the WTO or the accession negotiations. However it is worthwhile to note that during reciprocal trade negotiations, especially in case of WTO accession, such unilateral trade liberalizations are hardly recognized by the negotiating parties. Cambodia and Nepal had significantly reduced their tariffs before their WTO accession

⁵³ Arne Bigsten, *et al.* (2009), Gradual Trade Liberalization and Firm Performance in Ethiopia, WPS/2009-21, P. 4

⁵⁴ *Ibid*

⁵⁵ WTO (2007), Accession Ethiopia: Memorandum of Foreign Trade Regime, WTO document WT/ACC/ETH/3

⁵⁶ *Ibid*

⁵⁷ *Ibid*

⁵⁸ *Ibid*, P. 37

⁵⁹ See table 4.2

⁶⁰ *Ibid*

negotiations aiming to facilitate the accession process, but such reduction did not helped them from being requested to reduce their tariffs even further.⁶¹ Hence, such reductions will substantially compromise the limited bargaining power, the country has compared to its negotiating partners.

Besides, the country's trade protection system now includes no quotas, no seasonal tariffs and no tariff contingent, and quantitative restrictions have been almost entirely eliminated.⁶² Currently there are only about five prohibited items, which are put in place for health reasons and for preventing illegal traders from importing contraband classified as used clothing and rags.⁶³

Table 4.2: Ethiopia's Tariffs Compared to Other Countries (2009)

Country	Simple Average: all Products (Bound)	Simple Average: Agriculture (Bound)	Maximum Duty: All Products (Bound)
Djibouti	20.9 (41.3)	14.2 (49.9)	33 (450)
Egypt	17.3 (36.7)	70.7 (95.4)	>1000 (>1000)
Ethiopia	17.3 (no)	22.3 (no)	35 (no)
Kenya	12.6 (95.4)	19.9 (100)	100 (100)
Sudan	20.4 (no)	31.7 (no)	40 (no)
Tanzania	12.6 (120)	19.9 (120)	116 (120)
Uganda	12.6 (73.4)	19.8 (77.6)	80 (80)
Cambodia	14.2 (19.1)	18.1 (28.1)	35 (60)
Nepal	12.4 (26.0)	14.3 (41.4)	154 (200)
Vietnam	10.9 (11.4)	18.9 (18.5)	145 (200)

Source: World Tariff Profiles 2010

4.3.2 Exchange Rate Reforms

Devaluation of the national currency (Birr) was another important pillar of the trade policy reform package that has been implemented by the government since 1991/1992. As has been mentioned earlier in this chapter, one of the souring points of the import substitution policy pursued by the military regime was the overvaluation of the Birr, which was pegged at the rate of 2.07 Birr per US dollar. The overvaluation has adversely affected the country's trade balance.

⁶¹ Federico Foders (2008), *Accession of Cambodia and Nepal to the WTO*, gtz Trade Programme, P. 6-7

⁶² Mamo E. Mihretu (2005), *Preparation For WTO Accession: The Case of Ethiopia*, In Preparation for WTO Accessions: Insights from Developing Countries, Country Studies Commissioned by Simon J. Evennet, P. 128-129

⁶³ DTIS (2004), *Supra* note 50, P. 22

Cognizant of this fact, the new government, as part of its trade policy reform package embarked on drastic devaluation of the Birr. The first of the successive currency devaluation measures was taken in October 1992 and resulted in an exchange rate of 5 Birr per US dollar.⁶⁴ The devaluation episode has continued unabated and currently the exchange rate stands at 16.47 Birr per US dollar.⁶⁵ The devaluation is expected to encourage exports by raising payment for exports in terms of the national currency, while at the same time discouraging imports by keeping the payments for imports higher. This in turn is expected to exert a positive impact on the consistently deteriorating balance of payments by stimulating exports and restraining imports.⁶⁶

Besides devaluation, the government has taken a range of other foreign exchange related measures including; the introduction of interbank foreign exchange auction and elimination of the foreign exchange surrender requirement, and a significant reduction in the number of items included in the negative list used to determine import eligibility for foreign exchange access.⁶⁷

4.3.3 Prompting Exports

A sectoral policy is not limited to the establishment of the legal rules binding upon the agents that operate within a given sector. It can also comprehend measures aimed at the promotion and encouragement of economic activities. Trade policy is not an exception. Thus, the international legal trade regime is accompanied in all countries by export encouragement and support strategies. Likewise, the other key component of the trade reform package was export promotion. The development and poverty reduction policies and strategies of the government including ADLI clearly underlined the importance attached to exports and the commensurate necessity of export diversification and private sector participation in export trade.⁶⁸ Furthermore, strengthening the international competitiveness of traditional exports and diversifying the export base of the country, which is merely confined to few agricultural products bundle (coffee, pulses and oilseeds, etc.) is the fundamental export trade development objective of the government.⁶⁹

⁶⁴ Derrese Degefa (2001), *Supra note 5*, P.11

⁶⁵ NBE (2010) Exchange Rate: 16.4775, Applicable on: 2010-11-2, available at <http://www.nbe.gov.et>, last visited on November 24, 2004

⁶⁶ Amdissa Teshome (2007), *Supra note 6*, P. 8

⁶⁷ MOFED (2002), *Supra note 31*, P.114

⁶⁸ MOFED (2001), *Supra note 46*, P.53

⁶⁹ MOFED (2002) *Supra note 31*, and MOFED (2005) *Supra note 37*

As an integral part of the export promotion effort, the government has initiated a number of measures including the establishment of an export promotion agency, the introduction of a duty drawback scheme and the elimination of foreign exchange surrender requirements.⁷⁰ Exporters can now retain up to ten per cent of their foreign exchange receipts in foreign currency deposit accounts and sell the rest to any local bank or foreign exchange bureau at freely negotiated rates over an extended conversion period of four weeks.⁷¹ In addition, foreign investors in the export sector are allowed to buy foreign exchange for remittances. The extensive list of measures taken by the government to promote exports since the early 1990s is provided in the table below.

Export strategy was also prepared by MOTI in 1998, which sought to encourage increased penetration of Ethiopia's agricultural goods into global markets with the initial focus on cotton, coffee, fruit and vegetables. Priority was also given under this strategy to promoting exports of textile and leather garments as well as other manufactured goods for regional markets.⁷² The responsibility of promoting such objectives was given to the Export Promotion Agency, which was established in 1998 as an autonomous agency.⁷³ According to its establishing proclamation, the major responsibilities of the agency include, rendering professional support and training to exporters, enhancing the country's competitiveness in overseas markets, linking up Ethiopian exporters with foreign importers and providing necessary support to exporters in order to participate in regional and international trade fairs and other trade promotion events.⁷⁴

Table 4.3: Measures Taken to Promote Exports

Number	Export Promotion Measures
1	Foreign exchange retention scheme
2	Foreign supplies and loan scheme
3	Export price control replaced with ex-post price verification system, except coffee
4	Export duty on all commodities abolished except coffee
5	Voucher system and a bonded manufacturing warehouse scheme
	Credit guarantee scheme which embraces pre-and-post-shipment

⁷⁰ MOTI (1997), *Trade, Industry and Investment Policies and Performance of Ethiopia*, Addis Ababa, P. 10

⁷¹ UNCTAD (2002), *Investment and Innovation Policy Review: Ethiopia*, UN, UNCTAD/ITE/IPC/Misc.4, P.10

⁷² *Ibid*, P. 35

⁷³ FDRE (1998), *Ethiopian Export Promotion Agency Establishment Proclamation No. 132/1998*, 5th Year No. 9

⁷⁴ *Ibid*, Article. 5

6	credit guarantee and credit relief program is primarily aimed at encouraging export through alleviating pre-and-post-shipment and other temporary financing problems exporters may face.
7	A duty draw back scheme aimed at providing exporters of manufactured goods imported inputs at world market prices
8	Re-discount window opened at the National Bank of Ethiopia
9	Export licensing regulation and procedure simplified
10	Strengthening and enhancing institutional support for the export sector through strengthening/revitalizing existing institutions and establishing new institutions: the Ethiopian Livestock Marketing Authority, the Ethiopian Leather and Leather Products Technology Institute and the Ethiopian Export Promotion Agency with a view to provide the export sector with strong institutional support on a sustainable basis
11	To encourage exporters and create a spirit of competition among themselves various awards are also given to those with excellent export performances by MOTI; and
12	Enhancing private sector development and private-public partnership through providing an enabling legal and operating environment, the promotion of effective industry associations and creating a forum for consultation between the exporting community and government.

Sources: SDPRP (2002), DTIS (2004), and MOTI (1997)

The overall purpose of adopting export promotion policies and undertaking all these liberalization measures is to promote the competitiveness of Ethiopian export commodities and diversify the country's export base, which in turn is envisaged to improve the trade balance of the country. The forthcoming sections will demonstrate what impact these measure have caused in the export trade regime both in terms of export and import composition and destination.

4.4 The Ethiopian Trade Regime

As has repeatedly been noted Ethiopia is an agrarian economy with a very small industrial base. Agriculture is the source of livelihood for the vast majority of the Ethiopian population, means of employment for the overwhelming number of the society, and hence the backbone of the national economy. As a reflection of the overall economic structure, the Ethiopian merchandize export has been and still continues to be dominated by the agricultural sector. Agricultural and allied activities accounted for more than 85 per cent of export earnings, on average over the past few

years.⁷⁵ In contrast to imports, exports are very trivial, contributing to a chronic balance of payment and current account deficit. As is presented in the table below, despite the number of trade reforms and export promotion measures taken since the early 1990s, the country's trade balance has not been improved, if it is not worsened. Part of the explanation lies in the fact that while imports consistently rise as a result of import liberalization, exports remained to rely on few agricultural raw materials which are subject to a number of supply side constraints, price volatility, and low income elasticity. In addition, the country is a price taker in almost all of its export commodities, including coffee. The world price for Ethiopian coffee often depends on the performance of the major coffee suppliers (like Brazil and Vietnam) to the world market.⁷⁶

Table 4.4: Components of External Trade as a Percentage of GDP

Particular s	Year							
	1987/8 8	1988/8 9	1989/9 0	1990/9 1	2005/06	2006/ 07	2007/08	2008/ 09
Exports	5.26	5.83	4.50	2.98	7.70	6.1	6.50	4.6
Imports	15.19	13.41	10.84	11.10	33.90	26.4	30.40	24.5
Trade Balance	-9.93	-7.58	-6.34	-8.12	-26.20	-20.3	-23.90	-19.9

Source: Compilation from annual Reports of NBE

As can be inferred from the above table, although Ethiopia has experienced a chronic trade balance deficit even before the trade reform period, the post reform period has witnessed a more intensified deterioration in the balance of payment position of the country. The narrow range of trade deficit during the pre reform period may be attributed to the import substitution policies pursued by the then government and the resultant severe restriction on imports. But, considerable improvement has not been registered in the post reform period with regard to exports that can counterbalance the rising imports that may have been induced by the liberalization. Despite, its multifaceted adverse effect, import substitution has at least served its purpose during the 1980s by restricting imports, while export promotion is yet to serve its purpose of improving exports both in terms of volume and product coverage. This is not, however, to mean that exports did not increased at all, but in contrast to the rate of increase in imports their increase is trivial at best.

⁷⁵ Computation based on NBE Annual Reports of 2004/05, 2005/06, 2006/07, 2007/08, and 2008/2009.

⁷⁶ Shewangizaw Sileshi (2003), *Supra* note 24, P. 6

4.4.1 The Composition of Ethiopia's Foreign Trade

4.4.1.1 Exports

All major development and poverty reduction strategies endorsed by the government ranging from ADLI to SDPRP and PASDEP clearly underlined the importance attached to exports and the commensurate necessity of increasing and diversifying the country's export composition to ease the chronic foreign exchange shortage and reduce the heavy dependence on two or three agricultural commodities. The Diagnostic Trade and Integration Study (DTIS) sponsored by major international economic institutions under the Integrated Framework (IF) program has also recommended *inter alia* diversification in export commodities, increasing productivity in agriculture, livestock, and meat production, and strengthening the manufacturing and tourism industry.⁷⁷ All the same, the Ethiopian exports remained confined to few agricultural raw materials bundle of which a single agricultural product i.e. coffee constitutes the overwhelming majority. The bulk of export earnings of the country come from coffee which accounted for 35 per cent, on average of total export earnings over the past few years.⁷⁸ There has been a determined effort at diversifying the export base from the traditional coffee exports towards giving impetus to the non-coffee exports and bolstering value-added. However, the efforts to diversify the country's export base beyond coffee have not met with great success so far. As the following table demonstrates the composition of exports had remained essentially the same.

Table 4.5: Share of Major Export Items

Export Items	Percentage Share in Total Exports over the Years						
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	Average
Coffee	37.2	39.6	35.4	35.8	35.8	26.0	35.0
Oil seeds	13.8	14.8	21.1	15.8	14.9	24.6	17.5
Leather and Leather Products	7.3	8.0	7.5	7.6	6.8	5.2	7.1
Pulses	3.8	4.2	3.7	5.9	9.8	6.3	5.6
Meat and Meat Products	1.3	1.7	1.9	1.3	1.4	1.8	1.6

⁷⁷ DTIS (2004), *Supra* note 50

⁷⁸ Computation based on NBE Annual Reports of 2004/05, 2005/06, 2006/07, 2007/08, and 2008/2009.

Fruit & Vegetable	2.1	1.9	1.3	1.4	0.9	0.8	1.4
Live Animals	0.3	1.5	2.8	3.1	2.8	3.6	2.3
Chat	14.7	11.8	8.9	7.8	7.4	9.6	10.0
Gold	8.1	7.0	6.5	8.2	5.4	6.8	7.0
Flower	0.4	0.9	2.2	5.4	7.6	9.0	4.3
Others	11.1	8.6	8.8	7.7	7.2	6.3	8.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

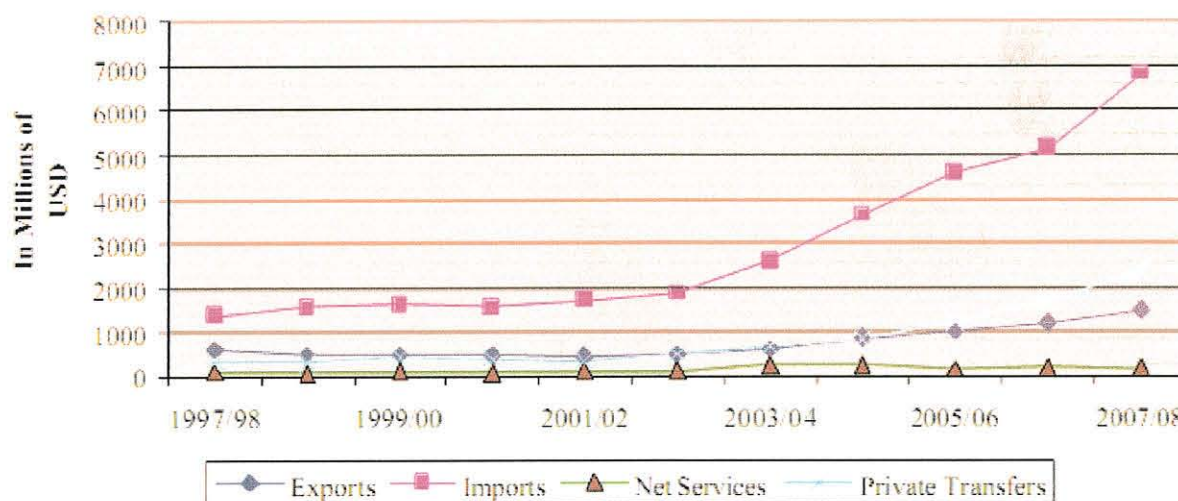
Source: Computation Based NBE Annual Reports

As can be observed from the above table, despite steady decline through time, coffee continued to be the dominant export commodity, distantly followed by oilseeds, chat, gold and a bunch of other agriculture products. It can also be observed that the share of few commodities such as flower and live animals has been increasing. In nut shell, however, despite the plethora of trade liberalization and export promotion measures taken ever since the country has adopted the structural adjustment program, much has not been changed in terms of export composition, although the relative share of the various agricultural exports had changed. This fact, among other things, implies that at least in short and medium term the export interest of Ethiopia relates to these agricultural commodities and any future liberalization must take the sector in consideration.

4.4.1.2 Imports

Trade openness, as broadly discussed in chapter one, have a great tendency to improve imports more than exports particularly in the short and medium term, leading to drastic trade deficit. This is what practically happened in Ethiopia. Since the trade liberalization measures have been taken imports are strongly increasing, while at the same time deteriorating the country's trade balance. Competition from imports may lead to specialization, efficient allocation of resources, cleanses the economy of inefficient producers, and most importantly enhances the consumers' opportunity to choose over a wide variety of better quality and cheaper imports. But, in the absence of equally increasing exports and competitive domestic industries, imports are economic burdens to the host country. In addition to huge foreign exchange needed to finance them, they may force domestic industries out of market, induce unemployment and hence retard economic growth.

Figure 4.1: Trends in Export and Import Growth (1997/98-2007/08)



Source: NBE Annual Report 2007/2008

Total share of imports in GDP has been 28.5 per cent, on average during the period between 2002/03 and 2008/09.⁷⁹ And as depicted in the figure below the share of imports has consistently increased over the past decade, contributing to the deterioration of the balance of payments.

In terms of imports by end use the composition of Ethiopian import is dominated by capital goods which accounted about 29.60, 33.88, 33.01, 33.2, 36.5, 28.0 and 32.0 per cent of the total imports in 2002/03, 2003/04, 2004/05/, 2005/06, 2006/07, 2007/08 and 2008/09, respectively.⁸⁰ Subsequent to capital goods, consumer goods, semi-finished goods, fuel and raw materials constitute the remaining imports of the country. It has to be noted, however, that the share of each import group often varies following changes in international price of fuel and other import commodities and hence it is difficult to discern a consistent trend in terms of their relative share.

4.4.2 The Direction of Ethiopian Foreign Trade

Unilateral trade liberalization measures are less likely to influence the direction of foreign trade as they are often undertaken on a non discriminatory basis and involve no reciprocity. However, it is worthwhile to review the export destination and import source of Ethiopian foreign trade to set the stage for the discussion on the possible implications of reciprocal trade liberalization.

⁷⁹ Computation based on NBE's Annual Reports of 2004/05, 2005/06, 2006/07, 2007/08, and 2008/2009.

⁸⁰ *Ibid*

Export destinations and import sources influence the scope of benefits and costs (especially in fiscal revenues) a country may gain or pay as a result of its reciprocal liberalization measure.

4.4.2.1 Exports

Similar to the commodity composition, the country's export sector is also characterized by geographic concentration where a significant proportion of the country's exports destined to very few markets. Looking at the most recent year (2008/09), continent wise, the main markets for Ethiopian exports were Europe, Asia, Africa and America, which accounted for about 41.7 per cent, 35.6 per cent, 16.6 per cent and 5.7 per cent, respectively.⁸¹ The export destination of Ethiopian exports becomes even more concentrated when it is viewed in terms of individual countries. Of the total exports destined to Europe during the aforementioned year, only four countries i.e. Germany, Netherlands, Switzerland and Italy took the lion's share.⁸² The Ethio-Sino relationship is one of the burgeoning diplomatic relationships of the last few years, and thus the Chinese market has emerged as one of the huge export markets for Ethiopian commodities during the same period. During the above mentioned year alone the Chinese market accounted for about 35.3 per cent of the total exports to Asia, followed by Saudi Arabia, UAE and Israel.⁸³ Of the total exports destined to Africa, 88.6 per cent went to three neighborhood countries i.e. Somalia, Sudan and Djibouti, where chat export is overriding.⁸⁴ Export to the United State accounted for 73 per cent of the total export to America during the same period.⁸⁵

These figures shows where the Ethiopian foreign trade interest lies in terms of trade partners. Ethiopian exports would greatly benefit from market ease in the aforementioned countries than in any other country at least in the near future and reciprocal trade liberalization which involve those countries would at least benefit the country in bolstering traditional exports.

4.4.2.2 Imports

Like the case of exports, Ethiopian imports are also characterized by geographic concentration. The country imports large part of its import commodities mainly from Asian countries. During

⁸¹ NBE (2009), *Supra note 1*, P. 70-71

⁸² *Ibid*

⁸³ *Ibid*

⁸⁴ *Ibid*

⁸⁵ *Ibid*

the year 2008/2009 out of the total imports of the country Asian countries accounted for 64.7 percent, followed by Europe (24.8 per cent), America (6.5 per cent), and Africa (3.9 per cent).⁸⁶ Of the total imports from Asia, China alone accounted for 26.2 per cent, followed by Saudi Arabia, India and UAE, each accounting for 25 per cent, 10.08 per cent, and 9 per cent respectively.⁸⁷ While the main imports from China are textiles, metals, telecommunication apparatus, vehicles, electric materials and machinery, 70 per cent of imports from Saudi Arabia and 60 per cent from UAE were petroleum products.⁸⁸ Among European countries Italy was the dominant supplier accounting for 24.5 per cent followed by Russia (9.3 per cent), and Turkey (8.9 per cent). Imports from Egypt Sudan and South Africa in sum accounted for 76.8 per cent of the total imports from the African continent.⁸⁹ The share of imports from Sudan has shown consistent increase ever since natural gas was started to be produced in that country.

In sum, China, Italy, Saudi Arabia, Egypt, and Sudan are the major suppliers of Ethiopian imports and reciprocal trade liberalization with any of these countries would have a considerable impact particularly in terms of fiscal revenue since imports from these countries upon reciprocal liberalization would enter in to the domestic market with less or no tariff imposed upon them.

⁸⁶ *Ibid*, P. 71-72

⁸⁷ *Ibid*

⁸⁸ *Ibid*

⁸⁹ *Ibid*

Chapter Five

Options for Ethiopian Foreign Trade Policy

5.1 Introduction

Promoting the diversification and competitiveness of Ethiopian exports has been and still is the fundamental foreign trade policy objective of the Ethiopian government. For the attainment of this objective, all the three regimes that took power since the second half of the twentieth century had designed and implemented different trade strategies ranging from import substitution to export promotion. However, most of these strategies have met with little success. The present government has been implementing outward oriented trade policies and has undertaken far reaching unilateral trade liberalization measures. Despite some progress in recent years, the competitiveness and composition of exports has, however, remained essentially the same. Cognizant of this fact the government has launched reciprocal trade liberalization efforts to secure market outlets and thereby integrate the domestic economy with the global economy.

However, by pursuing reciprocal trade liberalization, the country is heading into uncharted territory, where the decisions it makes will constrain its existing policy space and have a significant impact on the evolution of the economy. Undertaking binding trade liberalization agreements will significantly reduce the country's ability to use tariff and other trade related policies in the future as a means of encouraging production or nurturing local industries and expose the domestic industries for stiff competition. At the same time, it may also bring numerous benefits including; increased foreign market access, enhanced foreign investment inflow, credibility and predictability in the trade regime, efficient allocation of resources, technical assistance and capacity building support and other socio-economic and political gains.

Therefore, it is imperative that the country properly manages its trade integration process so as to minimize the possible challenges and maximize the benefits that may accrue from integration. This among other things requires designing and implementing an appropriate trade policy and strategies. Thus far, as has been noted in the preceding chapter, the country has no autonomous trade policy to speak of. Trade policy issues are scattered throughout poverty reduction and development strategy papers and different sectoral policies. Such policies, however, could not

help address the particular situation of the integration processes. Besides, the country has no experience in trade integration processes. Apart from the numerous bilateral trade and investment agreements concluded with different countries, thus far, the only major trade integration moves made by the country is joining the Common Market for Eastern and Southern Africa (COMESA) and concluding a Preferential Trade Agreement (PTA) with the neighbouring country of Sudan, which entails duty free access for all imports originating from either side.¹

Against this backdrop, the overarching objectives of this chapter are assessing the possible implication of the various trade integration initiatives, analyzing their relative merits and accentuating the need sequencing between the multilateral and regional integration processes.

5.2 The Multilateral Pathway

5.2.1 Ethiopia's Accession to the WTO: The Process and Current Status

Ethiopia has never been a signatory to the GATT. Neither the Imperial nor the Military regime had recognized accession to the multilateral trading system as a panacea for the development endeavor of the country. It was only in 1997, "two years after the establishment of the WTO that the country formally submitted an application for observership with a declaration of its 'intention to apply for accession to the WTO Agreements in the near future'".² The WTO General Council promptly accepted Ethiopia's application and bestowed an observership status to the country.³

After more than five years of observership and attempt to acquaint and familiarize itself with the WTO agreements and the workings of the Multilateral Trading System, the country eventually submitted its formal request to accede to the WTO under Article XII of the Marrakesha Agreement in January 2003.⁴ A month later, the General Council accepted the application and established an accession working party under the Chairmanship of N. MacMillan of the United Kingdom.⁵ Subsequently, as part of the accession procedure, the country embarked on the

¹ FDRE (2003), Ethio-Sudan Preferential Trade Agreement Ratification Proclamation No. 318/2003, Addis Ababa

² Melaku Gebeye (2009), Accession for What? An Examination of Ethiopia's Decision to Join the WTO, Journal of World Trade Law, Vol. 49, No. 43, No. 2, P.347

³ *Ibid*

⁴ WTO, Accessions: Ethiopia, available at http://www.wto.org/english/thewto_e/acc_e/al_ethiopia_e.htm last visited on October 30, 2010

⁵ *Ibid*

preparation of its Memorandum of Foreign Trade Regime (MFTR), which presents a comprehensive description of the nature of the country's trade and investment policies, the extent to which they have been liberalized and the legislative system in effect. The Memorandum was submitted in December 2006 to the WTO Secretariat and accordingly circulated to all WTO members.⁶ In response to the comments and questions sought by the circulation, two countries, namely, United States and Canada submitted a set of 250 questions.⁷ The questions normally flow from the circulated memorandum and essentially dealt with clarification. Ethiopia completed answering the questions and submitted them to the Secretariat on February 8, 2008.⁸

The first working party meeting on Ethiopia's WTO accession was held on May 16, 2008.⁹ Although the second Working Party meeting was scheduled to be held in the summer of 2009, it is not held yet as a result of disagreement on the appointment of a new Working Party Chairman in place of the retired Ex-Chairman.¹⁰ Ethiopia's first proposed Chairman was rejected by some Working Party members, especially by the United States, on procedural grounds that the Chairman must come from an ambassador based in Geneva.¹¹ Recently, Ethiopia has nominated the newly appointed ambassador of Denmark to the Permanent Mission in Geneva to serve as a chairman of the Working Party.¹² However, despite causing unnecessary delay in the already protracted accession course, such disagreement and confrontations may adversely affect accession process and most importantly confirm the widely held belief that nothing would be taken for granted in the accession process, where all decisions are need to be taken by consensus.

5.2.2 Rationales for WTO Accession

The motivations behind Ethiopia's decision to join the WTO are no apparent from official policy documents. Thus far, the only authoritative source which exclusively addresses the rationales of Ethiopia's accession to the WTO is the statement made by Ethiopia's Representative at the

⁶ *Ibid*,

⁷ Fortune (2010), Ethiopia Names New Chief of Accession to Trade Organization, Vol. 11, No. 539, Sunday August 29, 2010, P. 24, a second round of questions was also forwarded from the EU and dully replied by Ethiopia.

⁸ WTO, *supra* note 4

⁹ *Ibid*,

¹⁰ Interview conducted with Mr. Lisanework Gorfu, Head, Multilateral Trade Relation and Negotiation Division, Trade Relation and Negotiation Directorate, MOTI on May 6, 2010

¹¹ Fortune (2010), *Supra*

¹² *Ibid*

meeting of the WTO General Council on February 10, 2003. According to the Minutes of the Meeting, the Representative described the rationales of Ethiopia's WTO accession as follows

[The] government was fully convinced that the *best way* to accelerate economic growth and development was to integrate its economy into the multilateral trading system. To be a Member of the WTO was to be part of the rules-based multilateral trading system, and this would create confidence for investors and serve as an instrument to attract foreign direct investment for diversifying the production base and expanding the supply capacity of the country. It would also help to secure predictable and transparent market access.¹³

These, among others, were the main rationales that drive the Ethiopian government to apply for WTO accession and to be part of the multilateral trading system. Most of these objectives are not new to the country, achieving economic growth and development, promoting the diversification and competitiveness of exports and/or raising the supply capacity of the country are objectives which were directly or indirectly avowed in most government policy documents reviewed in the preceding chapter. The mechanism envisaged to achieve them is, however, entirely novel to the country. For the long past the Ethiopian government has been relied mainly on unilateral trade liberalization to achieve those objectives. However, as can be observed from the statement made by the representative, the Ethiopian government now recognizes multilateral trade liberalization as the "best way" to accelerate economic growth and development, attract Foreign Direct Investment (FDI) and secure predictable and transparent market access for Ethiopian exports.

5.2.3 Ethiopia's Preparation for WTO Accession and Possible Challenges

The process of accession to the WTO is not only technical and complex, but it is also tedious and onerous for acceding countries in general and for least developed countries in particular. To mention some, it requires preparation and submission of highly technical documents including memorandum on the foreign trade regime, concluding far reaching bilateral and multilateral negotiations, major revision of national legislations and implementing institutions, establishing appropriate organization and reporting structure within the government, and

¹³ WTO (2003), WTO doc. WT/GC/M/78, Minutes of the General Council meeting held on February 10, 2003, P. 2

managing impact assessment studies, training activities and consultation with stakeholders.¹⁴ The key measures taken in the context of Ethiopia's accession to the WTO are highlighted as follows.

Once the application for accession approved, the Ethiopian government embarked on several activities to facilitate the accession process. The first important measure taken by the government was to commission a report in conjunction with the World Bank to prepare a roadmap in order to guide the process in an organized fashion.¹⁵ The roadmap, inter alia identified different organizational arrangement options for the conduct of the negotiations, an approximate time table for the accession negotiations, and a preliminary list of capacity building and other technical assistance projects. According to its original version, the accession process was envisaged to be completed by 2009.¹⁶ However, due to delays in the process including in the submission of the MFTR, the final date of Ethiopia's WTO accession was revised to be 2013.

A WTO Affairs Department was established within the Ministry of Trade and Industry (MOTI) in order to organize and coordinate the overall process in accordance with the roadmap.¹⁷ Two national committees, i.e. the National Technical Committee and the National Steering Committee have also been set up to undertake the technical aspect of the accession process and to look after the accession negotiations, respectively.¹⁸ The latter committee is chaired by MOTI and composed of various ministries, agencies and other stakeholders, such as chambers of commerce.

Besides those institutional activities, several other activities have also been undertaken by the WTO affairs department, the Committees, the donor agencies, especially the USAID under its 'Doha Project for WTO Accession and Participation- Ethiopia', and international economic institutions. These activities include impact assessment studies on different agreements of the WTO, trainings and workshops to strengthen the institutional capacity of the WTO affairs department and MOTI as well as to create awareness among major stakeholders.

¹⁴ Mamo E. Mihretu (2005), *Preparation For WTO Accession: The Case of Ethiopia*, In *Preparation for WTO Accessions: Insights from Developing Countries*, Country Studies Commissioned by Simon J. Evannet, P. 122

¹⁵ *Ibid*

¹⁶ MOTI (2006), *A Roadmap for Ethiopia's WTO Accession*, Draft Version, October 11, 2006

¹⁷ Such department was recently dissolved and re-constituted as a Multilateral Trade relation and Negotiation Division under the Trade Relation and Negotiation Directorate, due to an alleged duplication of efforts with the previous foreign trade relation department of the Ministry, Interview with Mr. Lisanework *Supra* note 10

¹⁸ Mamo E. Mihretu (2005), *Supra*, P. 138

It is worth pointing out that owing to the far reaching unilateral trade liberalization measures taken by the country over the last two decades, Ethiopia's trade regime is significantly liberalized and most of the impact assessment studies undertaken so far observed that the current trade regime is essentially compatible with most WTO agreements.¹⁹ In the context of WTO accession the major challenge is expected to come in the service sector. Thus far, the major service sectors of Ethiopia including the financial sectors are either reserved for Ethiopian nationals or left to the government monopoly. In fact, services are considered as one of the least liberalized sectors at the multilateral level and the GATS has much flexibility that can be exploited by Ethiopia. However, the experience of the recently acceded countries implies that what matters during the accession negotiations is not what is stated in the agreements, but the willingness of the working party members and the negotiation capacity of the acceding country.

The other particular challenge of Ethiopia's WTO accession comes from the implementation of the complex and technical agreements of the WTO. WTO membership requires compliance with a number of trade and trade related laws and regulations. Besides, as has been discussed in chapter three the Uruguay Round has broaden the scope of the multilateral trading system and its principle of single undertaking (nothing has been agreed until everything has been agreed) means that Ethiopia will undertake commitments and/or concessions in all the WTO agreements, ranging from trade in goods and services to intellectual property rights. Given its limited financial, human and institutional capacity, and their complex and technical nature the implementation of these agreements would obviously pose significant challenge to Ethiopia.

5.3 The Regional Pathway

As has already been pointed out, during the past twenty years, the international trading system has been marked by the rapid proliferation of RTAs. Ethiopia has not stood aside from the trend towards RTAs. The country was a founder member of the Organization of African Union (OAU) and is still an active player in its successor organization, the African Union (AU). Accordingly, she has signed and ratified the Abuja Treaty and committed to the objective of establishing the African Economic Community (AEC). The Country is also a founder member of different sub regional economic communities such as COMESA, IGAD and SFC. Currently she has launched

¹⁹ *Ibid*

a process of joining the COMESA FTA and the proposed FTAs under the IGAD, EPA and SFC framework.²⁰

Like the case of most African countries, Ethiopia's regional integration initiatives are subject to the so called "spaghetti bowl effect," which refers to the potential problems arising from lack of coherence among different overlapping RTAs. All IGAD members except Somalia and all SFC members except Yemen are also members of COMESA. Therefore, it is imperative for Ethiopia to devise mechanisms to overcome the difficulties linked to overlapping membership. Overlapping membership poses different challenges; firstly, negotiation resources and capacity of the country will be overstretched; secondly, the often complex rules of origin create a maze of (sometimes conflicting) criteria for the granting of preferences, raising the costs of administering such agreements; fourthly, multiple membership fees will become expensive to pay and maintain for Ethiopia. In this respect, given it is yet to become a member of these RTAs; this is a critical time for Ethiopia to evaluate its options and choose the appropriate RTA which serves its best interest. Otherwise negotiating superfluous RTAs will irrationally waste the limited negotiation resources and capacity of the country and undermines the possible benefits of joining RTAs.

5.3.1 Common Market for Eastern and Southern Africa (COMESA) and Ethiopia

COMESA is a regional integration grouping of nineteen African countries which have agreed to promote regional integration through trade and to develop their natural and human resources for the mutual benefit of all their peoples.²¹ It was founded in 1993 as a successor to the Preferential Trade Area (PTA) for Eastern and Southern Africa, which was established in 1981.²² With a total population of more than 400 million in 2010, and covering a geographical area of 12 Million (sq km) currently, COMESA is one of the largest Regional Economic Communities in Africa.²³

The COMESA Treaty which sets the agenda for COMESA envisages the progressive development of the Common Market in to a FTA, a CU and eventually in to an Economic Community. The first two steps have already been achieved with the establishment of a FTA in

²⁰ Interview conducted with Mr. Mekbib Tilahun, higher expert, UN Agencies and Regional Economic Cooperation, at MOFED on October 26, 2010.

²¹ COMESA, *About COMESA*, available at www.comesa.int, last visited on September 2010.

²² *Ibid*

²³ *Ibid*

2000 and a CU in 2009.²⁴ Thus far, the following 14 countries, Burundi, Comoros, Djibouti, Egypt, Kenya, Libya, Malawi, Madagascar, Mauritius Rwanda, Seychelles, Sudan, Zambia and Zimbabwe have become full members of the FTA.²⁵ Of the remaining member countries, while DR Congo and Uganda reduce tariffs by 80 per cent, Ethiopia has cut tariffs just by 10 per cent.

The CU was officially launched on June 7, 2009 by setting a Common External Tariff (CET) of 0 per cent for raw materials and capital goods, 10 per cent for intermediate goods and 25 per cent for final/ consumer goods.²⁶ However, the CET is yet to be implemented because of the three year transition period agreed to enable the Member States to make the necessary adjustments to the requirements of the Customs Union, and to align their national tariff structure to the CET.

The Common Market applies a multi speeds approach to regional economic integration, making it possible for a group of countries to move faster in the regional economic integration process than other countries.²⁷ Accordingly, in its current state, COMESA is a PTA, a FTA and a CU for those countries who have agreed to implement the CET. This, *inter alia*, resulted in diversified membership status and led to the creation of two types of membership commonly referred to as 'fast trackers' and 'slow trackers' according to their integration speed within the common market.

Ethiopia is one of the 'slow trackers'. Despite being a founder member of the Common Market the country is yet to join the FTA/CU. She declined to join the FTA when it was launched in 2000, claiming its national economy was not ready enough to compete at a free trade area level.²⁸

While Ethiopia's participation in the Common Market is still at a limited preferential level, five additional countries have joined and become a full member of the FTA since its establishment in 2000. With respect to Ethiopia, although the process to join the FTA has been launched some years ago, no significant step has been taken so far. According COMESA's Annual Report of 2009 Ethiopia alongside Swaziland has been referred as a country "yet to make decisive move to

²⁴ COMESA (2009), COMESA Annual Report 2009, Lusaka, Zambia, P. 4

²⁵ *Ibid*

²⁶ *Ibid*, P. 28

²⁷ Jakobei Cord, *et al.* (2005), Overlapping Membership in COMESA, EAC, SACU and SADC: Trade Policy Options for the Region and for EPA Negotiations, A Research Commissioned by GTZ, P. 14

²⁸ Interview conducted with Mr. Yishak Tekaligne, Head, Regional Trade Relation and Negotiation Division, Trade Relation and Negotiation Directorate, MOTI on October 28, 2010

join the FTA".²⁹ Officials at the regional trade relation and negotiation division of MOTI, however, believe that the country is heading in the right direction to join the FTA and studies are being finalized to determine whether to join the CU.³⁰ It is worthwhile to note at this juncture that joining the FTA and the CU have substantially different implications and hence Ethiopia's potential membership in the COMESA FTA and CU must be appreciated differently. Hence, the possible implications of Ethiopia's membership in the FTA and CU are analyzed subsequently.

As briefly discussed in section 3.2.3 FTAs refers to preferential trade agreements where tariff and non tariff barriers are eliminated among partners but, each country maintains its own customs tariff with respect to third countries. Therefore, up on joining the COMESA FTA Ethiopia will be required to remove its tariffs and non tariff barriers for all or most commodities originating from COMESA Countries. However, she will continue to apply its own tariffs on commodities originating from outside COMESA Countries. Therefore, the impact of Ethiopia's membership in the FTA will, among other things, depend on the country's intra COMESA trade.

Table 5.1: Intra-COMESA Trade by Country, 2007-2008

Country	Year (Values in US \$ million)			
	2007		2008	
	Exports	Imports	Export	Imports
Burundi	36.6	175.4	17.0	75.0
Comoros	0.2	2.8	0.0	14.1
Congo DR	188.1	665.8	511.3	718.7
Djibouti	31.7	108.0	2.1	44.6
Egypt	494.3	312.2	1,669.9	1,164.1
Eritrea	6.3	4.9	4.3	4.5
Ethiopia	123.8	213.7	152.4	324.0
Kenya	1,114.3	428.3	1,427.6	410.9
Libya	153.5	278.5	233.2	932.5
Madagascar	31.7	122.8	12.9	68.7
Malawi	183.7	140.0	283.9	596.6
Mauritius	75.4	120.8	82.0	140.8
Rwanda	50.7	264.9	207.9	408.2
Seychelles	0.7	26.0	1.9	48.5
Sudan	29.7	441.5	128.4	892.7
Swaziland	191.1	25.5	168.0	51.1

²⁹ COMESA (2009), *Supra* note 24, P. 4

³⁰ Interview with Mr. Yishak Tekaligne, *Supra*

Uganda	367.2	515.9	532.9	570.6
Zambia	612.2	394.6	778.5	780.5
Zimbabwe	258.6	312.2	171.9	97.6

Source: COMESA Annual Report 2009

As can be observed from the above table, Ethiopia's intra COMESA trade is one of the lowest both in terms of merchandise exports and imports in the region. Egypt and Kenya has dominated the export share of the region accounting for 26 and 22 per cent of the total intra COMESA market share, respectively in 2008. Ethiopia has no significant intra-COMESA market share both in terms of exports and imports. The share of Ethiopia in the intra-COMESA exports is limited to 2.7 per cent, while its share in the intra-COMESA imports is only 5.6 per cent compared with 15.9 % for Egypt, 12.7 % for Kenya, 12.2 % for Zambia and 10.6 % for Uganda in 2008.³¹

As has been discussed in the preceding chapter, Africa in general has not been any significant export destination or import source of Ethiopia. In fact, over the past several years there has not been any change in this pattern. In 2008/09 for instance Ethiopia's exports to African countries accounted for only 16.6 per cent of the country's total exports, while imports from African countries accounted merely 3.9 per cent of the country's total imports.³² This low level of intra-regional trade flow implies that the potential reduction of tariffs would not pose a considerable threat to Ethiopia in terms of revenue reduction. Therefore, at least, in principle Ethiopia may not sustain that much revenue loss by joining the COMESA FTA. The only potential threat in this respect is a possible trade diversion towards Egypt and Kenya, which have relatively strong manufacturing sector in the region. The duty free access will give manufacturing imports from these two countries an extra competitive advantage and hence may divert trade in their favour.

Regarding exports, the FTA will provide duty and quota free access to its member countries. However, the main concern for Ethiopia and in fact for all other COMESA Countries is the product similarity or low product complementarities of the region. Product complementarities between countries are an important indicator of the potential for expansion of intraregional trade.³³ Different studies have observed that product complementarities and levels of

³¹ COMESA (2009), *Supra note 24*, P. 18

³² NBE (2009), *Annual Report of 2008/2009*, Addis Ababa, Ethiopia, P. 71

³³ Khandelwal Padamja (2004), *COMESA and SADC: Prospects and Challenges for Regional Trade Integration*, IMF Working Paper, WP/04/227, P. 15

intraregional trade are low in COMESA Countries and thus the potential for expansion of trade beyond a certain extent is limited.³⁴ In this respect, Khandelwal had observed that "while there is scope for Egypt and Kenya to export to the region, there is not much scope for other countries to do the same since there are few complementarities for their exports".³⁵ The potential benefit of such market access could also be undermined by the lack of efficient infrastructure in the region. In the absence of efficient infrastructure the potential of increased intra-regional trade is doubtful.

The other area of concern for Ethiopia while contemplating to join the COMESA FTA must be COMESA's expansion programme. Currently, together with the East African Community (EAC) and the Southern Africa Development Cooperation (SADC), COMESA has launched negotiations for the establishment of a tripartite FTA by 2012 comprising 26 countries in these three Regional Economic Communities (RECs).³⁶ The tripartite COMESA-EAC-SADC FTA will obviously augment both the negative and positive impacts of joining the COMESA FTA for Ethiopia. In this respect, the inclusion of the Republic of South Africa in the FTA as a SADC member country may in particular open additional market access for Ethiopian exports and commensurately pose challenge to the domestic industries and the fiscal revenue of the country.

Membership in the COMESA CU, on the other hand, will have a different implication for Ethiopia. It is noteworthy to reiterate, here that the creation of CUs is substantially different from that of FTAs. The creation of an FTA among a group of countries does not require the adoption of any "common policy;" it is enough that each of the involved countries modifies its legislation and eliminates the existing barriers towards commodities originating from and destined to the other members. However, the creation of CU involves two crucial issues, the definition of the "common trade policy" of the Union towards third countries and the creation of a single customs territory, in which all the separate constituting countries' customs territories are merged.

Therefore, while joining the COMESA CU Ethiopia will adopt the three band tariff rate system of the COMESA CET as opposed to its six band tariff rate system and reduce its current maximum tariff of 35 per cent to 25 per cent according to the COMESA CET. And more importantly since the formation of a CU requires the establishment of a single customs territory,

³⁴ *Ibid*

³⁵ *Ibid*

³⁶ COMESA (2009), *Supra* note 24, P. 7

Ethiopia would have no control on commodities that originate from the union countries. That is unlike FTAs, CUs do not apply rules of origin, because there is only a single customs union. This customs union regulates the destination of commodities within the union regardless of their point of entry and distributes the tariff collected accordingly. This, however, requires efficient and well functioning system. Hence, one of the issues Ethiopia must consider before joining the CU is whether member countries of the Union are capable enough to maintain such a system.

5.3.2 The Intergovernmental Authority for Development (IGAD) and Ethiopia

IGAD was established in 1996, replacing the Intergovernmental Authority on Drought and Development (IGADD), which was established to find solutions to the problems caused by the severe drought and subsequent famines that had affected the region in the early 1980s.³⁷ IGADD had gradually become more concerned with questions of peace and security and accordingly its founding members decided in the mid-1990s to revitalize it into a fully-fledged regional political, economic, development, trade, and security organization.³⁸ IGAD is now one of the prominent RECs in Africa and has been designated as one of the eight building blocks for the AEC.³⁹

Promoting and maintaining peace and security, attaining sustainable economic development and creating an enabling environment for foreign, cross-border and domestic trade and investment are the prime objectives of the organization.⁴⁰ Regional economic cooperation and integration are given special impetus and high priority to promote long-term collective self-sustaining and integrated socio-economic development. In accordance with this objective, the organization has recently launched trade negotiations to establish a FTA among its member countries.⁴¹ The regional integration process mapped out by its Minimum Integration Plan (MIP) requires members to eliminate all forms of tariff and non tariff barriers by 2011 and 2010, respectively.⁴²

³⁷ Emmanuel Fanta (2008), *Dynamics of Regional (none)- Integration in East Africa*, UNU CRIS Working Paper W-2008/2, P. 12, Member countries of IGAD include Djibouti, Ethiopia, Kenya, Somalia, Sudan and Uganda. Eritrea has withdrawn its membership in 2007. Available at <http://www.sudantribune.com/spip.php?article21508>

³⁸ IGAD (2000), *Profile IGAD*, Available at, www.igadregion.org, last visited on September 25, 2010.

³⁹ AEC, South African Department of Foreign Affairs <http://www.dfa.gov.za/foreign/Multilateral/africa/aec.htm>

⁴⁰ IGAD (1996), *The Agreement Establishing the Intergovernmental Authority on Development (IGAD): Article 7*, Nairobi Kenya, IGAD/SUM-96/AGRE-Doc

⁴¹ IGAD (2008), *Annual Report, 2008*, Available at www.igadregion.org, last visited on September 25, 2010.

⁴² African Union (2009), *Minimum Integration Programme (MIP)*, Addis Ababa, Ethiopia, P.88

Ethiopia has been a member, indeed, a founder member of IGAD. She has signed and ratified the Agreement establishing IGAD and has played a significant role in its development.⁴³ Apart from the socio-cultural and ethnic similarities, Ethiopia shares geographical boundary with virtually all the member countries of IGAD. Moreover, as a land locked country, Ethiopia is absolutely dependent on the member countries of the Authority to get access to the sea. Therefore, the country has massive interest in the organization unparalleled by the interest of any other country.

Ethiopia also has a strong trade relation with most member countries of IGAD. As has already been noted, IGAD member countries are the major destinations of Ethiopia's exports in Africa. 88.3 per cent and 88.6 per cent of Ethiopian exports to Africa in 2007/08 and 2008/09, respectively, were destined to three IGAD member countries, namely Somalia, Sudan and Djibouti.⁴⁴ On the import side, Ethiopia imports large amount of petroleum products from Sudan, which accounted for 68.3 per cent of Ethiopian imports from Africa in 2007/08 together with imports from Egypt and another IGAD member country, Kenya.⁴⁵ In 2008/09 imports from Sudan has considerably increased and accounted for 28.1 per cent of Ethiopian imports from Africa.⁴⁶ On the other hand, imports from Kenya mainly consist of consumer goods and manufacturing products.

Given the fact that three IGAD member countries, i.e. Djibouti, Kenya and Sudan, have already joined the COMESA FTA, and Ethiopia has concluded a zero tariff PTA with Sudan, the negotiations for the establishment of the IGAD FTA could be straight forward. From the Ethiopian perspective the FTA negotiation is all about extending the zero per cent tariff preference already granted to Sudan to Djibouti, Kenya, Uganda and Somalia. By extending such preference to the latter countries, Ethiopia may expose its infant domestic industries to modest competition from the relatively strong Kenyan manufacturing industries and may incur some revenue loss as Kenya is one of the major suppliers of Ethiopian imports in Africa. In return, Ethiopia *inter alia* will benefit from the increased competition and favourable market access.

⁴³ FDRE (2003), Intergovernmental Authority on Development Establishment Agreement Ratification Proclamation No. 366/2003, 9th Year No. 91 Addis Ababa, September 9, 2003.

⁴⁴ NBE Annual Reports of 2007/08 and 2008/09

⁴⁵ *Ibid*

⁴⁶ *Ibid*

The sub-region being one of the most hostile and instable regions in the world, the presence of a strong and favourable trade relation among the member countries may increase the interstate dependency and hence reinforce peace and security in the region. This, on the other hand, will be of a paramount importance to Ethiopia in creating conducive environment for domestic and cross border trade and investment. Moreover, as a land locked country, the formation of a FTA among the member countries of IGAD will have a substantial importance to Ethiopia in terms of offering favourable access to the sea. Currently, Ethiopia has seven potential sea outlets, i.e. Djibouti, Berbera, Mombasa, Port Sudan, Asab, Massawa, and Mogadishu. Of these outlets, Djibouti, Mombasa, Port Sudan and Mogadishu are found within four IGAD member countries.⁴⁷ The formation of a FTA under IGAD will possibly improve the trade relation among the countries in the sub region and would have a significant impact on strengthening Ethiopia's access to the sea. However, it does not mean that the FTA will have a direct impact on the transit regime of the sub-region, which is currently governed by bilateral agreements, but the increased trade relation among the countries in the sub region would pave the way for Ethiopia to utilize the potential sea outlets in a better condition. In this respect, the infrastructural developments that would be installed to enhance the intraregional trade would also have indirect impact on the utilization of some of the sea outlets which are not being utilized due to lack of infrastructure.

However, given the overlapping membership noted above, Ethiopia's membership in the COMESA FTA would significantly undermine the economic relevancy of the IGAD FTA. Thus, before acceding to the IGAD FTA Ethiopia must decide on its membership in the COMESA FTA to evade the problems of overlapping memberships and save negotiation resources.

5.3.3 Economic Partnership Agreement (EPA) and Ethiopia

The Economic Partnership Agreement (EPA) has its origin in the co-operation agreement signed between the European Union (EU) and the more than 70 countries from Africa, Caribbean and Pacific (ACP) in Lomé, Togo, in 1975.⁴⁸ The successive Lomé conventions negotiated since then had granted preferential access to the EU market for ACP countries, without requiring them to

⁴⁷ These four ports are found in Djibouti, Kenya, Sudan and Somalia, respectively

⁴⁸ Karingi Stephan N. and Deotti Laura (2009), IIEPA Points to the Classic Regional Trade Agreements After all: Should African Countries Really be Worried, African Trade Policy Center, Work in Progress No. 75, P. 1

reciprocate.⁴⁹ Nonetheless, as they merely represent a unilateral discriminatory treatment, they were proved incompatible with WTO rules.⁵⁰ They comply neither with the *reciprocity* and *substantially all the trade* requirement of the GATT Article XXIV nor were they available to all developing countries, or restricted to just LDCs as authorized by the Enabling Clause. Thus, EU and ACP countries had to secure waiver to maintain the Lomé preference system and the WTO accorded them two waivers, which are commonly referred to as the *Lomé waivers*. The last Lomé waiver was applied until the 31th of December 2007.⁵¹ From that date, products coming from ACP countries could no longer benefit from an exemption of the MFN principle. However, maintaining preferences on a long term basis by securing a waiver has become increasingly difficult and hence the EU and ACP countries decided to replace the Lomé preference system in general with regional Economic Partnership Agreements based on reciprocal trade conditions.

In June 2000, the EU and the ACP countries agreed to replace the Lomé Conventions with the Cotonou Agreement.⁵² This Agreement, which covers the period 2000-2020, comprises of cooperation in three pillars: political; development; and economic and trade cooperation.⁵³ The economic and trade component of the Cotonou agreement was expected to be replaced by the EPAs as of January 2008.⁵⁴ The objective was that, when the period of application of the Lomé waiver expired, it remained still possible to discriminate in favor of ACP countries, this time not in application of the waiver but by virtue of the general exception of the GATT Article XXIV.

Accordingly, negotiations between the EU and ACP countries for the WTO compatible EPAs were officially launched on the 27th of September 2002.⁵⁵ EPAs are aimed at progressively removing all barriers to trade and entail rights and obligations for both sides. Their prime objective is to contribute to the development of a trade regime that promotes sustainable development and the integration of ACP countries into the global economy through a framework for reciprocity, differentiation, regional integration, and co-ordination of trade and aid. For the purposes of negotiations, the more than 70 ACP countries have been grouped into six negotiation

⁴⁹ *Ibid*

⁵⁰ See, WTO document WT/DSB/M/37, WTO

⁵¹ See, WTO document WT/MIN(01)15, WTO

⁵² Karingi Stephan N. and Deotti Laura (2009), *Supra note 52*

⁵³ *Ibid*

⁵⁴ The Cotonou Agreement (2001), Article 37 (1)

⁵⁵ FSS Update (2006), Accord Awareness Creation Workshop on WTO and EPAs, Issue No. 11, Addis Ababa, P. 5

regions i.e. West Africa, Central Africa, Eastern and Southern Africa (ESA), the Southern African Development Community (SADC), the Caribbean (CARIFORUM) and the Pacific.

As one of the ACP countries, Ethiopia is a signatory of the Cotonou Agreement.⁵⁶ The country is currently negotiating the EPA as part of the ESA configuration, which includes Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Seychelles, Tanzania, Uganda, Zambia, and Zimbabwe. These sixteen countries, twelve of which are LDCs, have officially commenced negotiating the EPAs on February 7, 2004.⁵⁷ The latest deadline for the conclusion of the ESA-EC EPA negotiations was July 31, 2009, but only four ESA countries, Madagascar, Mauritius, Seychelles and Zimbabwe, managed to sign the bilateral Interim EPA (IEPA).⁵⁸ The five members of the East African Community (EAC)⁵⁹ Customs Union have collectively initialed a single agreement and two other ESA members have initialed bilateral IEPAs.⁶⁰ Ethiopia together with four other LDC ESA members has declined to initial an IEPA, and opt to continue exporting to the EU under the unilateral non-reciprocal Everything but Arms (EBA) initiative, which forms the EU's Generalized System of Preference (GSP) regime.⁶¹

The EU is an important trade partner to Ethiopia, both in terms of merchandise imports and exports. It is by far Ethiopia's largest export market, accounting for nearly 41.7 per cent of the country's total merchandise exports during 2008/09.⁶² The majorities of Ethiopian merchandise exports to the EU are primary agricultural products with little or no value-added, such as; Coffee, flower, oilseeds, pulses, leather and leather products, and textiles and garment. In contrast, Ethiopia imports value added products, such as machineries, metal and grain from EU.

Ethiopia's exports to the EU are currently governed under three different arrangements: the Most Favoured Nation (MFN) rate available to all countries; the standard Generalized System of Preferences (standard-GSP) available to all developing countries; and the unilateral non-reciprocal Everything but Arms (EBA) initiative available to all LDCs. The EPAs, therefore, are

⁵⁶ FDRE (2001), Cotonou Agreement Ratification Proclamation No. 242/2001, 7th Year No. 30 Addis Ababa

⁵⁷ African Trade Policy Center (2007), EPA Negotiations: African Countries Continental Review, Report, P. 62

⁵⁸ CTA (2010), EPA Negotiations: ESA Configuration, Executive Brief Update, Available at <http://www.cta.int>

⁵⁹ *Ibid*, the five member countries of the EAC are Burundi, Kenya, Rwanda, Tanzania, and Uganda

⁶⁰ *Ibid*, Comoros and Zambia delayed their signature of their respective IEPAs

⁶¹ *Ibid*

⁶² NBE (2009), *Supra note 32*, P. 70

additional arrangement for Ethiopian exports to the EU. As pointed out earlier, the underlying rationale for the conclusion of EPAs is making the Lomé/Cotonou preference system WTO compatible. Such issues however are not the main concerns of least developed ACP countries. LDCs are beneficiary of the EBA initiative which grants unilateral preferential treatment to all LDCs and hence compatible with the WTO pursuant to the provisions of the Enabling Clause.

Making the Lomé/Cotonou preference system WTO compatible is the concern of those non LDC ACP countries that might lose preferential access to the EU market because of the WTO incompatibility of the Lomé/ Cotonou preference system. For least developed ACP countries like Ethiopia there are little impetus to seek the conclusion of the EPAs. Unlike EBA, EPAs involve reciprocal market access concession, and involve commitments in new areas, such as government procurement, investment, and services.⁶³ As a beneficiary of EBA, Ethiopia may gain little or nothing in terms of market access from EPA but will undertake market access commitments. Thus, from the Ethiopian perspective, the formation of a FTA under the EPA framework essentially means exchanging a unilateral preference for a reciprocal preference.

The most challenging issue within the context of EPA for Ethiopia is the level of market access that is to be granted to the EU in reciprocity. Since the objective of the EPAs is to bring a WTO compatible reciprocal preference system, it is necessary that the partnership agreements comply with the *substantially all the trade* and other requirements of the GATT Article XXIV. Although there is no legal definition of the *substantially all the trade* requirement, as briefly discussed in chapter three, it seems apparent from the EU's interpretation of the requirement that the EPAs need to cover about 90 per cent of the trade between the parties to be WTO compatible.⁶⁴ This means ACP countries including Ethiopia will be expected to liberalize about 90 per cent of their trade with the EU. This would obviously have a considerable revenue impact for Ethiopia. The key factor that influencing the revenue impact of an EPA is the share of the tariff revenue currently derived from EU imports. In this respect we have already seen that EU is the major source of Ethiopian imports. In addition a World Bank study (2007) has calculated that import from EU contribute 16 per cent of Ethiopian tariff revenue and according to its estimation the

⁶³ CTA (2010), *Supra note 58*

⁶⁴ Patel Mayur (2007), Economic Partnership Agreements between the EU and African Countries: Potential Development Implications for Ghana, Oxford University, P. 16

country will lose about 17-18 per cent of its tariff revenue up on the conclusion of EPA.⁶⁵ Therefore, "when tariffs against the EU are removed, import prices in Ethiopia may decline by less than the fall in the duty and there will be a transfer of some or all of the previously collected tariff revenue to EU firms with little or no beneficial impact on the domestic market".⁶⁶

Apart from the revenue implication, given the relative strength and efficiency of EU producers, duty free access under the EPA framework will expose Ethiopian infant industries to stiff competition. The zero tariff preference that will be extended to EU products up on the conclusion of EPA will make them cheaper in the domestic market, especially in contrast to non EU imports. This, on the other hand, creates another threat for Ethiopia in terms of trade diversion.

Therefore, given the fact that Ethiopia has duty and quota free access to the EU for "essentially all" of its products under the EBA initiative the only possible way she may benefit from the conclusion of EPAs is only if the EPAs become EBA plus in a sense that they address market entry barriers in a manner more effectively than in the EBA context, such as through simplified rules of origin. The other source of benefit would be if the EPA assists the country with technical, financial and other means to solve the longstanding supply-side bottlenecks, which severely hampered the country's capacity to exploit market access opportunities. However, it is worthwhile to point out that, the EU has made it clear that there is no way that development issues will be included under EPAs. According to the EU developmental issues will continue to be regulated by the Cotonou agreement and the EPAs should only deal with the trade component of the Cotonou agreement for the purpose of maintaining WTO compatible preference system.

Thus, Ethiopia need to be cautious and before rushing to conclude the agreement must ensure to preserve ample policy space to give protection for its sensitive sectors such as agriculture and longer transition period for the implementation of the agreement. In this respect, Ethiopia must analyze the commitments undertaken by those ACP countries that have already concluded an interim agreement and build on such lessons to lessen the adjustment costs that will be inflicted.

⁶⁵ Brenton Paul, *et al* (2007), Evaluating the Revenue Effects of Trade Policy Options for COMESA Countries: The Impacts of a Customs Union and an EPA with the European Union, World Bank Trade Department, P. 3

⁶⁶ *Ibid*, P. 17

5.3.4 Sana'a Forum for Cooperation (SFC) and Ethiopia

The Sana'a Forum for Cooperation (SFC) was set up by Yemen, Sudan and Ethiopia in October 2002 and has been joined by Somalia and Djibouti later.⁶⁷ The Cooperation aims to boost regional trade and economic cooperation among its member countries through promoting cross border trade and ensuring a safe and stable environment for economic cooperation and development within the group.⁶⁸ The Cooperation has no secretariat and organizational structure.

Studies are being carried out to launch a FTA among the member countries of the Cooperation in accordance with the Cooperation Agreement which envisages a zero-tariff trade. As a key player in the cooperation Ethiopia is expected to participate in the formation of the FTA. However, the establishment of the SFC FTA will further complicate the difficulties linked to overlapping membership in the region and apart from inducing negotiation and administrative burden will undermine the benefits that Ethiopia may gain from its membership in IGAD and COMESA FTAs. From trade perspective, the SFC FTA can add no value for Ethiopia except granting a duty free access to the Yemeni market, which can successfully be achieved through concluding bilateral zero-tariff PTA similar to the one Ethiopia currently has with Sudan.

As has repeatedly been stated, constituting overlapping RTAs complicates the implementation of the agreements, increases the transaction costs of conducting trade, raises the possibility of mutually inconsistent provisions and creates administrative burden due to its often complex and inconsistent rules of origin. Moreover, from a legal stand point in case there is a dispute among the parties, it is difficult, to determine the applicable law or agreement and may give rise, *inter alia*, to the well known problem of "forum shopping" (the search for the most convenient forum).

In fact, Yemen is an important trade partner to Ethiopia. Along with Djibouti and Somalia, she is the main recipient of Ethiopian chat exports, which is the third most important Ethiopian export commodity. The two countries have also concluded a bilateral trade agreement in 1992, granting MFN treatment with some exemptions and other four bilateral agreements dealing with different areas including civil aviation, exchanging of technical experience, cooperation in market studies,

⁶⁷ Yusuf Bacry, et al.(2008), How to Optimize Advantages of Accession to the WTO and Measures to be Taken to Meet Possible Challenges, PSD-Hub Publication No.1, P. 34, Djibouti is not a full member of the SFC yet.

⁶⁸ UNDP Ethiopia (2009), Study to Establish Free Trade –Sana'a Forum for Cooperation, REP/016/2009

cooperation in science, tourism, investment agriculture and other areas.⁶⁹ Ethiopia can easily build on this favourable economic cooperation and seek for the conclusion of a bilateral PTA.

5.4 The Relative Merits of Multilateral and Regional Trade Liberalization for Ethiopia

Ethiopia's multilateral and regional trade integration initiatives are yet to be completed. While it is too early to assess the specific pros and cons of these initiatives, the preceding sections have already shed light on the general implications. This section intends to assess the relative merits of the multilateral and regional integration initiatives. In doing so, the section gives emphasis on three points, predictable business environment, technical assistance and capacity building support and access to foreign markets. From the discussion made under chapter three, one can fathom that these are not the only possible benefits of accession to the WTO or RTAs. However, although there are numerous other benefits these are the most realistic benefits for Ethiopia.

For instance, WTO accession is widely praised for offering access to the binding Dispute Settlement Mechanism (DSM). However, as an LDC Ethiopia lacks the necessary financial and technical capacity to exercise its rights under the Dispute Settlement Body (DSB) and hence such access is of less importance to the country. That is the cost of pursuing an action under the DSB in terms of time, finance, and technical/legal expertise is beyond the means of Ethiopia. The fact that only a single LDC, Bangladesh against India, has initiated a dispute in the whole history of the multilateral trading system also implies that access to the DSB is not realistic *per se* for Ethiopia at least in the short and medium term. Moreover, although WTO accession is a potent tool to attract FDI, it could not be considered as a direct benefit of WTO accession. It is rather an indirect benefit that can be influenced by the other attributes of accession such as, improved access to foreign markets and the transparency and predictability of the business environment.

Likewise, there are many other possible benefits of regional integration ranging from enlarging economies of scale and improving bargaining power to addressing weaknesses in infrastructure and harmonization of standards and custom procedures. But most of these benefits as discussed earlier are either impractical or at best of marginal importance to Ethiopia. That is the RTAs in which Ethiopia is seeking membership are not capable enough to offer such benefits. The low

⁶⁹ WTO (2007), Accession Ethiopia: Memorandum of Foreign Trade Regime, WTO, WT/ACC/ETH/3, P. 166

product complementarities, weak institutional infrastructure, and overlapping membership among the RTAs would lessen the benefits that can be obtained from membership in the RTAs.

5.4.1 Predictable Business Environment

Ethiopia has undertaken far reaching unilateral trade reform measures over the past two decades. As part of this reform the country has *inter alia* reduced its maximum and simple average tariff from 230 to 35 per cent and from 41.6 to 17.5 per cent, respectively. Besides, despite its key role in the socio-economic and cultural life of the society, the average agricultural tariff of the country has significantly been reduced and kept merely at 22.3 per cent in 2009.⁷⁰ Such level of tariffs reduction, according to Fikremarkos "is not only WTO-plus liberalization, but also makes the country perhaps one of the most liberal traders in the world".⁷¹ However, unilateral measures do not lock in existing trade policy reforms against future backtracking. The country's trade reform measures have, as a result, been fraught with uncertainty and unpredictability.

Reciprocal trade commitments can lock in previous unilateral trade liberalizations that otherwise would remain unbound and hence vulnerable to backsliding. By pursuing membership in the multilateral trading system and in a number of RTAs, Ethiopia will reduce the uncertainty or/and increase the credibility and predictability of its trade regime, which is often considered as the single most important step a government can take to encourage investment and get the economy moving.⁷² Besides, it has increasingly become apparent that, in order to attract Foreign Direct Investment (FDI) to achieve productivity gains, countries need to demonstrate greater credibility and predictability in their trade regime.⁷³ De Cordoba *et al.* have observed that investors will not invest if they suspect the government may reverse its announced policies.⁷⁴ According to them a way to gain credibility is to sign up to international agreement committing to liberalization. In similar vein, Bossche Peter argues that "traders and investors operating, or intending to operate,

⁷⁰ WTO OMC, ITC and UN (2010), World Tariff Profiles, P. 74

⁷¹ Fikremarkos Merso (2005), Ethiopia's Accession to the WTO: A Strenuous Step for a Poor Nation Seeking Economic Prosperity, Action Aid Ethiopia, P. 64

⁷² Philippe H. Le Houerou (1995), Studies of Economies in Transition: Investment Policy in Russia, World Bank

⁷³ Laird Sam (2000), The WTO Agenda and the Developing Countries, CREDIT Research Paper No. 00/5, P. 3

⁷⁴ De Cordoba Santiago Fernandez et al (2004), Adjustment costs and Trade Liberalization, UNCTAD, P. 69

in a country that is bound by such legal rules will be able to predict better how that country will act in the future on matters affecting their operation in that country".⁷⁵

In this respect, although, both multilateral and regional commitments can be used as a potent tool to tie the hands of the government from reversing previous unilateral trade liberalizations, there are numerous reasons why multilateral liberalization might provide better or more credibility and predictability to the Ethiopian trade regime than can regional trade liberalization. This section aims at describing those reasons through highlighting the particular natures of the two options.

Tariffs are one of the most traditional barriers to international trade in goods. In the multilateral trading system, the GATT recognizes the legality of tariffs. This contrast with the general prohibition of quantitative restrictions contained in GATT Article XI and confirms the multilateral system's preference for tariff barriers because, among other reasons, these are more transparent and easier to be applied on a non-discriminatory basis. While recognizing tariffs, the GATT stipulates the conditions under which they are imposed. This is specified in the rule for market access contained in GATT Article II, which provides that each WTO Member establishes a schedule of tariff concessions which specifies the highest tariffs to be applied to each type of product. The tariff commitments made by WTO Members in multilateral trade negotiations and up on accession are thus, enumerated in these schedules of concessions. Thus, the tariff commitments that will be made by Ethiopia up on accession will become part of these schedules.

The schedules of concessions establish ceiling bindings and as long as each Member's schedules are considered binding, no unilateral increase thereof can be made. Apart from the exceptions allowing a tariff increase, a modification in order to raise a tariff binding would require the use of the procedure stipulated in GATT Article XXVIII concerning "Modification of Schedules", which generally requires a complex negotiation with interested Members and paying compensations. Even here the MFN rule comes to picture and ensure that such compensation extends to all WTO members, raising the cost of reneging. This implies that once a commitment is made at the WTO, it would be very difficult for the government to renege on its commitments.

⁷⁵ Bossche Peter Van den (2005), *The Law and Policy of the World Trade Organization: Text, Cases and Materials*, Cambridge University Press, New York, P. 36

Moreover, the multilateral system ensures the predictability and stability of its member countries' trade regime also through other basic principles. The transparency requirements entrenched under virtually all WTO agreements requires members to disclose their policies and practices publicly within the country or by notifying the WTO.⁷⁶ This together with the regular surveillance of national trade policies through the Trade Policy Review Mechanism provides an important means of encouraging transparency both domestically and at the multilateral level.⁷⁷

Therefore, WTO membership will help lock in the existing liberalizations and significantly contribute to the credibility and predictability of the Ethiopian trade regime. This on the other hand, will play an important role in signaling the international community that Ethiopia's trade regime is bound to international trade rules and hence attract foreign investment. In this respect it is worth quoting the speech made by the Ethiopian Representative at the WTO General Council Meeting in 2003 directly. While expressing the country's decision to apply for accession the Representative held that,

To be a Member of the WTO was to be part of the rules-based multilateral trading system, and this would create confidence for investors and serve as an instrument to attract foreign direct investment for diversifying the production base and expanding the supply capacity of the country.⁷⁸

RTAs can also help address concerns over policy credibility by locking in domestically implemented trade liberalization and functioning as an agency of restraint.⁷⁹ However, not all RTAs play such role. RTAs between developing countries (South-South RTAs) are unlikely to exercise much restraint on their member countries' behavior.⁸⁰ Most South-South RTAs have no effective mechanism at their disposal to enforce their decisions and oblige Members to comply with their commitments. They are often reliant on the political commitment of their member countries than effective and binding enforcement mechanisms. The WTO, however, does have a proven enforcement procedures and its dispute settlement mechanism is substantially stronger than any dispute settlement mechanism or diplomatic process envisaged by many RTAs.

⁷⁶ WTO (2005), Understanding the WTO, 3rd Edition, World Trade Organization, P. 12

⁷⁷ *Ibid*

⁷⁸ WTO (2003), *Supra* note 13

⁷⁹ Khandelwal Padamja (2004), *Supra* note 33, P. 19

⁸⁰ Hoekman Bernard and Schiff Maurice (2002), Benefiting From Regional Integration, In Hoekman Bernard Mattoo Aaditya, and Philip English (eds.) Development, Trade, and the WTO, World Bank, Washington, DC, P. 553

In this respect, all the major RTAs Ethiopia is currently negotiating or preparing to negotiate for membership except the EPAs are South-South RTAs, where the majority of the membership is held by LDCs. These RTAs lack the necessary resource and legal structure to lock in their member countries' previous reforms. The withdrawal of Lesotho, Mozambique, Namibia and Tanzania from COMESA and Eritrea's suspension of its membership in IGAD explain the political commitment countries have towards these institutions and the degree of economic and political risks countries face in relinquishing their membership from these institutions. As long as the economic and political risk of opting out of these institutions remains insignificant there is no guarantee that Ethiopia's potential commitment in these institutions would not be reneged. This, however, does not mean that countries cannot quit their membership in the WTO. In principle, countries can withdraw from the WTO⁸¹, but no-one ever has. Part of the explanation is countries are least likely to take the economic and political risk of opting out of the multilateral trading system, which represents 92 per cent of the global population and 95 per cent of world trade⁸² and widely considered as an emblem of openness.

In contrast to South-South RTAs, North-South RTAs are perceived to provide relatively more credible lock-in mechanisms and do more to improve policy credibility.⁸³ Commitments made with a large high-income country or region (such as the United States or the European Union) are considered to be more binding or to be perceived as such.⁸⁴ Mexico's membership in NAFTA and Eastern European countries membership in European agreements are often raised as key examples of how North-South RTAs induce credibility and predictability in the southern partner's trade regime. However, the credibility and predictability in the Southern partner's trade regime induced by such arrangements applies only with respect to the respective developed country partner. That is since RTAs are preferential treatments by nature the credibility and predictability induced by their creation is limited to those countries within the RTA and the trade regime of the country will remain uncertain and unpredictable from non-RTA members' perspective. Therefore, though Ethiopia's membership in the EPA may increase the credibility and predictability of its trade regime, such effect will apply with respect to the EU and the

⁸¹ See The Agreement Establishing the WTO: Article XV

⁸² Bossche Peter Van Den (2005), *Supra note 75*, P. 103

⁸³ Hoekman Bernard and Schiff Maurice (2002), *Supra note 80*

⁸⁴ *Ibid*

Ethiopian trade regime continues to be uncertain and unpredictable from non-EU member countries' perspective, because the EPAs regulate the EU-Ethiopia trade relations only. However, the credibility and predictability that will be induced by Ethiopia's membership in the multilateral trading system is more general and applies to more than 150 countries on MFN basis and it is least likely that Ethiopia would maintain a different trade regime for non members.

In general, adherence to WTO rules and binding agreements will enhance the credibility and predictability of the Ethiopian trade regime than membership in any of the RTAs. Given the degree of trade liberalization unilaterally made by the country over the last two decades, increasing the credibility and predictability of its trade regime is of paramount importance in order to attract foreign investment. By increasing capital stock, foreign investment can contribute to a more efficient use of existing resources and absorb unemployed resources and thus increase a country's output and productivity.⁸⁵ However, the impact of foreign investment depends on the nature of the incoming investment.⁸⁶ While those foreign investments meant to tap export markets by taking advantage of the country's comparative advantage contribute to the export growth of the country, foreign investments meant to capture the domestic market may not do so.

5.4.2 Technical Assistance and Capacity Building

Ethiopia is currently involved in a plethora of trade negotiations ranging from accession to the WTO and COMESA FTA/CU to negotiations for the establishment of FTA within the IGAD, and the Economic Partnership Agreement (EPA) framework. By pursuing membership in these multilateral and regional trade institutions/agreements, the country aims to integrate its economy to the global economy and thereby promote the diversification and competitiveness of the export sector. The attainment of these objectives, inter alia, depends on the country's capacity to exploit the opportunities that would be created by its membership in these trade institutions/agreements. However, as has repeatedly been noted, the country suffers heavily from supply side constraints and lacks the necessary capacity to make use of trade opportunities. Therefore, capacity building supports that may ensue from its membership in these institutions/agreements will contribute in strengthening the country's capacity to take advantage of the potential trade opportunities.

⁸⁵ Seetanah, B. and Khadaroo, A. J. (2007), Foreign Direct Investment and Growth: New Evidences from Sub-Saharan African countries, Paper prepared for the 2007 CSAE conference.

⁸⁶ *Ibid*

Furthermore, reciprocal trade negotiations being complex and technical by nature and new to the country, would pose a substantial challenge to the country in terms of providing the necessary financial, human and institutional resources for their completion and implementation. In this regard, the government has also made it clear that as an LDC Ethiopia is not capable enough to provide these resources without the help and assistance of others.⁸⁷ Technical assistance would enhance the general trade related expertise and institutional capacity of the country, in addition to improving its trade related negotiation and rules implementation capacity. Therefore, it is imperative to assess the relative prospects of the country's potential membership in the already mentioned multilateral and regional trade institutions/agreements in terms of their potential to offer the necessary technical assistance and capacity building support.

In practical terms, trade related technical assistance and capacity building support usually consists of activities such as seminars, workshops, training programs in trade rules and procedures, courses on negotiating skills, legal advice and assistance with preparing draft laws, technical missions, the provision of manuals, guides, documents, and/or support for research and data collection.⁸⁸ These activities are not direct impacts of accession to the WTO or RTAs; however, given their importance in strengthening the trade related negotiating capacity, national trade policy and/or capacity to trade of developing and least developed countries they are often considered as one of the main benefits of reciprocal trade liberalization agreements for least developed countries like Ethiopia.⁸⁹ In this respect, WTO membership is of paramount importance to Ethiopia in offering trade related technical assistance and capacity building support than membership in RTAs for reasons that will be discussed subsequently.

IGAD FTA/SFC FTA

Of the RTAs Ethiopia is currently negotiating or preparing to negotiate, IGAD FTA and SFC FTA are yet to be established and given the weak institutional backing they have, they are least likely to provide technical assistance and capacity building support for Ethiopia. The SFC is yet to have a secretariat and has no institutional base. Likewise, despite its significant contribution in

⁸⁷ WTO (2003), *Supra note 13*, P.2

⁸⁸ IOB (2005), Aid for Trade? An Evaluation of Trade Related Technical Assistance, Policy and Operation Evaluation Department, No. 300

⁸⁹ Langhammer Rolf & Luke Mathias (2000), WTO Negotiation and Accession for Vulnerable Economies, Kiel Institute of World Economics, Working Paper# 990, P.5

promoting peace and security in the region, IGAD is dependent on contributions from its member countries who are entirely LDCs except Kenya and funds from donor agencies. Its trade related technical assistance and capacity building program has not been extended beyond the livestock sector where it has undertaken significant measures in promoting and enhancing the livestock sector of the region in conjunction with multilateral institutions and donor agencies.⁹⁰

COMESA FTA/CU

As regards financial resource to support technical assistance and capacity building activities, the characteristics of IGAD and SFC is also shared by COMESA. However COMESA has a relatively strong institutional base to coordinate technical assistance and capacity building activities through its various agencies. As provided under Article 156 and 157 of its establishment treaty, technical cooperation in human resource development is one of its key areas of cooperation. Currently, Ethiopia is the seat of one of the numerous institutions of COMESA, the Leather and Leather Products Institute (LLPI), established to enhance the regional integration process and foster the economic development of the region.⁹¹ LLPI, inter alia, aims to contribute to the sustainable development, competitiveness and integration of the leather sector of the region through trade and investment promotion and human resource development.⁹² The institute operates as a technical institution and a center of excellence in leather and leather products processing and manufacturing technology.⁹³ Furthermore, COMESA has launched different programmes, trade policy, trade facilitation, multilateral transport, information communication technology, energy, private sector development, investment promotion, and gender mainstreaming, to assist in the achievement of trade promotion within the region. Ethiopia has benefited and will continue to benefit from these programmes regardless of her accession to the FTA/CU as a member of COMESA.

⁹⁰ An Interview conducted with Mr. Mekbib Tilahun, *Supra note 20*

⁹¹ COMESA, *About COMESA: Leather and Leather Products Institute (LLPI)*, available at, <http://about.comesa.int/index.php>, last visited on October 22, 2010

⁹² *Ibid*

⁹³ *Ibid*

EPA

The possibility of increased development assistance to ACP countries has often been seen as a potential benefit of EPA negotiations.⁹⁴ The EPAs are expected to supply technical assistance and capacity building supports to ACP countries. It has also been noted earlier in this chapter that together with more relaxed rules of origin, technical assistance and capacity building supports are the only meaningful potential benefits of EPAs for Ethiopia. It has been argued that "if an EPA is to become an instrument for development, it is imperative that sufficient and timely financial and technical support be mobilized to enhance the competitiveness and supply capacity of ACP countries, thereby enabling them to benefit from integration into the world economy".⁹⁵

The EU has pledged that ACP countries will be supported and compensated by resources from the European Development Fund (EDF). As part of its 10th EDF the EU agreed to commit €22.6 billion for all ACP countries, to cover the period 2008-2013.⁹⁶ Of this budget Ethiopia receives € 644 millions in programmable resource.⁹⁷ These resources are allocated to three focal sectors: transport and regional integration, private sector development and food security and rural development.⁹⁸ Besides, the EU has provided different technical assistance packages to strengthen the trade related negotiation and rules implementation capacity of the ACP countries. The technical assistances mainly include short term trainings, workshops, and seminars aimed at enhancing the expertise and institutional capacity of government officials and trade related ministries in a bid to boost their trade related negotiation and rules implementation capacity.

However, it is worth mentioning that development issues are part of the Cotonou Agreement and Ethiopia will continue to receive such assistances regardless of the EPA as a signatory to the Cotonou agreement. Besides, the EU consistently argued that since EPAs are only the trade components of the Cotonou Agreement, they would not deal with development issues as such issues would continue to be regulated under the Cotonou Agreement, which covers the period

⁹⁴ Patel Mayur (2007), *Supra note* 64, P. 25

⁹⁵ *Ibid*

⁹⁶ EU, European Development Fund, available at http://europa.eu/legislation_summaries/development/overseas_countries_territories/r12102_en.htm, last visited on November 2, 2010

⁹⁷ EU, EU Relation with Ethiopia, available at http://eeas.europa.eu/ethiopia/index_en.htm, last visited on November 2, 2010.

⁹⁸ *Ibid*

2000-2010.⁹⁹ Therefore, technical assistance and capacity building supports that may accrue from Ethiopia's negotiation of EPA in the post negotiation periods depends on whether development issues i.e. technical assistance and capacity building would be included in the EPAs. Many ACP countries are, however, increasingly insisting that they should be included.

WTO

As has been noted earlier Ethiopia's membership in the WTO has a relatively huge potential in terms of offering technical assistance and capacity building supports to the country. Technical assistance and capacity building support constitute one form of Special and Differential Treatments (SDTs) provided under numerous WTO agreements for developing and least developed countries. Although these clauses fail to impose legal obligation on the developed WTO member countries to provide the necessary funds for the provision of technical assistance and capacity building activities, it is believed that the WTO as an institution, has ample experience and resource base to provide such assistance and support. According to Langhammer and Lucke (2000) "the WTO is institutionally prepared and financially endowed to help least developed and poor developing countries to form human capital in trade policy formulation that can also be used for other legal issues".

Since the first WTO Ministerial Conference was held in 1996 in Singapore several initiatives has been adopted by the WTO in conjunction with other multilateral institutions to provide technical assistance and capacity building support for developing and least developed countries. The Singapore conference adopted the comprehensive and integrated WTO plan of action for LDCs.¹⁰⁰ The plan envisages closer cooperation between the WTO and other multilateral and bilateral agencies assisting LDCs in the areas of trade.¹⁰¹ Accordingly, a high level meeting convened by the WTO in 1997 launched the Integrated Framework (IF) for trade related technical assistance to support LDCs in their trade and trade related activities.¹⁰² This initiative was designed by six multilateral agencies as the principal mechanism for LDCs to mainstream

⁹⁹ Patel Mayur (2007), *Supra note* 64, P. 26

¹⁰⁰ Luke David F. (2002), Trade-Related Capacity Building for Enhanced African Participation in the Global Economy, In Hoekman Bernard Mattoo Aaditya, and Philip English (eds.) Development, Trade, and the WTO, The World Bank, Washington, DC, P. 510

¹⁰¹ *Ibid*

¹⁰² *Ibid*

their national trade objectives in to national development plans and benefit from WTO membership. Ethiopia has already seen the benefit of this programme. A Diagnostic Trade and Integration Study (DTIS) has been prepared in 2004 as part of the IF programme. The study has assessed impediments to trade and integration of Ethiopia in the world economy and provided recommendation to improve the diversification and competitiveness of Ethiopian export bundle.

Another follow up to the call for coordination of trade related technical assistance by the Singapore plan of action was the launching of the Joint Integrated Technical Assistance Programme to selected LDCs and African countries (JITAP) in 1998.¹⁰³ This programme has been widely praised as a path breaking effort to address the problems of least developed and other poor developing countries.¹⁰⁴ Many countries in Africa have significantly benefited from this programme and Ethiopia will become one of the beneficiary countries up on accession.

Furthermore, during the fourth Ministerial Conference at Doha WTO members have made new commitments through various paragraphs of the Doha Declaration on technical assistance and capacity building to enhance the integration of LDCs to the multilateral trading system. The Conference has also led to the establishment of the Doha Development Agenda Global Trust Fund (DDAGTF) to finance the Technical Assistance and Training Program (TATP) of the WTO.¹⁰⁵ Moreover, as follow up to this Conference, the WTO and OECD took the initiative of jointly establishing the Doha Development Agenda Trade Capacity Building Database (DDATCBDB).¹⁰⁶ These initiatives have further strengthened the capacity of the WTO to provide technical assistance and capacity building activities for developing and least developed countries. However, the demand for technical assistance and capacity building in the WTO is still much higher than the supply and Ethiopia will receive such assistance only in competition with other least developed and poor countries. Therefore, appropriate strategy is needed to effectively benefit from the technical assistance and capacity building programmes of the WTO.

In sum, in order for Ethiopia to reap the full benefits of its multilateral and regional trade liberalization initiatives, there is a need for technical assistance and capacity building to help

¹⁰³ IOB (2005), *Supra note* 88, P. 39

¹⁰⁴ *Ibid*

¹⁰⁵ *Ibid*, P. 40

¹⁰⁶ *Ibid*

address the trade related negotiation and rules implementation capacity as well as to reduce or eliminate the numerous supply side constraints of the country. The country's membership in the already mentioned institutions/agreements will provide technical assistance and capacity building supports of various degrees and it is up to the country to effectively utilize such opportunities in order to enhance its expertise and institutional capacity not only to negotiate and implement agreements but also to strengthen its national trade policy designing and implementation capacity.

5.4.3 Access to Foreign Market

As has been discussed under section 2.2 the presence of reciprocity behind a country's trade liberalization measure is the key element that tells between unilateral and reciprocal trade liberalization. Hence, unlike the unilateral liberalization measures that has been pursued over the last two decades, the current multilateral and regional trade liberalization initiatives are expected to induce reduction in foreign trade barriers and hence open market access for Ethiopian exports.

Before looking in to the country's multilateral and regional trade liberalization initiatives' potential in opening foreign markets for Ethiopian exports it is imperative to answer two interrelated question of paramount importance concerning the relevance of market access to Ethiopia. These are, whether Ethiopian exports lack access to foreign markets and whether the country has the capacity to make use of market access opportunities. The answer to these questions, on the other hand, revolves around the foreign market access opportunities the country has at its disposal and whether the country has took advantage of them.

As an LDC Ethiopia has preferential market access in wide range of countries under the General System of Preference (GSP) which includes access to the markets of, Australia, Canada, P. R. China, EU, Japan, Norway, Republic of South Korea, Switzerland, Turkey, and USA.¹⁰⁷ Ethiopian exports also enjoy duty and quota free access to the US and EU market under the AGOA and EBA initiatives, respectively. These preferential schemes provide market access for virtually anything the country is able to produce and supply.¹⁰⁸ Besides, Ethiopian exports

¹⁰⁷ ERCA (2010), Preferential Trade Agreements, available at <http://www.erca.gov.et/preferntial.php>, last visited on November 12, 2010

¹⁰⁸ Melaku Geboye (2009), *Supra note 2*, P.357

receive preferential treatment in all the 19 member countries of COMESA and a zero tariff preference in the Sudanese market under the preferential trade agreement signed in 2002.¹⁰⁹

Despite such a wide range of market access opportunities, the country's export trade remains trivial for decades and its contribution to the national GDP is very minimal. Besides, as discussed in the preceding chapter the Ethiopian export sector is characterized by both product and geographic concentration. While the product composition is overwhelmingly dominated by agricultural and allied activities, the export destination is confined to few countries in Europe and Asia. The existing trade pattern also implies that Ethiopian exports receive preferential treatment in their major destinations. According to the NBE's Annual Report, 41.7 per cent of Ethiopian exports in the 2008/2009 budget year were destined to European markets¹¹⁰, where essentially all Ethiopian exports are allowed to enter on duty and quota free basis under the EBA initiative. However, Ethiopia's utilization rate of preferential market access opportunities both under EBA and other preferential schemes is very low compared to other beneficiaries.¹¹¹ For instance, as can be observed from the table below, Ethiopia's textile and apparel export to the United State under AGOA is very minimal compared with the export of other beneficiaries.

Table 5.2: Textile and Apparel Export to the USA under AGOA

Beneficiary	Value (1000 dollars)		
	2007	2008	2009
Ethiopia	4 559	9 357	6 622
Kenya	245 685	244 744	194 630
Mauritius	108 686	95 668	98 620
Swaziland	134 635	124 172	94 164

Source: <http://www.agoa.info/>

These facts imply that market access issues are not the main impediments of Ethiopian exports. Rather, as observed by Fikremarkos, and extensively reiterated in this paper the key problems facing Ethiopian export products are "lack of capacity to produce export products both in terms of quality and quantity".¹¹² Hence, unless they are seen from a different stance market access issues could not have particular importance to Ethiopia, at least in the short and medium term.

¹⁰⁹ WTO (2007), *Supra* note 82, P. 165

¹¹⁰ NBE (2009), *Supra* note 32

¹¹¹ Interview with Mr. Yishak Tekaligne, *Supra* note 28

¹¹² Fikremarkos Merso (2005), *Supra* note 71, P. 70

That is access to foreign markets that can be obtained from binding reciprocal trade agreements may have an indirect significance in attracting foreign investment, which may help address the supply side constraints that dampen a response to market access opportunities.

While reciprocal market access opportunities are secured and predictable as they are subject to international trade rules, "preferences are unilateral decisions which could at any time be taken away from the beneficiaries without any justification".¹¹³ Thus, they are least likely to motivate investors to invest their capital, especially long term investment.¹¹⁴ Since there is no guarantee as to how long the preference will stay, investors could not have confidence to plant their investment projects, especially long term ones relying on such market access opportunities.

Moreover, benefiting from a preferential scheme requires complying with several requirements, technical, administrative, or intended to establish the origin of the product.¹¹⁵ Given the cost and sometimes the complexity of these constraints, the benefit of preferential agreements cannot be considered as automatic, costless or unconditional. Therefore, the predictable and secured market access that could be obtained from undertaking reciprocal trade agreements would have some relevance, particularly in the long term and in attracting foreign investment in the short term. However, the degree of market access opportunities that could be created by accession to the WTO and the different RTAs differ substantially and is subsequently reviewed.

WTO

The bilateral market access negotiations between acceding states and incumbent members are the most complex and time consuming of the WTO accession process. However, these negotiations are utterly one sided and are all about the extent of market access commitments to be undertaken by the acceding state. The acceding state could have no say on the market access it receives in exchange. That is because; incumbent members have already negotiated their market access commitments and such has become an integral part of the General Agreement by virtue of Article II: 1 of GATT, which requires market access commitments undertaken by member

¹¹³ *Ibid*, P. 71

¹¹⁴ UNCTAD (2004), World Economic and Social Survey 2004: Trends in Policies in the World Economy, UN, New York, P. 27-28

¹¹⁵ Candau Fabien and Jean Sébastien (2005), What Are EU Trade Preference Worth for Sub-Saharan Africa and other Developing Countries? CEPII Working Paper No. 2005-19, P. 4

countries to be enumerated on schedules of tariff concession and annexed to the main body of the Agreement.

Therefore, up on accession Ethiopia will only benefit from market access concessions negotiated by incumbent members in previous multilateral rounds of negotiation in which it did not take part. The main concern here is, however, Ethiopia is already enjoying these market access conditions. That is because, even though WTO members are at liberty to discriminate against non-members by treating member countries more favourably, "in practice, such discrimination hardly take place and non-members like Ethiopia enjoy the same market access conditions as WTO members under the MFN principle".¹¹⁶ Hence, tariffs faced by Ethiopian exports will not change as a result of membership in the WTO. However, WTO membership will considerably enhance the credibility and predictability of the already secured market access opportunities.

EPA

Ethiopia has a duty and quota free market access to the EU, its most important export market, under the EBA initiative. These preferential system covers virtually any product the country is able to produce and supply and thus the EPA has very little to do with enlarging market access opportunities for Ethiopia. In these respect the only purpose of EPA could be transforming the current unilateral preference system, which is characterized by uncertainty and unpredictability, in to a secured and predictable system bound by a legal agreement. In fact, Ethiopia may also benefit from simplified rules of origin, but it is not yet known whether EPAs will entail such upshot.

COMESA FTA

Membership in the COMESA FTA will entail a zero tariff preference for most or all Ethiopian exports to the markets of the COMESA FTA Signatories. Given the current preference margin, which is limited only to 10 per cent, duty free access to COMESA member countries can be considered as a significant market access opportunity for Ethiopian exports. However, the "low

¹¹⁶ Derk Bienen (2009), Preparedness of the Ethiopian private Sector to Benefit from WTO Accession, Trade and Development Discussion Paper No. 02/2009, P. 4

product complementarities" of the region¹¹⁷ and lack of infrastructure to facilitate intraregional trade must be the main concern for Ethiopia. Most countries in the region are exporters of primary agricultural products and this product similarity and concentration will obviously impede the possible utilization of the market at least in the near future.

Regardless of such concern, membership in COMESA FTA is expected to contribute to the diversification of Ethiopian exports. According to the DTIS almost 60 per cent of increase in exports due to duty free access to COMESA is expected to occur in meat products. Manufacturing exports are also expected to increase by more than one per cent following Ethiopia's membership in the COMESA FTA.¹¹⁸ That is mainly because; the zero tariff preference will give them an extra advantage in contrast to non COMESA exports to the region.

IGAD/SFC FTA

Both of these trade arrangements are typical examples of overlapping membership and hence would practically become meaningless in terms of market access if Ethiopia joins the COMESA FTA. That is mainly because while all member countries of IGAD except Somalia are also members of the COMESA FTA, all member countries of the SFC except Yemen are member countries of IGAD. Therefore, if Ethiopia joins the COMESA FTA/CU these arrangements will add no substantial market access to Ethiopian exports except to that of Somalia and Yemen.

5.5. Sequencing¹¹⁹ the Multilateral and Regional Trade Liberalization Processes

Effectively managing the interface between regional and multilateral initiatives requires greater synergy between national development objectives and external commitments. Central to this challenge facing developing countries is to design and implement an appropriate and strategic pacing and sequencing of national, regional and multilateral liberalization, so as to maximize development gains from these processes of trade liberalization and regulatory commitments.....

UNCTAD (2005)

¹¹⁷ Khandelwal Padamja (2004), *Supra note 33*, P. 14

¹¹⁸ DTIS (2004), Ethiopia Trade and Transformation: Summary and Recommendations; Diagnostic Trade and Integration Study, Volume 1, Final Version, P. 31

¹¹⁹ The term "sequencing" is commonly used in relation to trade liberalization to refer to the timing or pacing of liberalization among different economic sectors. However, its utilization under this section only refers to the timing between different trade liberalization initiatives in the context of multilateralism versus regionalism.

Ethiopia is pursuing its multilateral and regional integration initiatives simultaneously without any sequential feature and clear priorities to speak of. The two processes are perceived as mutually reinforcing and complimentary. However, the theoretical debate reviewed in chapter three revealed that the interplay between these two tracks of trade liberalization is contentious at best and depends on the particular situations of a country and the RTAs under consideration.

Although some countries engage in multilateral and regional trade negotiations simultaneously, neither have they given equal priority to each track nor did they join the multilateral and regional trading systems at once. United States became interested in RTAs only after the 1980s while the Treaty of Rome was signed only ten years after the entry in to force of the GATT.¹²⁰ Most COMESA members joined the WTO long before they embark on the establishment of COMESA and China has embarked on RTAs only after she secured membership in the WTO.¹²¹ On the other hand, Ethiopia is negotiating to join the WTO and different RTAs at the same time without setting any clear priorities. Multilateralism and Regionalism may or may not be complementary, but as the quote from UNCTAD at the beginning of this section suggests, it is imperative for countries like Ethiopia to design and implement an appropriate sequencing between its multilateral and regional integration initiatives for reasons generally discussed subsequently.

By pursuing reciprocal trade liberalization, Ethiopia may benefit from an increased competition on the domestic market, increased choices for consumers, improved access to foreign markets, enhanced predictability in its trade regime, enhanced foreign investment in flows, and increased technical assistance and capacity building support. But, such benefits are neither guaranteed nor costless.¹²² First, they are conditional on various factors and in particular on the country's capacity to make use of them. Second, trade liberalization brings numerous adjustment costs with it, especially during the short and medium term.¹²³ As has already been discussed, these costs are expected to be substantial for Ethiopia, owing to its dependency on tariff revenues and inability to reallocate factors of production within and between sectors. It should be noted here

¹²⁰ The Rome Treaty was signed in 1957 and established the European Economic Community (EEC)

¹²¹ Yang Jun, et al. (2009), The Impact of the ASEAN-China Free Trade Area on China's Economy and Regional Agricultural Development, In Chun Chunlai (ed.), China's Integration with the Global Economy: WTO Accession, Foreign Direct Investment and International Trade, MPG Books Group, UK, P. 183

¹²² Hoekman Bernard and Porto Guido (2010), Trade Adjustment Costs in Developing Countries, available at <http://www.voxeu.org/index.php?q=node/5200>, last visited on November 2, 2010.

¹²³ De Cordoba Santiago Fernandez et al (2004), *Supra note 74*, P. 69

that the degree of trade liberalization Ethiopia will be required to undertake by joining the WTO and the RTAs is substantially different. While WTO accession requires the country to reduce its trade barriers, joining the RTAs entails eliminating them. Undertaking commitments both at the multilateral and regional level at the same time would therefore increase the degree of the possible revenue loss and the level of competition that would be faced by the domestic industries.

A sequenced approach on the other hand will among other things provide much needed adjustment time for the domestic economy. Sequencing the regional and multilateral integration process would possibly reduce the degree of trade liberalization the country will undertake at a time and this on the other reduces the adjustment costs, by distributing them over a different period of time. Sequencing will also provide Ethiopia with the opportunity for "learning by doing". The lessons drawn from liberalizing trade at the multilateral level can be used to lessen adjustment costs of trade liberalization at a regional level and vice versa. However, if trade is liberalized at both levels simultaneously there would be no such opportunity.

The other reason justifying the need for a sequenced approach relates with the capacity of the country to handle multiple negotiations at the same time. Complex international trade negotiations, whether at the bilateral, regional, or multilateral level and given the wide range of issues covered and the possible impacts that their outcomes might have on domestic policymaking, require countries to make significant resource investments in the development and improvement of the human, technical, financial, and physical infrastructure necessary to have robust and sufficient negotiating capacity.¹²⁴ However, many developing countries face challenges and resource limitations in developing such negotiating capacity to the extent needed to ensure their effective and substantive participation in trade negotiations.¹²⁵ Besides, trade negotiations require careful planning, preparation, analyses of data, consultations with stakeholders including private sector and civil society (employers, workers' representatives and

¹²⁴ South Center (2004), Strengthening Developing Countries' Capacity for Trade Negotiations: Matching Technical Assistance to Negotiating Capacity Constraints, Doha High Level Forum on Trade and Development, Background Paper No. 4, P. 2

¹²⁵ *Ibid*

other interest groups).¹²⁶ Hence, it is reasonable to assume that handling more than one set of negotiations at once poses additional challenge for developing countries because of their capacity and resource limitations and substantially curtail the quality of the agreements they would undertake.

Given its lack of experience in trade negotiations, and the extremely limited financial, human and institutional resources, negotiation capacity is a legitimate concern for Ethiopia. The government has acknowledged that the country lacks the necessary human, institutional, financial and administrative capacity to undertake the WTO accession process.¹²⁷ And in similar vein the DTIS had observed that the country lacks the necessary negotiating capacity and knowledgeable staff to carry on with the WTO accession negotiations.¹²⁸ Simultaneous negotiations at the multilateral and regional level will overstretch the limited negotiating resources and capacity of the country and significantly impact on the quality, especially the degree of commitments, of the agreements to be negotiated. A sequenced approach help address such problems and allows the country to pool all available resource together and exert maximum effort and energy on each and every agreement. This would obviously enhance the quality of the agreements to be negotiated, giving ample time and resources for stakeholder's participation, undertaking adequate impact assessment studies and identifying clear negotiating positions.

However, it is worthwhile to note that there is no hard and fast rule to determine the appropriate sequence between multilateral and regional integration. Neither there is a common trend in the experience of countries. For instance, while China embarked on regional integration only after it has successfully completed its WTO accession, Vietnam acceded to the WTO only after she joined a plethora of RTAs. Hence, it is up to Ethiopia to determine the right sequence between its multilateral and regional integration initiatives taking in to account both economic and non economic factors. The following two sub sections appraise the general implication of the two possible scenarios, i.e. RTA membership ahead of WTO accession and the reverse situation.

¹²⁶ *Ibid*

¹²⁷ WTO (2007), *Supra note 69*, P. 2

¹²⁸ DTIS (2004), *Supra note 118*, P. 54

5.5.1 RTA Membership Ahead of WTO Accession

Ethiopia is involved in a plethora of regional trade integration negotiations. The possible implications of these negotiations have been discussed in the preceding sections. However, as has repeatedly been mentioned the key question about RTAs is whether the benefits of trade creation exceeds the costs of trade diversion. As things stands now most of the RTAs Ethiopia is negotiating to join, have potential trade diversion and marginal trade creation effects. Concluding these agreements ahead of WTO accession will have multifarious implications. However, before assessing such implications it is necessary to shed light on their compatibility with WTO rules on RTAs and accentuate the need for an appropriate sequencing between the RTAs themselves.

The MFN principle of the WTO has significant exceptions which allow member countries to conclude RTAs, provided certain conditions are satisfied. To establish WTO compatible RTAs under COMESA, IGAD and SFC, it can be sufficient to meet only the relatively undemanding requirements of the Enabling Clause, which essentially provides a dispensation from WTO rules for various trade arrangements involving developing countries. COMESA has already been notified under the Enabling Clause and the proposed FTAs under IGAD and SFC could easily be notified under the same Clause. The main concerns for Ethiopia in this regard are COMESA CU and the EPA. An RTA with a developed country will have to be notified under GATT Article XXIV and examined by the Committee on Regional Trade Agreements, where it will be subject to more rigorous scrutiny. In particular, fulfilling the *substantially all the trade* requirement of the above Article will pose a significant challenge. Joining the COMESA CU will pose another major challenge to Ethiopia in terms of WTO compatibility. Unlike FTAs, CUs require maintaining a Common External Tariff (CET), and this would obviously complicate the WTO accession process since Ethiopia could not reduce its tariff level below the CET.¹²⁹ However, since most other members of the RTAs are WTO members¹³⁰ ensuring the WTO compatibility of these RTAs is inevitable whether they are concluded before or after Ethiopia's WTO accession.

¹²⁹ In order for Ethiopia to reduce its tariff below the CET, other members of the union must also do the same, which is least likely. However, it can be argued that Ethiopia may not be required to reduce its tariffs below such level.

¹³⁰ Among the members of IGAD, COMESA, SFC and EPA, the only non WTO members other than Ethiopia are; Eritrea and Libya (COMESA), Sudan (COMESA, IGAD and SFC) and Yemen (SFC).

As mentioned elsewhere above, overlapping membership is the main characteristics of Ethiopia's regional trade integration initiatives. In spite of being obstacles to the utilization of the possible benefits of regional integration, overlapping memberships will pose tremendous administrative burdens to Ethiopia. From the economic and legal perspective the first best option to overcome the difficulties linked to overlapping memberships is to join as few RTAs as possible. However, the recent trend towards regionalism reflects both economic and non economic motivations and countries aspire to join RTAs for political reasons as well. In such conditions, the other possible mechanism of mitigating the problems of overlapping membership is harmonization of integration rules such as rules of origin. However, this mechanism does not seem practical in Africa as most RTAs opt to implement their own rules of origin and tariff phase-down schedules.

In this respect, Ethiopia can avoid or ease the difficulties related to overlapping membership; first, by not negotiating the SFC FTA and second, by implementing a right sequence between COMESA FTA and IGAD FTA. Given the fact that virtually all IGAD members are also members of the COMESA FTA Ethiopia's membership in the COMESA FTA ahead of IGAD FTA will substantially reduce the economic relevancy of the IGAD FTA. Unless it becomes COMESA FTA plus, the establishment of IGAD FTA would serve no economic purpose if Ethiopia joins the former. The IGAD FTA will therefore be forced to harmonize its rules of origin and other aspects of the FTA with that of COMESA. This would not only solve the problems of overlapping membership but also saves the limited negotiation resources of the country.

With respect to undertaking RTAs ahead of WTO accession, the EPA will play a critical role. First, as a negotiation with a strong trading partner, it presents enormous trade negotiation experiences. Trade related technical assistances and capacity building supports provided by the EU will also strengthens the trade related negotiation and rules implementation capacity of the country. Such experience and assistance will help Ethiopia in negotiating its terms of accession in the WTO. Second, once the EPA is concluded any further liberalization by Ethiopia especially at the multilateral level will considerably reduce the margins of preference that would be enjoyed by commodities originating from EU. It is reasonable therefore to assume that the EU would not opt to reduce its margin of preference. Hence, by concluding the EPA prior to WTO accession,

Ethiopia may avoid the market access concession demands that would otherwise come from the EU. But, there can be no legal grounds prohibiting the EU from demanding Ethiopia to undertake further trade liberalization commitments during the WTO accession negotiations.

The other possible advantage of undertaking the regional trade integration initiatives ahead of WTO accession relates with using these initiatives as experience for further liberalization at the multilateral level. Ethiopia may use the RTAs as laboratories for testing the impact of reciprocal trade liberalization before embarking on multilateral trade liberalization; their operating experiences can provide the basis for far reaching trade liberalization at the multilateral level. We have already seen that trade liberalization will entail significant adjustment costs and hence by liberalizing its trade regime at a regional level Ethiopia may build on the lessons, acquaint itself with the implications of such liberalization and prepare itself for multilateral liberalization.

Undertaking RTAs ahead of WTO accession will have certain drawbacks as well. First, as it has already been discussed preferential trade liberalization, especially in the context of EPA will possibly entail revenue loss and trade diversion. Such impacts would be exaggerated when the RTAs are concluded before WTO accession. That is mainly because in situations where Ethiopia is not a WTO member the margins of preference extended to the members of the RTAs would be significant and this would increase the occurrence of trade diversion. In situations where the country's MFN tariffs are not bound at the multilateral level the trade diversion and revenue losses may also induce the government to raise the current tariff rates to compensate the losses.

The second possible drawback relates with the precedent it leaves for the WTO accession negotiations. Ethiopia's tariff regime is already liberalized to a significant extent and acceding to RTAs would totally remove these tariffs against those commodities originating from the members of the respective RTAs. In fact, as we have already seen WTO does not prohibit the formation of RTAs. However, despite being a self claimed rules-based organization, the WTO has no rules when it comes to the requirements for accession. As we have already seen the very provision that governs the accession process, i.e. Article XII of the Marrakesh Agreement, simply states that new member may join the organization on terms to be agreed between it and the incumbent members. During the accession negotiations, as can be learned from the accession

experience of Cambodia, Nepal¹³¹ and other countries, the existing (applied) tariff structure of the acceding country plays a vital role. Accordingly, the demanding WTO members, such as the United States may insist to reduce the margin preference extended to Ethiopia's RTA partners. In particular, the preferential treatments that would be given to the EU under EPA may leave a bad precedent for the accession negotiations and weaken Ethiopia's bargaining power.¹³²

5.5.2 WTO Accession Ahead of RTA Membership

For a country with a level of financial, human and institutional capacity as low as Ethiopia, the first and foremost difficulty of acceding to the WTO is ensuring the conformity of its laws regulations and administrative procedure with the complex and technical multilateral agreements. Such process *inter alia* requires a high degree of expertise with effective and efficient institutional backing. To this effect Ethiopia needs a significant level of technical assistance and capacity building supports from the rest of the world. As briefly discussed in sub section 5.4.2 such assistances not only enhance the trade related negotiations and rules implementation capacity of the country but also strengthens the country's capacity of trade policy making, trade analysis and implementing trade related reforms in general. In the same sub section we have observed that WTO accession is much better than Ethiopia's regional integration initiatives in offering such technical assistances and capacity building supports. Therefore, acceding to the WTO ahead of RTA membership among other reasons will place Ethiopia in a better position both in undertaking negotiations and implementing regional trade agreements.

The WTO accession negotiations will provide an opportunity to negotiate entry into a very comprehensive arrangement which would require a full appreciation of all the areas being negotiated and the capacity of the country to make commitments in these different areas. Bearing in mind that the concession made at the WTO may not be as deep as what may be required in the context of a regional agreement, one may very well find that the experience in negotiating at the WTO would assist Ethiopia when it negotiates RTAs. Moreover, in the absence of strong institutions at the regional level the structured approach in the WTO may

¹³¹ Mathema Kanhaiya B. (2005), Nepal's WTO Accession Negotiations: Lessons for LDCs, In Preparation for WTO Accessions: Insights from Developing Countries, Country Studies Commissioned by Simon J. Evennet, P. 245

¹³² In these respect, it has to be reminded that France had convinced Albania to withdraw audiovisual commitments that it had made to the United States by threatening to block the country's WTO accession.

provide the necessary experience and strengthens the country's expertise, which may enable Ethiopia to negotiate from a position of advantage when it undertakes more detailed and comprehensive agreements at the regional level.

The other advantage to Ethiopia in negotiating WTO accession before embarking on the regional arrangements is that it would have a clear indication of its minimum obligations (MFN obligations) and on the basis of that it would be able to determine what additional concessions it would be willing to make in the context of RTAs. Hence, setting the MFN obligations ahead of RTA membership will help Ethiopia know the preference margin it will extend to RTA partners.

Apart from those points raised in the preceding sub sections as advantages of concluding RTAs ahead of WTO accession, the major drawback of embarking on WTO accession prior to RTAs relates with the difficulty of undertaking WTO accession as per a schedule. Besides being a multi-year and time consuming, the accession process is susceptible to delays. As we have already seen an issue as entirely procedural as the appointment of a Working Party Chairman can successfully stall the whole process. Therefore, if Ethiopia postpones its membership in RTAs until its entry in to the WTO this would leave the country lag behind its partners in the regional integration process. For instance, in this scenario Ethiopia may find it difficult to cope with other members of COMESA FTA/CU once they integrate their economy.

Generally however given its relative importance to Ethiopia particularly in offering technical assistance and capacity building support, inducing credibility and predictability in its trade regime, and attracting foreign investment, WTO membership shall be given priority ahead of membership in RTAs. In particular, the technical assistance and capacity building supports that can be obtained from acceding to the WTO will be of great importance to Ethiopia to develop its human and institutional capacity for undertaking somehow deep and comprehensive RTAs such as the EPA. Moreover, as has been discussed in the preceding sections there are no pressing reasons for Ethiopia to join RTAs at this juncture, at least, as the RTAs are not capable enough to induce large benefits. On the other hand, Ethiopia's entry in to the WTO before the conclusion of the ongoing Doha Development Agenda (DDA) will have a paramount importance. Although the DDA is expected to introduce some leniency in the accession of LDCs to the multilateral trading system, it is apparent from the agendas on the table that it will also result in new agreements.

Hence, concluding the accession process in due time and securing reasonable terms of accession is essential for Ethiopia both to make use of trade opportunities and mitigate adjustment costs.

Chapter Six

Conclusion and Recommendations

6.1. Conclusion

In view of the far reaching unilateral trade liberalization measure that have been undertaken over the last twenty years, the recent multilateral and regional integration initiatives of Ethiopia constitute an important step forward in deepening its integration in to the global economy. However, pursuing trade liberalization through different trading arrangements at the same time is not an easy road for any country and especially for a least developed country like Ethiopia. Thus, Ethiopia has to be vigilant in choosing the trading arrangement that best serves its interest.

The multilateral and regional trading arrangements are basically contradictory owing to their underlying principles. While the pillar of the former is non-discrimination the corner stone of the latter is discrimination. However, they coexist as a result of the departure from the fundamental non discrimination principle of the multilateral trading system permitted in accordance with the provisions of Article XXIV of the GATT, the Enabling Clause and Article V of the GATS.

Therefore, in principle, Ethiopia can pursue multilateral and regional integration at the same time. However, the prospects and challenges of membership in the multilateral and regional trading arrangements are not similar. With this premises the overarching objectives of this study were twofold. First, to assess which one of these trading arrangements is best suited to assist the country reap larger benefits. Second, it was to explore the need for sequencing the multilateral and regional integration processes and to look for the appropriate sequence between them.

Choosing between the multilateral and regional trading arrangements is however a highly complex task because of the multifarious impact each trading arrangement has on Ethiopia. Such choice is further complicated by the fact that the regional trade agreements have no similar impacts either. To this effect this study has opted to assess the impacts of the multilateral trading system and the different regional trade agreements independently and compare their relative merits on the basis of their ability to induce transparency and predictability on the domestic policy regime, to strengthen the trade related technical and institutional capacity of the country and to provide more favourable, predictable and transparent market access for Ethiopian exports.

The assessment along these lines has suggested that compared to the regional trade agreements (i.e. the COMESA FTA, and the proposed FTAs under the IGAD, EPA and SFC framework) the multilateral trading system (i.e. WTO) will provide greater benefits to Ethiopia.

The rules based multilateral trading system as enshrined under the WTO would entail reforms in a wide range of areas and provides effective and efficient mechanisms to lock in those reforms. Thus, it would help Ethiopia attract much needed foreign investment through being a powerful signal of transparency, credibility and predictability. It would also offer various technical assistance and capacity building supports, enhancing the trade related technical and institutional capacity of the country. Moreover, it would add considerable transparency and predictability towards the market access opportunities Ethiopia is currently enjoying on preferential basis.

This does not mean that regional integration or membership in regional trade agreements would not provide any benefit to Ethiopia. It would provide a range of benefits, but the benefits would be undermined by numerous factors. For example, regional integration would provide more favourable market access even compared to the multilateral trading system. However, with respect to the COMESA FTA and the proposed FTAs under the IGAD and SFC framework, the value of such market access would be undermined by the low product complementarities of the region, lack of efficient infrastructure and of course by the problems related to overlapping membership. Whereas in relation to the EPA, it would be undermined by the fact that Ethiopia is already enjoying a duty and quota free access to the EU market under the EBA initiative.

Regarding the issue of sequencing, undertaking the multilateral and regional integration processes at the same time would pose a significant challenge to Ethiopia. Given the limited financial, human and institutional resources of the country, engaging in more than one process at the same time would overstretch the limited resources and thus considerably affects the country's capacity to effectively undertake the processes. This is of particular importance in relation to negotiating accession to the WTO and the proposed FTAs whereby the commitments Ethiopia would undertake as part of its membership obligations are largely influenced by its negotiation capacity. On the other hand, sequencing the integration processes would enhance the country's negotiation capacity through providing sufficient preparation time, opportunity to pull all available resources together and opportunity to apply lessons learned from one process to

another. Moreover, sequencing would help to lessen the economic and institutional burden of ensuring compliance or implementing commitments that would be undertaken at the regional and multilateral level, by distributing them over different period of time.

6.2. Recommendations

Multilateral and regional integration are approaches for increasing the degree and effectiveness of Ethiopia's linkage with the global economy. Neither should be taken as a goal or an end in its own. However, pursuing the appropriate integration approach at the appropriate time is essential to fully reap the benefits and mitigate the challenges thereof. To this effect, prioritizing and sequencing between multilateral and regional integration is of paramount importance to Ethiopia. In light of this and the conclusions made above the following measures should be taken in to account to ensure that the multilateral and regional integration works to the benefits of Ethiopia.

- Ethiopia needs to be clear of what it wishes to achieve in integrating its economy with the global economy. This requires identifying national economic priorities so as to determine which integration path is best suited to realize these priorities. Moreover, since the various trade integration initiatives launched both at the multilateral and regional level necessarily interacts with each other an effective coordination mechanism needs be installed. Towards this end, Ethiopia has to prepare a comprehensive and autonomous trade policy.
- The prospects and challenges of integration through the multilateral trading system and regional trade agreements are essentially different. Therefore, Ethiopia needs to give priority to the trading system which best serves its interest. In this respect, the highest priority must be given to multilateral integration, because Ethiopia would benefit most from the rules based multilateral trading system than from the Regional Trade Agreements.
- Ethiopia could not afford to deal with multiple trade integration processes at the same time. Especially, given its limited financial, human and institutional capacity as well as inability to easily adjust to trade liberalization, sequencing the integration process must be given emphasis. Such measure not only helps in economizing resources but also in negotiating a better terms of accession both at the multilateral and regional level and create favourable conditions for the implementation of commitments that would be undertaken thereof. In this

respect, Ethiopia must join the multilateral trading system before embarking on regional integration, because the multilateral trading system would enhance its trade related negotiating capacity, give clear indication of its MFN obligation to determine what additional concession it would be willing to make at the regional level and to conclude the multilateral integration process without further delays.

- This however does not mean that Ethiopia should completely leave its activities towards regional integration. In the meantime Ethiopia should try to accustom itself with the rules and principles of the different Regional Trade Agreements and prepare itself to take advantage of the opportunities that would be created upon its regional integration.
- Sequencing must also be implemented in relation to the regional integration process, so as to tackle the problems linked to overlapping membership and in particular to avoid any contradiction between its potential commitments under different regional trade agreements. In this respect, since it is the largest regional trade agreement comprising almost all member countries of the other regional trade agreements, joining the COMESA FTA ahead of the proposed FTAs under the IGAD and SFC must be considered.

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