

Preparing for Economic Partnership Agreements



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In 2000 the Cotonou Agreement committed signatories to replace by 2008 the trade regime that had governed exports from the African, Caribbean and Pacific (ACP) group to the EU for the last quarter of the 20th century. Negotiations on a successor regime began formally in 2002, but only in the past year have they begun to address the details of what might be in Economic Partnership Agreements (EPAs) between the EU and six sub-ACP regions.¹

There is a great deal of work yet to be done if a new, coherent and developmentally friendly regime is to be in place by the end of 2007. All ACP states have to prepare their positions on:

- what they seek from the EU (their 'offensive' agenda);
- how they should respond to EU requests (their 'defensive' position).

These preparations are needed even by least developed countries (LDCs) which will continue to have access to the EU market under the 'Everything but Arms' (EBA) provisions regardless of what happens to Cotonou. EBA gives these countries a 'safety net' – but without preparation of their 'first best' offensive and defensive positions they cannot know whether or not they should use it, or could do better by entering an EPA.

This Briefing Paper identifies the key areas still to be negotiated and, most importantly, the preparations that are required. It is the first of four main outputs from an IDS research project intended to support national debates within each ACP country over their negotiating positions (see Box 1).

Much ink has been spilled over the potential economic effects of the EPAs. Supporters argue that they will be 'development agreements' underpinning and reinforcing the integration efforts already being made by ACP states. Critics counter that EPAs will force reluctant ACP governments to open their markets to subsidised EU exports and are a vehicle for undesirable policy innovations on which the EU has been rebuffed in the WTO.

Since not even rudimentary details of an EPA yet exist on paper, it is not possible to identify who is right. That is not the purpose of this Briefing Paper or the broader research. Rather, it is to facilitate the process whereby countries and observers identify:

- what would need to be included in an EPA for it to be 'development friendly and supportive of integration';
- what features in an EPA could justify the fears expressed by the critics?

The ACP 'offensive' agenda

Although the scope for further improvements in the EU's market access regime is limited by the commodity

composition of ACP exports there is room for improvement in three areas:

- liberalising access on Common Agricultural Policy (CAP) products that are still subject to tariffs or tariff quotas (TQs);
- making more realistic and less onerous the rules of origin for sensitive, labour-intensive manufactures; and
- providing positive support to help producers meet Europe's sanitary and phytosanitary standards (SPS).

Preparation of the offensive agenda involves three steps: one is general and applies to all ACP states; the others have to be undertaken first at a national and then at a regional level. The general step is to identify the 'first best' objective for improved EU access, which is the benchmark against which EU offers are to be judged.

The goal

On residual tariffs and TQs it is easy to identify the ultimate goal: EBA-equivalent access for all ACP. An early internal Commission proposal was for precisely this, and it is still sufficiently widely supported by certain member states and parts of the EU bureaucracy for it to be a realistic goal. For the rules of origin the recent

Box 1: Support for the EPA negotiations

In addition to this Briefing Paper IDS is developing a methodology and set of databases that can be used by both governments and civil society in each ACP state to identify which products should be included or excluded from liberalisation under an EPA.² The aim is to encourage an informed debate both within countries and between members of each regional group. This can be part of the preparation and consensus building currently under way in ACP states as they formulate their negotiating positions.

The methodology will be described in a **Handbook** that will be made available electronically to all ACP organisations that request it, together with a **dataset** for the country concerned.³ The data will cover the country's imports from the EU and applied tariffs. It will allow users familiar with Excel to build simple lists of EPA inclusions/exclusions on the basis of different assumptions on sensitivity.

IDS will also undertake a **demonstration exercise** for each ACP state³ showing which items would be excluded from liberalisation if governments chose to avoid liberalising the products facing the highest applied tariffs. The exercise will make a small number of alternative assumptions about the proportion of imports that could be excluded. These worked examples can be supplied electronically to organisations in the ACP states concerned.

A second **Briefing Paper** will describe the broad picture painted by the demonstration exercise conducted for all ACP states. It will indicate how substantial the liberalisation under the EPAs would be if governments were to follow the assumption of excluding the items with the highest tariffs, how this might change if, instead, some revenue generating items were excluded, the extent to which there appears to be an overlap in the potential exclusions of EPA members, and the likely economic impact of the changes described.

recommendation of the Africa Commission⁴ might be a good place to start. It proposed that the origin rules require only a minimum of 10 percent value to be added within a country.

The Africa Commission also made key proposals that the EU introduce new SPS regulations only if they pass a 'development test' and always following close consultation with developing countries to ensure that they are realistic. It also recommended substantial financial and technical assistance to make the second of these possible.

National priorities

The second step is for each state to prioritise such improvements in market access. This exercise must take into account their own supply characteristics and add in calculations concerning the erosion of existing preferences.

Not all ACP countries can realistically expect to export every product to the EU. For those African tropical countries, for example, that do not have the climate to export horticulture, the removal of the relevant residual CAP barriers is not a high priority. Countries in which foot and mouth disease is endemic and for which eradication is either technically infeasible or financially unviable are never likely to be able to meet the EU's SPS requirements for beef. In their case, too, the removal of residual restrictions is of little importance.

By contrast, other countries will have substantial additional requirements. The beneficiaries of the Sugar Protocol and banana exporters, for example, face serious preference erosion in the EU market. For these countries, a set of EU policies that maintains as much as possible from the pre-existing regime may be a much higher priority than new concessions.

Forging a regional position

Having established a national position, each country then needs to ensure through intra-regional negotiation that it is upheld by its partners. This will be part of the last of the three sequential steps, which is to link the offensive and defensive agendas. How valuable would an adequate EU response on the offensive agenda be for a particular country, and how much should it be willing to 'concede' (if this becomes necessary) on its defensive agenda in order to secure these gains? This is the bottom line that ACP states need to reach by the time the negotiations have come to a critical stage. If they are partially successful on the offensive agenda and partially unsuccessful on the defensive one, do they sign the EPA or walk away? If they walk away will their ACP partners do the same, or are interests sufficiently different that an accord unacceptable to one might be acceptable to others? If so, can negotiation and compromise between ACP states at this stage lead to a more united front in presenting their position to the EU?

The ACP 'defensive' agenda

Under Lomé and Cotonou the ACP were required merely to treat the EU no less favourably than any other industrialised trade partner. In complete contrast, the new EPAs will offer duty-free access for 'substantially all' EU exports to the ACP. In the jargon, the ACP are

expected to offer 'reciprocity'. This has been the focus of most discussion so far, but with little quantification.

The requirement for reciprocity is the critical element in the EU Commission's mandate, even though this includes a range of other demands (see Box 2). It is critical in three senses and is the demand on which the defensive agenda must be researched as the first priority. The three facets of its centrality are:

- it underpins the WTO justification for EPAs (which in turn must have a bearing on the EU's own bottom line in the negotiations);
- it has major implications for the production structure and government revenue of ACP states; and
- the potential impact can be quantified and scenarios constructed on the basis of reasonably realistic assumptions.

For these reasons it is the element of the ACP defensive agenda on which this Briefing Paper and the broader project concentrate. The ACP must also prepare for the other areas in Box 2 – but these require separate treatment.

The effects

If ACP countries reduce their tariffs on imports from the EU this will have potential 'revenue' and 'competition' effects. The scale of these will be determined by the extent to which imports increase and their price in the domestic ACP markets falls. Their distribution (between sectors, producers and consumers) will be set by which tariffs are reduced.

The revenue effect of EPAs is easiest to describe and hardest to calculate. Most ACP countries rely heavily on import taxes to raise government revenue because they are relatively easy to collect. Reducing tariffs will tend to reduce revenue (unless alternative, administratively

Box 2: Other key EU demands

The EU wants what are called 'charges having equivalent effect' to be abolished immediately on entry into force of EPAs (i.e. in 2008). These are taxes or charges that apply to imports and not domestic output. How many ACP states are even aware of the charges they currently impose (such as excise duties, that may apply with differential effect to imported items) that the EU might construe as 'charges having equivalent effect'? And what would be the consequences of their summary abolition?

The EU also wants the EPAs to cover both services and the so-called Singapore Issues of competition policy, investment, trade facilitation and transparency in government procurement. The Singapore Issues are especially contentious with critics who argue that the EU's leverage over the ACP is being used to bypass developing country opposition to these areas being negotiated in the WTO.

The Commission's mandate on safeguards and anti-dumping appears to ignore the concerns expressed by ACP states in relation to import surges for products subsidised by the EU. The section on safeguards refers only to Cotonou Annex V, Article 8; this deals only with the rights of the EU to impose safeguard restrictions, not to the reciprocal rights of the ACP (obviously enough, given that Cotonou does not provide for reciprocity). It may be the Commission's intention that identical rights will apply to the ACP – but since the EU subsidises exports whilst the ACP do not, the safeguard needs of the two groups are different. The Article on anti-dumping appears to limit action to the rights that the ACP already possess under the WTO.

more difficult, taxes replace them), but not necessarily in a linear fashion. If a country levies an import duty of 20 percent on imports of \$1 million it will raise revenue of \$200,000; if the tariff is cut to 10 percent but the value of imports jumps to \$2 million, exactly the same level of revenue will be raised.

Just as the scale of the revenue effect will depend partly on what happens to the flow of imports, so will the scale of the competition effect. If, following the tariff cut, importers reduce prices on the domestic market, sales can be expected to rise – putting pressure on domestic producers of competitive goods. Imports will increase and domestic production of the competitive goods decline.⁵ But a tax cut does not always feed through into a price cut! If prices do not fall (e.g. because suppliers increase their margins) there will be no increased competition for domestic suppliers.

The choices

ACP countries will have a certain degree of choice because they will not need to liberalise all of their imports, only 'substantially all'. Moreover the tariff cuts that are made will be introduced over a transition period which is likely to be of at least 12 years and, if the recent Africa Commission recommendation were adopted, could be as long as 20 years. Governments will have the choice to defer until the end of the transition period (perhaps 2028) liberalisation of some products that are particularly important for revenue or particularly sensitive for competition.

Because the impact of reciprocity will be influenced by the choices that are made, the selection process is profoundly political. Different choices will create different outcomes, winners and losers. It is important, therefore, that the preparation process involve an informed national debate in order to strike the most appropriate balance.

This IDS project aims to help the debate be an informed one. Building detailed scenarios is very time consuming and requires specialist skills. There is a need, therefore, for a widely usable dataset and methodology which can facilitate discussions within countries. Such discussions can contribute to the definition of the very limited number of scenarios that it will be possible to simulate rigorously in the way that at least one ACP region has already begun to do (Box 3).

Rules and precedents

Although the precise extent to which products can be excluded from liberalisation will be part of the negotiations there is little doubt that not all products must be liberalised. Such certainty as exists stems from the requirements of the WTO, from the EU's long-standing interpretation of these requirements, from the precedents of other agreements, and from recent statements of the Commission.

The WTO requirement is set out in Article 24 (plus Article 5 of the GATS) which specifies the essential features that must be fulfilled by any free trade area or customs union if the states forming them are to be safe from attack by the WTO members against whom they discriminate. The salient phrase of Article 24 is that a free trade agreement must cover 'substantially all trade'.

Box 3: Technical preparation is time consuming

Calculating the competition and revenue effects of alternative EPA configurations is time consuming. This is illustrated by the technical support COMESA has provided to negotiations on a common external tariff (CET) and on EPAs. First, the SMART model of the World Bank and UNCTAD was modified to allow simulations to be made using the tariff nomenclature of COMESA's CET. Officials in COMESA countries had to be trained to use the model with several possible scenarios and interpret the outputs in order to 'predict' outcomes in a broad-brush fashion.

Actually running the simulations posed logistical problems. Officials in the COMESA countries could not directly run the model which sits on machines in Washington and Geneva because of the absence of high-speed, broadband internet connections. A temporary solution has been for the Secretariat to assemble the simulations wanted by the member countries and send a COMESA officer to Geneva to run them all and send the outputs back to the countries for interpretation. Following this the region meets to discuss the level at which the CET should be set.

The same approach is being used to look at the impact of EPAs (but using the GSIM model, which is an update of SMART). The output of the model should allow countries to make decisions on product coverage and on phase-downs. A test case methodology is being trialled with one country before being replicated. It involves five steps:

- (i) run the model with the current tariff structure and 2003 import data from ASYCUDA/ EUROTRACE;
- (ii) remove the effects of the top 50, 100 and 150 imports from the EU by putting back in a weighted average tariff at the 4-digit level for these imports from the EU (thus assuming that these imports will not be covered by a ESA-EU FTA);
- (iii) repeat (i) except use an assumed COMESA CET rather than the current tariff;
- (iv) repeat (ii) using the assumed COMESA CET;
- (v) carry out various simulations on the above with various phase-down scenarios between 2006 and 2020.

The entire process will then have to be replicated for every country (including trips to Geneva) before the region can begin in earnest to identify a common negotiating strategy.

Although the term 'substantially all' has not been defined definitively, the EU has long stated its view in WTO committees. This is that the phrase should be interpreted 'quantitatively' in relation to the proportion of trade that is covered. This stands in contrast to a 'qualitative' interpretation (for example by the inclusion of all major sectors), as some WTO members would like.

The EU has given expression to this approach in its recent agreements. In the Trade, Development and Co-operation Agreement (TDCA), for example, the EU and South Africa have agreed to reduce to zero tariffs on a group of products that, in total, accounted for 90 percent of the value of trade between them in the base year. They are doing this asymmetrically: the EU is reducing to zero its tariffs on products that account for 94 percent by value of its imports from South Africa, and South Africa is doing the same on products that account for 86 percent of its imports from the EU.

It remains to be seen what proportion of ACP imports the EU will ask to be liberalised but if the spirit of the TDCA were applied then the range of products that would need to be liberalised by the ACP would be even smaller than has applied to South Africa. The EU already provides duty-free access on over 98 percent of ACP exports so that, without any further liberalisation, the 'average of 90 percent' could be achieved by the

ACP liberalising only 82 percent of the value of their imports from Europe.

A recent presentation by a Commission official⁶ has indicated that the ACP might be expected to liberalise on an even smaller share: it puts forward the following proportions of imports from the EU:

West Africa	81 percent
Central Africa	79 percent
East and Southern Africa	80 percent
Southern Africa	76 percent
Caribbean	83 percent
Pacific	67 percent

Scenario building

Whilst it is not yet possible to provide a definitive assessment of 'benefits' or 'costs' of EPAs (let alone an economic analysis of their effect), there is a clear and urgent need for a set of 'what if' analyses. These would identify the potential product exemptions from specific EPAs.

The strategic choice for each ACP state individually, for members of EPAs collectively, and for the entire ACP group as a whole is to determine whether or not the 'costs' of an EPA exceed the 'benefits' or *vice versa*. Scenario building will help in two ways. First, it can identify critical features of EPAs that need to be included in order the better to promote ACP interests. Second, it will help states to decide whether or not they expect the EPA negotiations to turn out satisfactorily and, hence, whether or not they need to take advantage of the Cotonou reference to 'alternative arrangements' for states that do not enter EPAs.

Making assumptions

Simulating the revenue effects of different EPA configurations is a complex task requiring access to very detailed government figures on tax collection. The *potential* competition effects are more easy to assess in a way that can be widely understood, inform a national debate and not be wholly misleading.

Countries already rank their production sectors in terms of relative sensitivity to import competition by having different levels of tariffs. The range of goods produced in any ACP country will be relatively narrow. It is not difficult through a combination of quantitative and qualitative analysis to paint a realistic picture of what may happen to a sector if the tariff on relevant imports (competing goods or inputs) is reduced from its present level.

A simple methodology can be devised to start this process (see Box 1). The aim is to identify for each country a 'comfort zone' with different groups of product exclusion. This limited range of defensive scenarios could then be subjected to the more tricky analysis required to simulate revenue effects.

Through a combination of the two processes, countries would be able to identify a defensive strategy that strikes a balance between the competitive and revenue effects of reciprocity. Some of the exclusions from liberalisation will be products that compete with sensitive domestic output. Others will be products that are important for revenue generation.

An integrated strategy

This would indicate the extent to which there are likely to be either revenue or adjustment costs as a result of liberalisation in the short to medium term. It would also help governments to ensure consistency with other trade negotiations, so that the same products are protected in each. For example, the list will probably overlap with that of products for special treatment by non-LDCs in the Doha negotiations.

Making this link to other negotiations will be very important in several ways. An EPA will require reciprocity only to the EU, but is it realistic to assume that other OECD states will not seek equal (or better) access? The TDCA has already provoked the USA to seek a free trade area with South Africa and its customs union partners.

More general liberalisation will affect both the adjustment and the economic effects of EPAs. The wider the scope of liberalisation, the more likely it is that tariff revenue will fall and competition with domestic suppliers increase. By the same token, the favourable economic effects foreseen by liberal trade economists are also more likely.

Notes

- ¹ **West Africa:** Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo.
Central Africa: Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Sao Tome and Principe.
East and Southern Africa: Burundi, Comoros, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia, Zimbabwe.
Southern Africa Development Community: Angola, Botswana, Lesotho, Mozambique, Namibia, Swaziland, Tanzania.
Caribbean: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Surinam, Trinidad and Tobago.
Pacific: Cook Islands, Federation of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu.
- ² The research is being funded by the UK Department for International Development (DFID). The views expressed in this Briefing Paper are those of the authors alone, and do not necessarily reflect those of DFID.
- ³ Subject to data availability.
- ⁴ 'Our Common Interest: Report of the Commission for Africa', March 2005 (www.commissionforafrica.org).
- ⁵ If the goods concerned are inputs to other goods rather than for sale to consumers, domestic production of the goods using the inputs may increase.
- ⁶ Maerten, C. 2004. 'Economic Partnership Agreements: A New Approach to ACP-EU Economic and Trade Co-operation', presentation to TRALAC Annual International Trade Law Conference, November.

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