

The Economic Partnership Agreements: Rationale, misperceptions and the non-trade aspects

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Abstract: There has been much discussion and controversy surrounding the economic partnership agreements (EPAs) currently being negotiated between the EU and the African, Caribbean and Pacific (ACP) countries. This paper aims to clarify this debate by addressing some common misperceptions in the existing assessments of the economic impact of the EPAs. It also elucidates the rationale for the EPA approach by explaining what the EPAs will be and, perhaps more importantly, what they will not be. The paper explains the reasons why the EU sees the EPAs as the only feasible means to secure the development of its ACP partners in a way which will be legally viable and thus acceptable to the non-ACP developing countries. Finally it sheds some light on the non-trade aspects of the EPAs that are rarely touched upon in existing studies.

Draft

Comments welcome

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1. Introduction

The EU has a long history of partnership with the countries of the Africa, Caribbean, Pacific (ACP) grouping. This partnership is based on historical links, including trade relations supported by highly preferential market access to the EU. Market access for the ACP under the Cotonou Agreement or the Everything but Arms (EBA) initiative is generous. Over 97% of ACP exports entered the EU duty free under preferences in 2005. However, in spite of this preferential treatment ACP trade with the EU has not diversified and their share of EU trade has steadily declined over the last 30 years. Clearly, preferential market access alone has not been adequate to stimulate an export-led growth in the ACP.

At the same time, non-ACP developing countries at the same development level as the ACP have not been granted the special treatment which ACP countries receive from the EU. This is in breach of the fundamental principle of the most favoured nation (MFN) treatment set out in Article I of the GATT. Because of this, the EU has been forced to seek a series of waivers from other WTO members to enable its special trade regime for the ACP to continue. The latest of these waivers was only agreed in Doha in 2001 with the express condition that the EU and ACP must agree new WTO compatible trade arrangements by the end of 2007 after which the waiver would expire.

The negotiations on this last waiver were difficult and it is unlikely that WTO members would agree to extend it.¹ Those who doubt the willingness of developing countries to question special treatment for other developing countries need look no further than the long and bitter 'banana wars' during which non-ACP countries have challenged a series of frameworks established by the EU to provide special access to the market for ACP bananas.²

In the ACP-EU Partnership Agreement, signed in Cotonou on 23 June 2000 (hereafter referred to as the Cotonou Agreement), the Parties agreed to conclude new WTO-compatible trading arrangements, so-called 'economic partnership agreements' (EPAs), which aim at progressively removing barriers to trade and enhancing co-operation in all areas relevant to trade.³ The purpose of the EPAs is to help the ACP to integrate into the world economy and to promote their sustainable development as well as poverty reduction. In order to be WTO compatible, EU trade relations with the ACP will have to move from a context framed by a GATT Article I waiver to one framed by the rules on free trade agreements (FTAs) and/or customs unions, i.e. Article XXIV of the GATT. The precise interpretation of the requirements of Article XXIV has subsequently spurred perhaps the most contentious debates in relation to the EPAs.

¹ Several concessions were required to other developing countries to secure the waiver. Notably extra access in tuna for several Asian countries and in bananas for Latin America.

² Most recently, e.g., Colombia's and Panama's requests for consultations at the WTO in March and June, 2007, respectively.

³ Formal negotiations at the level of all ACP countries started in September 2002. In October 2003, regional negotiations got under way with West Africa and Central Africa, in February 2004 with Eastern and Southern Africa and in April 2004 with the Caribbean. The EPAs are scheduled to enter into force by 1 January 2008. The non-reciprocal trade preferences under the Cotonou Agreement, for which a waiver in the WTO until 2007 has been granted, will continue to apply in the meantime.

Despite the breath of the coverage of the EPAs, the debate around them usually focuses on the potential negative effects of a change from the status quo to one compatible with WTO rules, while concentrating on the elements of the agreements related to trade and market access. Critics see the EPAs as an attempt by the EU to force open developing country markets with mercantilist interests in mind. They fear that this market opening will lead to the closure of ACP industries, the undermining of regional trade and major losses in government revenues.⁴ However, critics of EPAs too often forget that the status quo is no longer an option for EU-ACP relations. Not only is the status quo one of declining value of preferences and falling ACP trade shares, other developing countries simply will not accept a solution that is not in conformity with the international legal framework, c.f. above.

Moreover, although WTO compatibility is essential for EPAs, they are not straightforward FTAs. While a legally secure trade regime is crucial for investor confidence, this aspect is just one part of the EPA agenda. EU-ACP trade relations have always rested on strong cooperation well beyond their trade related aspects and this will continue with the EPAs. The combination of transparent rules, increased co-operation, legal security, support for regional integration and links to development finance make EPAs quite unique. Still, the Commission recognises that it is essential to reduce any risks of negative impacts by careful design of the EPAs and accompanying development support measures.

This paper seeks to elucidate the debate by explaining what the EPAs will be and, perhaps more importantly, what they will not be. It will clarify the rationale for the EPA approach, point to some common misperceptions in the existing assessment of the economic impact of the EPAs and shed some light on the non-trade aspects of the EPAs that are rarely touched upon in existing studies. An important aim of the paper is also to explain the reasons why the EU and the ACP see the EPAs as the only feasible means to secure the development of its ACP partners in a way which will be acceptable to the non-ACP developing countries.

Section 2 takes stock of the EU-ACP trade relations over the past decades. Section 3 lays out the legal context and demonstrates that the trade regime of Cotonou has to change to be WTO compliant. Section 4 discusses the existing literature on the economic impact of the EPAs and shows that in many cases the underlying assumptions are flawed. Section 5 discusses the non-trade components of the EPAs and their likely economic impact. Finally, section 6 provides some conclusions.

2. EU-ACP trade and economic relations: an overview

If market access were the key to development, the ACP countries would be amongst the richest in the developing world. Since 1975 they have been offered increasing access to the EU market and the vast majority of their products now enter EU markets duty free. Under the Cotonou Agreement, all industrial products (a definition which includes fisheries) originating in ACP countries are exempted from EU customs duties, while preferences for agricultural products are differentiated.⁵ However, even for these products, the ACP LDCs can choose to

⁴ For example, an informal coalition of Non-Governmental Organisations including 11.11.11, ActionAid, Bread for the World, Church Development Service, Oxfam International, and Enda on 14 February 2007 called on the European Commission to stop pressuring Africa to agree new trade relationships by the end of the year, warning that the current proposals would have very damaging implications for development, see http://www.oxfam.org.uk/applications/blogs/pressoffice/2007/02/ngos_denounce_eu_pressure_over.html.

⁵ Tropical products which do not compete with European products enter the EU market duty free. Temperate products face an exemption or reduction of customs duties, while fruits and vegetables are subject to seasonal restrictions. Other agricultural products face quantitative restrictions or are excluded from preferential treatment.

use the provisions of the GSP EBA (Everything but Arms) scheme to gain duty free access to EU markets. Moreover, for certain products (bananas, beef and veal, and sugar), the EU provides special market access for the non-LDCs via the so-called commodity protocols. Yet, the ACP countries have become increasingly marginalised on the EU market, see Annex Figure 1. The lagging behind of the ACP compared to the group of all developing countries started in the late 1980s and early 1990s and is further exacerbated in the beginning of the 2000s. Today, the ACP share of EU trade stands at less than 3%, while the EU is an important market for the ACP, especially for their agricultural goods, taking 23% of their exports.

The EU-ACP trading relationship is to a large extent based on complementarity with ACP exports still overwhelmingly made up of raw materials. Over 60% of ACP exports to the EU are now in just four basic commodities – oil and gas (41%), diamonds (13%), cocoa (6%) and aluminium (about 3%) – while EU exports are concentrated in manufactured goods (machinery (30%) and vehicles (10%)). Annex Figure 2 shows that EU exports to and imports from the ACP have mirrored each other quite closely. In the period 1975-2006, in all but five years, the EU has had a trade deficit with the region. Recent trends of increased ACP exports and a shift in the trade balance is almost exclusively down to high oil prices.

There are also regional differences in the EU's trade with the ACP. Annex Table 1 shows that West Africa is by far the EU's largest trading partner among the ACP regions, followed by the Caribbean and the SADC group. The ACP regions of Central Africa, Pacific and the SADC group show, by and large, a surplus in their trade with the EU over the period, while the opposite holds true for the Caribbean and the Eastern and Southern Africa. EU trade with West Africa shows a deficit in three of the last five years, including the two latest years for which figures are available.

Annex Figure 3 displays the evolution of economic growth in the ACP and in low-income countries, as defined by the World Bank, from 1975 to 2006.⁶ Except for in 1976, 1979 and in 1991, economic growth in low income countries generally has surpassed that in the ACP. The average growth rate of the former and the latter are 4.6% and 2.8%, respectively. As a result, poverty levels remain high in the ACP and are even increasing in some countries.

3. The EPAs and the legal context

While only part of the overall package, an essential element of the EPAs is that they will ensure that trade relations between the EU and the ACP are WTO compatible. There are two key legal frameworks of relevance to the EU's relations with the ACP. Firstly, the so-called 'enabling clause', which allows signatories to accord differential and more favourable treatment to developing countries⁷ and secondly, the legal basis governing preferential trade agreements between countries - Article XXIV of the GATT. Both of these frameworks will be briefly considered in order to clarify exactly to what requirements future EU-ACP relations need to conform.

3.1. The 'Enabling Clause'

The 'enabling clause', agreed in 1979, allows developed contracting parties to grant preferential tariff treatment to products originating in developing countries in accordance with the Generalized System of Preferences (GSP), i.e., non-reciprocal and non-discriminatory

⁶ The figures are presented based on availability since growth figure for all countries all years are not available.

⁷ GATT decision of 28 November 1979 (L/4903), Differential and more favourable treatment reciprocity and fuller participation of developing countries.

preferences beneficial to the developing countries. It also allows special treatment of the group of countries classified as least developed countries (LDCs) by the UN. The implication of the enabling clause is that all non-LDCs should be treated equally by the party providing market access.

The problem, in this context, is that the ACP country group does not correspond to the LDC grouping. Although most ACPs are poor, only half of them are LDCs. For the ACP's treatment under the Cotonou Agreement to be WTO compatible, the EU would have to provide the same preferential treatment to all of the 178 developing countries which are eligible for the EU GSP. As we shall see later, this would be problematic, not only for the EU, where sensitivities on market access for large developing countries are a political reality, but also for the ACP. They would see their preferential access eroded and would find it difficult to compete with non-ACP developing countries, many of which are more competitive in key ACP exports. Thus, a solution which seeks to achieve legal compatibility through the enabling clause does not seem to be a feasible option.

3.2. GATT Article XXIV

The other option available to ensure the continuance and strengthening of market access for the ACP to EU markets is therefore through preferential trade agreements under GATT article XXIV. This article enables member states of the WTO to form a customs union or a free-trade area, provided that substantially all trade (SAT) between the parties is liberalised, that trade barriers on the whole are not increased as a result of the agreement and that the formation be concluded within a reasonable length of time.

However, the two key principles here – 'substantially all trade' and 'a reasonable length of time' – are not defined in the GATT, thus leaving them open to interpretation. Critics of the EPAs insist that the EU is interpreting these principles too stringently in order to force open ACP markets. However, the fact is that agreements which do not clearly meet such criteria are likely to be challenged in the WTO.

Concerning the first principle there is no baseline figure agreed in the WTO, although precedent indicates that a figure of around 90% (including both the volume of trade and the number of tariff lines) is acceptable to members. The EU for its part aims for at least a 90% threshold in its FTAs.

In the situation of legal uncertainty, some NGOs and ACP negotiators have argued lower figures would be needed to avoid negative impacts of the EPAs. For instance, TWN Africa and Oxfam (2007) argue that to avoid any negative impact from an EPA, Kenya would need to exclude more than half its trade from liberalisation with the EU. If Kenya liberalises 50% of its imports from the EU and the EU liberalises 100% that would indicate that, overall, 75% of trade between the two are liberalised. Perez and Karingi (2006) argue that if African countries reciprocate tariffs elimination on 60% of their European imports, the EPA would be neutral in terms of output. This, in turn, point to an overall degree of trade liberalisation of 80%.

The coverage in the EU's Trade, Development and Co-operation Agreement (TDCA) with South Africa, a country that is at a higher level of development compared to most ACPs is 91%. However, if the EU fully liberalises its imports from the ACP, the ACP will have to liberalise less than 90% of trade. Depending on the balance of trade between the parties this

could lead to liberalisation of 80% or less of trade.⁸ In the South African case, the EU liberalised 95% of its import trade and South Africa 86%.

On the question of the 'reasonable length of time' for implementation, in 1994, WTO members agreed that it should exceed 10 years only in 'exceptional cases'. In the EU's TDCA with South Africa, the transitional period was set at 12 years. The substantially longer lead times, such as the 20 or 25 years suggested by some ACP negotiators and NGOs, would need to be justified on the grounds of being exceptional, a concept which, although not impossible, is difficult to establish. A recent UNECA report has pointed out that there are international precedents for periods longer than 10 years, for example the Canada-Chile FTA, which has a 19.5 year implementation period (Lang, 2006).

What the UNECA article fails to do is distinguish between timeframes in the sense of Article XXIV and the overall timeframe for the agreement. If an FTA is to meet the requirements of Article XXIV then it must liberalise substantially all trade in a reasonable time period. The parties to an agreement can then agree on any time frame they want to liberalise any remaining sectors but this does not count as "liberalised" for the purposes of WTO compatibility. Furthermore, according to Canadian and Chilean submissions to the WTO, the Canada-Chile agreement eliminates tariffs on 99.8% of trade covering 99% of tariff lines (WTO, 1998)

3.3. The EU's market access offer

In the negotiations, the EU has offered to remove all remaining quota and tariff limitations on access to the EU market for the ACP. This offer covers all products, including agricultural goods like beef, dairy, cereals and all fruit and vegetables. It will apply immediately following the signing of an agreement - with a phase-in period for rice and sugar. The only exception will be South Africa where a number of globally competitive products will continue to pay import duties. This offer will give all ACP countries the same access to EU markets under EPAs that Least Developed Countries have under the EBA. Hence, all ACPs will face the same access to the EU market.

It is important to understand one key element of the political economy of these negotiations. Unlike for other current or likely EU FTAs, in the case of the EPAs the Commission is not subject to any significant lobbying by EU industry for market access in the ACP region. The unfortunate fact is that most ACP markets are too small and underdeveloped to be of interest to EU business. In this sense these negotiations differ significantly from traditional FTA negotiations in that there is no long 'offensive list' of products which the EU wishes to see liberalised. Within the boundaries of the need to conform to SAT requirement, which calls for a certain opening of the ACP market, but also provides certain flexibility, the EU is open to discuss whichever exclusions the ACP countries consider to be in their best development interests. However, a serious effort to conform to the SAT requirement is unavoidable.

⁸ However, it is important to remember that the liberalisation commitments of each party as far as the volume of trade is concerned depend on the balance of trade between the two partners. Each ACP region is in a different position as far as trade balances are concerned, so an asymmetric EPA has different implications for them.

4. Assessing the impact of the EPAs

4.1. Common misperceptions

Over the period of these negotiations there have been numerous attempts to assess the likely impact of the EPAs on ACP economies. For several reasons, most of these efforts have been inadequate. Unless important pitfalls (such as access to data and quality of data) are recognized and proper methodologies and underlying assumptions used, unsound policy conclusions will be drawn on the basis of flawed analyses.

Firstly, to get a proper view of the impact of trade policy change we need to look, not only at the static effects of tariff changes, but also the dynamic effects of these impacts within the rest of the economy. In other words, if resources are being used to produce goods in which the country is not competitive and trade liberalisation means that uncompetitive firms exit the market, economic theory indicates that these resources (capital and labour) will move into other activities which are more productive.

The best way to model such interactive processes is to use a computable general equilibrium (CGE) framework. Unfortunately, the most widely used database to carry out such assessments, the Global Trade Analysis Project (GTAP) database, does not include any of the ACP regions, as the detailed data required are not yet available. Individual countries, especially those in southern Africa are modelled, but the 'rest of sub Saharan Africa' group is large, about 35 countries, making it very difficult to pinpoint impacts. Overall, trying to establish the real impact of the EPAs through a CGE modelling exercise, as some have tried to do (Perez and Karingi, 2006, Tekle et al, 2006) is therefore unsatisfactory. The European Commission is currently sponsoring a project, together with the World Bank, to disaggregate the GTAP database according to the EPA regions. The dataset is now being finalised and tested and this will facilitate region-specific analyses.

Up to now, however, efforts to quantify the impacts of EPAs have tended to fall back on more static models which look at the existing situation, in terms of trade and tariffs and model the static impact of change. Although this 'partial equilibrium' approach is useful for identifying products vulnerable to import surges or losses in tariff revenue, it is not one which gives an indication of overall impact. Almost by definition, it leads to negative impacts, as it emphasises increased ACP imports, with no counter-weighting increase in exports or production due to the activity fuelled in other parts of the economy. This is the approach taken in many EPA studies, including many of those by UNECA (e.g. Ben Hammouda et al, 2005, Ben Hammouda et al, 2006, Milner et al, 2005).

Secondly, there are serious data problems with even this basic approach. Analysis of the trade data encompassed in the World Bank's Integrated Trade Solution (WITS) database, on which many of these studies are based, indicates that there are major discrepancies in e.g. intra-ACP trade, especially in Africa, where intra-sub-Saharan Africa exports are on average 25% higher than intra-sub-Saharan Africa imports in the early 2000s.⁹ This figure is far too high to be explained by a potential difference in c.i.f. and f.o.b. charges. Even trade flows to and from the EU do not always correspond to the figures from Eurostat. This is probably because of use of different statistical regimes, an additional issue which researchers do not seem to have taken seriously. As a result, the extent to which we can have confidence in the projected outcomes is limited.

⁹ Based on extraction made in October 2006.

Thirdly, the way in which 'sensitive products' (those likely to remain protected) are defined in the negotiations is key. One basic approach to simulation could simply be to analyse the production structure in the ACP countries and compare this with the structure of imports from the EU, so as to identify sectors or products in which competition may increase following the implementation of the EPAs. However, such data is generally not available at a useful level of disaggregation. Another way would be to choose products for exclusion such to minimise the impact on tariff revenue in the ACP, or to simply liberalise those tariff lines where the highest tariffs are found (the approach taken by Stevens and Kennan, 2006). However, the tariff data that is available for this region is often out of date, thereby adding to the difficulties. Indeed, tariff liberalisation is an on-going process in many of the ACP countries, partly due to their own regional integration efforts.

Fourthly, realistic assumptions on negotiating outcomes and up to date tariff figures are required if studies are to be useful. There is a substantial difference between trade being liberalised over a 10 or 15 year period and the frequent assumption in studies that trade would be fully liberalised from day one of the agreement entering into force (an eventuality that is not envisaged by any party). There will be substantial asymmetry in the agreements with the ACP countries not only required to liberalise substantially less than the EU, but also at a slower pace. Certain duties, for example on luxury products not produced in most ACP regions, such as wines or luxury cars, can also be replaced by excise duties collected at the border (similarly to Value Added Tax payable on imports) further offsetting losses.

Fifthly, a comprehensive approach to revenue impacts would need to estimate the efficiency of tariff revenue collection in the ACP, rather than simply assuming full collection, as many studies do. Problems with customs efficiency, plus a welter of special exemptions, which tend to apply in particular to the kind of high end products and industrial inputs that the EU exports, mean that actual collection rates are often well below theoretical levels. Thus losses in tariff revenue are likely to be far below predictions. Busse et al (2004) estimate average duty collection efficiencies in West Africa at 67%, falling as low as 30% for some key importers such as Ghana (Busse et al (2004), Table 13). The IMF estimates effective duty collection rates in the Eastern Caribbean at 60% (IMF, 2005).

Somewhat related to this point, there is also a need to examine the link between tariff levels and the prevalence of corruption/smuggling, in order to analyse if reducing/eliminating tariffs could help to tackle these problems and therefore increase collection rates – thus counteracting shortfalls in tariff revenue. Moreover, one would have to take account of the fact that tariff revenue may actually increase, at least initially, during the implementation period of the agreements if imports increase as tariffs are lowered.

Finally, studies model those aspects which are readily quantifiable - trade and tariffs - however these are only one element of the agreements. They will also cover many other elements which are more difficult to quantify, but which have the potential to bring substantial benefits to the ACP. These elements will be considered in section 5

4.2. So called "alternatives" to EPAs should be approached with great care

Article 37:6 of the Cotonou Agreement contains provisions under which the EC agrees to consider alternative trade arrangements for any non-LDCs which decide they are not in a position to conclude an EPA. This article had a deadline of 2004 that was subsequently extended to 2006. However, at May 2007 ACP-EU Joint Council of Ministers, all the ACP regions issued declarations of their commitment to conclude EPAs by the end of the year.

Nevertheless, it may be of interest to briefly review those studies that either assume or propose non-EPA solutions or so called alternative EPA solutions.

Most studies compare a hypothetical EPA with the status quo, which is not a realistic baseline.¹⁰ The reason why the Cotonou Agreement proposed such radical change in EU/ACP relations was that the status quo was generally agreed to be legally untenable. As outlined above, waivers in WTO for continued preferential access for the ACP are not likely to be forthcoming indefinitely. Thus, in the absence of EPAs the EU-ACP relationship will need to move towards the other alternative legal framework – the enabling clause.

The most likely means to achieve this is through the provision of access under the GSP. The EU general GSP scheme covers about 7200 products. Non-sensitive products (slightly less than half of the products covered) enjoy duty free access, while sensitive products (mainly agricultural products, but also textile, clothing and apparel, carpets and footwear) benefit from a tariff reduction of 3.5 percentage points of *ad valorem* duties compared to the most favoured nation (MFN) tariff and a 30 percent reduction of specific duties (with a few exceptions).¹¹ For textiles and clothing, the reduction is 20 percent of the *ad valorem* MFN duty rate.¹²

Thus any impacts of EPAs need to be compared with the lesser levels of market access, compared to the Cotonou Agreement, which would be available in the absence of an agreement. Some commentators have indicated that reversion to the GSP would make little difference to most ACP countries (Perez, 2006 and Stevens and Kennan, 2005). Looking at the situation in more detail, there is good reason to believe that a reversion to the GSP would have significant impacts on trade flows for several countries. The key potential difficulty with the GSP for ACP countries, apart from the fact that it is less generous than the Cotonou Agreement, is that it is ‘generalised’ – in other words covers all developing countries, including competitive ones such as China and India. This fact is not taken adequately into account by most commentators.

If the ACP countries were to fall back to a level of market access of GSP countries, this would seriously reduce their absolute preferences and preferential margin vis-à-vis other developing countries on the EU market and likely impact strongly on their exports. Falling back on GSP also has disadvantages in terms of the lack of security in market access (GSP is revised every 10 years, with minor interim revisions). This is a disadvantage for the ACP and undermines the capacity for market access to stimulate investment.

Several commentators have suggested that if the standard GSP is not an option, then the EU's special incentive arrangement for sustainable development under its GSP+ scheme, hereinafter referred to as GSP+ would be a good alternative to EPAs (Bilal, 2007, Perez, 2006, Draper, 2007 and TWN Africa and Oxfam, 2007). The GSP+ is more generous than the standard GSP scheme. It allows for duty free access to the EU market of all the goods covered by the general GSP scheme.¹³ However, The European Commission estimates that under a

¹⁰ One of the few exceptions is the presentation by Fontagne, Laborde and Mitaritonna (2006).

¹¹ Tariffs are suspended if preferential treatment results in (*ad valorem*) duties of one percent or less, or in specific duties of €2 or less.

¹² This concerns mainly products in chapters 50-63 of the Harmonised System (HS).

¹³ However, for products for which Common Customs Tariff duties also include *ad valorem* duties, the specific duties are not eliminated.

GSP+ regime ACP exporters would have been liable for theoretical duties of €750 million on 2005 exports to the EU as compared to zero under an EPA regime.¹⁴

In addition, GSP+ has a specific objective of stimulating sustainable development. To be eligible, beneficiaries must have ratified and effectively implemented 16 core human and labour rights conventions, as well as at least seven of eleven further conventions related to the environment and governance principles, as well as demonstrating that their countries are 'vulnerable'.¹⁵ A vulnerable country is one that is not be classified by the World Bank as a high income country during three consecutive years, and (i) whose five largest sections of its GSP-covered imports to the Community represent more than 75 % in value of its total GSP-covered imports and (II) whose GSP-covered imports to the Community represent less than 1 % in value of total GSP-covered imports to the Community.

It seems unlikely that any ACP country would have difficulty conforming to these vulnerability criteria in principle. However, a brief look at the situation in November 2006 indicates that of all ACP countries, only the Seychelles and St Vincent and the Grenadines have implemented even the 16 required core conventions. Thus significant efforts would be required before most ACP countries could qualify for GSP+. Allowing ACP countries access to GSP+ benefits without ratifying the relevant conventions is not an option as it would undermine the whole 'sustainable development' objective of the scheme.

Even if all ACP countries did qualify through ratifications, the scheme would not provide as generous access as EPAs, or indeed maintain the status quo. This is largely because the GSP+ does not include two key ACP exports – sugar and bananas. These two products made up almost 4 % of ACP exports to the EU in 2005, but certain regions, such as the Caribbean, are significantly more dependent on these two products. In addition, in the case of West Africa, shipping lines carrying bananas also support the export of other tropical fruits. Studies consistently show that many ACP countries are internationally uncompetitive in the production of both of these products (e.g. Gillson et al (2005)). This is especially the case for the Caribbean, which is heavily dependent on both. In the case of sugar, even the EU's agreed internal reforms, which will cut prices by 36%, will render several ACP suppliers, perhaps with the exception of Belize and Guyana (Gillson et al (2005)).

Some have suggested simply expanding GSP+ to include these few key exports (Perez, 2006). However, by definition this access would have to be extended to all suppliers qualified for the scheme. As this includes several Latin American countries with potential supply capacity in one or both of these key exports, the likely outcome would be severe erosion of ACP exports, as explained in Curran (2007).

Thus the most likely alternative to EPAs for non-LDC ACP countries – GSP or GSP+ for those who qualify – cannot hope to provide similar levels of market access to the current system or an EPA. If EPAs are not concluded, market access for ACP countries to the EU market would inevitably deteriorate, with subsequent loss of exports, jobs and foreign exchange. The EU is determined to avoid such an outcome. This is why it is concentrating its efforts on achieving a satisfactory outcome to the EPA negotiations.

¹⁴ Calculations based on trade data from COMEXT. These observations do not hold, of course, for LDCs, which already have quota and tariff free access to the EU market under the EBA.

¹⁵ A vulnerable country is one: that is not be classified by the World Bank as a high income country during three consecutive years, and whose five largest sections of its GSP-covered imports to the Community represent more than 75 % in value of its total GSP-covered imports and (b) whose GSP-covered imports to the Community represent less than 1 % in value of total GSP-covered imports to the Community.

5. The non-'trade' aspects - key elements which are too often sidelined

There are many elements of the EPAs which do not relate to the simple opening of markets through tariff reduction. Some are related to trade and others are not. These have become increasingly important with the gradual lowering of tariff barriers over the last decades. Most are difficult to quantify and therefore tend to be sidelined from any existing impact studies of EPAs. It is important to note that the objective of the EU is not to enforce EU type rules in the ACP regions, but rather to foster agreement, especially within regional groupings, on certain minimum standards.

5.1. Trade facilitation

The reduction in the physical and institutional barriers to trade has enormous potential to increase both trade volumes and the benefits which economies gain from them. This is particularly so in developing countries (DCs). A number of studies indicate that trade facilitation is the major source of gains from the Doha Development Agenda (DDA) and in particular so for DCs. The estimates are rough, but there is a broad consensus that trade facilitation could double the gains coming from goods liberalisation.¹⁶ The potential savings from trade facilitation are unsurprising when the complexities of trading in DCs are considered. UNECA have estimated the extent of certain barriers to trade in Africa. They find that the average delay at Sub-Saharan African customs is 12 days, compared to 5.5 days in East Asia (UNECA, 2004). Analysis by ECOWAS found that there were between 7 and 2 checkpoints per 100kms along intra-ECOWAS highways (quoted in Alaba, 2006). Delays in trading have serious implications for a country's exports. Persson has estimated that a reduction of exporting delays by one day in ACP countries would stimulate exports on average by 1% (Persson, 2007).

The quality of infrastructure is a key factor in stimulating trade. Coulibaly and Fontagné (2005) find that if all inter-state roads in the West African Economic and Monetary Union (WAMEU)¹⁷ were paved, countries would trade three times more than at present. This effect is particularly important for land-locked countries, for whom shipping goods through a transit country accounts for 4% of trade costs. A recent study by Morrissey et al (2007) of the non trade aspects of EPAs found that trade facilitation measures could make an important contribution to economic growth and efficiency through increased revenue collection, reductions in trade costs and promotion of greater regional cooperation.

5.2. Rules, standards and regional integration

Clear and predictable rules are a key factor in business efficiency as industry needs a predictable environment to flourish. Studies have consistently shown that a favourable regulatory environment is a key stimulant for FDI (Gorg et al, 2006). In addition, the positive impacts of FDI on economic growth are magnified in a sound regulatory context (Busse and Groizard, 2006). Morrissey et al (2007) reviewed the regulatory elements of EPAs and found that the types of regulatory reforms proposed should improve the business environment and make investment more attractive.

Investment decisions and sourcing of supplies and inputs are affected by the extent to which countries can meet formal and informal standards related to quality, sanitary protection and

¹⁶ See e.g. Hertel and Keeney (2006) and Wilson, Mann and Otsuki (2004).

¹⁷ UEMOA in French.

marketing. The security of intellectual property affects choices over outsourcing of production and transfer of technology. The EPAs seek also to enhance co-operation, build regional ACP institutions and capacity and to harmonise legal and institutional frameworks within the ACP regions themselves in all these areas in order to help diversify production away from price driven basic commodity exports towards quality driven value added and integrated production systems.

Regional integration and the development of regional institutions – building credible regional markets with common rules for business – could make a huge difference to the attractiveness of the ACP. The small size of ACP markets is one of the key reasons why they have had difficulty attracting FDI beyond the narrow extractive industry sector (Morrissey et al, 2007). Building regional markets will help domestic industry to become more efficient as well as making these markets more attractive for FDI.

5.3. Investment, competition and procurement

In terms of the key areas of investment and competition, Morrissey et al (2007) reviewed the evidence and found that there is support in the literature for the provision of predictable frameworks in both of these areas. In the case of investment, the inclusion of investment provisions in regional integration agreements has been shown to stimulate investment (Levy et al, 2002, Dee and Gali, 2003). Whether it is the investment provision themselves, or the predictability and ‘locking-in’ of reforms that the regional agreements provide is subject to debate, however the positive impact on the investment climate seems clear (see also Evenett et al, 2007, on this point). Minimum provisions on national treatment and non-discrimination within the EPA context would help to provide such security.

Certainly, anti-competitive practices are widespread in ACP countries (Evenett, et al, 2006), thus there is potential for important impacts from the establishment of a more transparent and predictable competition framework. At the least hard-core cartels need to be addressed. Effectively dealing with such cartels on a regional level should, not only improve the competitive environment, but also demonstrate the benefits of active competition policy, stimulating further efforts in the future. Although host governments may wish to protect certain industries for a variety of reasons, it is clear that a more competitive environment reduces prices and benefits consumers and there is some evidence that this is conducive to growth. The OECD has estimated that improving competitiveness policy in developing countries to the level prevalent in the OECD would increase per capita GDP by almost 8% on average (OECD, 2006). In the same way, opening up government procurement has been shown to reduce prices significantly – by around 30% in the EU (European Commission, 2004).

5.4. Good governance

Research has consistently found that good governance is a key factor in stimulating foreign direct investment. Asiedu (2006) found that corruption and political instability discourage FDI in Africa, while an efficient legal system and a good investment framework have the opposite effect. Obwona (2001) finds that macroeconomic and political stability have been more important than incentive schemes in stimulating FDI in Uganda, where he finds a positive relationship between FDI and GDP growth. Mlambo (2005) surveys the existing situation in southern Africa and concludes that countries in the region need to reduce regulation, enforce property rights, improve the bureaucracy and reduce corruption if they are to increase FDI flows. Busse and Gröning (2007) find evidence that trade liberalisation can

help to improve governance in developing countries and their results also support the EU approach towards deeper regional integration. These factors are all issues which will be addressed in the context of the EPAs.

5.5. Services

Services are key to economic growth and, unlike many other FTAs, EPAs seek to be comprehensive trade agreements that include agreements on trade in services. While any agreement must be compatible with GATS Article V, which is based on similar principles to GATT Article XXIV, the EU will similarly ensure asymmetry in commitments with the ACP. Analysis of services on an ACP basis is limited but UNCTAD (2006) data provides a reasonable proxy, showing that they are the largest contribution to GDP in the poorest countries (42% and growing compared to 33% and falling for agriculture). EPAs will seek to build on this and help the ACP diversify through services as well as within goods trade.

5.6. Development Support

While not directly part of the economic rationale, EPAs provide the opportunity to co-ordinate reform with development finance. Related support will include capacity building for sectors of the economy that face adjustment, customs reform, regional integration, support for fiscal adjustment and monitoring and funds to help offset any observed fiscal losses. Support to EPAs and regional integration lies behind the decision to increase regional allocations to the ACP from the European Development Fund (EDF) over the period 2008 – 2013 by 50% to €1.8 billion out of an overall co-operation package of €2 billion.

EPA related development support provided by the EDF will be complemented by financial assistance from EU member states, but specific financial commitments will not form part of the EPA agreements. This is to avoid any implied conditionality or link between the depth of ACP reform commitments and the disbursement of development finance in order to respect the competencies of EU and ACP institutions and to ensure that trade reform is based on incentives linked to economic rationale rather than external financing.

Nevertheless, to ensure that EPAs contain no unaffordable commitments, the negotiating process has established specific co-ordination bodies to identify the associated capacity building needs and earmark support needs within national and regional development finance planning processes. Institutions linked to EPA implementation will subsequently provide a platform to co-ordinate and monitor the delivery and effectiveness of that support.

6. Summary and conclusion

The objective of the EPA process is to promote development in the ACP, including regional integration within the ACP (based on existing initiatives). Through integration between the EU and the ACP, the EPAs are intended to act as a stepping stone to the gradual integration of the ACP countries into the world economy. The agreements will be consistent with WTO rules and in some respects go beyond. The EU liberalisation of trade will be more far-reaching and rapid compared to that of the ACP. Furthermore, the inclusion of services and the creation of transparent, predictable and regional rules on issues such as investment, public procurement and competition policy are essential to successful economic governance and key to attracting more local and foreign investment in the ACP and thus also to development.

The EU-ACP joint conclusion that the EPAs are the most appropriate way to break the current negative trends in EU-ACP trade and to move forward is motivated by the understanding that

the EPAs are not simply trade agreements, but co-ordinated packages of measures supported by extensive development assistance. This approach enables EU-ACP relationship to move to a structure which is WTO compatible and therefore free from the threat of challenge. It provides a structured framework for supporting EU development assistance and supports the emerging regional economic communities of Africa. The latter is seen as a key economic and political objective by many politicians on both the EU and ACP sides. These multiple advantages were why EU and ACP leaders agreed in the Cotonou Agreement to negotiate EPAs as the best option for framing future EU-ACP trade relations.

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Annex 1

Figure 1: EU15 imports from ACP and Developing countries 1975 – 2006

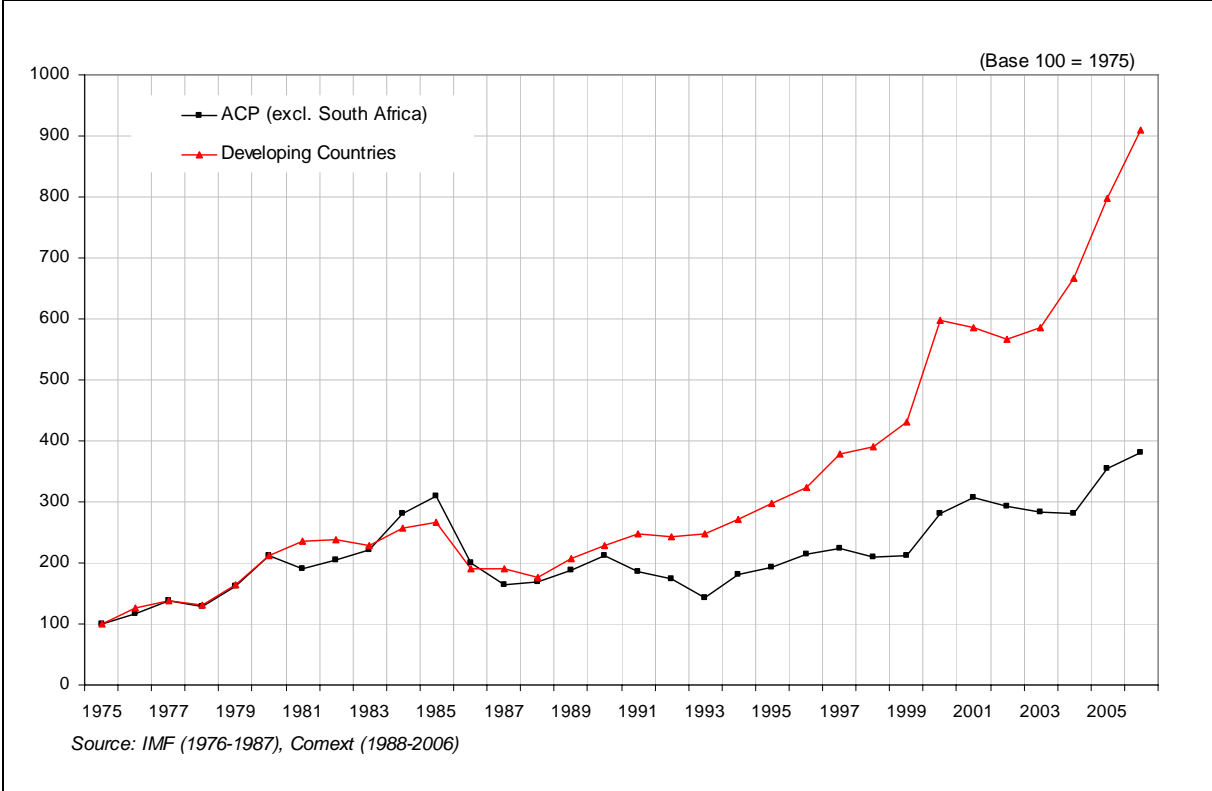


Figure 2: EU-15 trade with the ACP, excluding South Africa, 1988-2006 (€million)

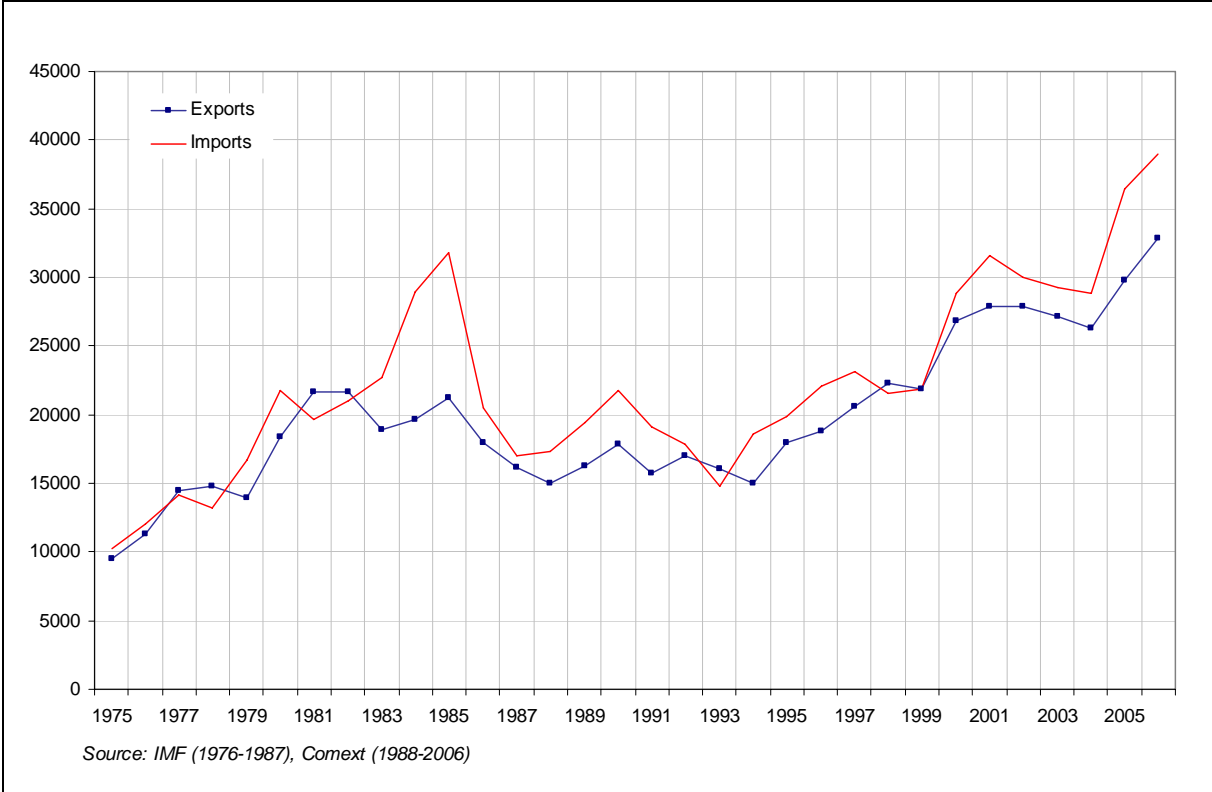


Table 1: EU trade with the six ACP regions, 2002-2006 (€million)

| Country | EU Trade | 2002 | 2003 | 2004 | 2005 | 2006 |
|-------------------------|----------|-------|-------|-------|-------|-------|
| Central Africa | Imports | 4901 | 4432 | 4361 | 5486 | 6185 |
| | Exports | 3380 | 3484 | 3134 | 3443 | 3718 |
| Carribbean | Imports | 6816 | 6014 | 5862 | 7521 | 8472 |
| | Exports | 8261 | 7758 | 7176 | 7974 | 7598 |
| Eastern & South. Africa | Imports | 4776 | 4513 | 4339 | 4414 | 4590 |
| | Exports | 4066 | 4452 | 4425 | 5377 | 6032 |
| Pacific | Imports | 520 | 735 | 1070 | 1453 | 838 |
| | Exports | 587 | 231 | 325 | 665 | 336 |
| SADC group | Imports | 5748 | 4567 | 5473 | 7476 | 7085 |
| | Exports | 2455 | 2893 | 2619 | 3135 | 4194 |
| West Africa | Imports | 11127 | 12412 | 11038 | 14147 | 16581 |
| | Exports | 13125 | 12245 | 12327 | 13552 | 15446 |

Source: COMEXT

Figure 3: Annual GDP Growth in the ACP and in low-income countries (%)

