



**Working Paper**

**Economic Partnership Agreements:  
What's the best way forward?**

## Executive summary

### Background to Economic Partnership Agreements

- At present the EU unilaterally offers trade “preferences” – lower tariffs than would normally apply – to African, Caribbean and Pacific (ACP) countries. This arrangement was ruled illegal by the WTO in 1996. The EU was given a temporary waiver, and given time to find a replacement. This waiver expires at the end of 2007.
- The EU has proposed Economic Partnership Agreements (EPAs). Under these agreements ACP countries will form themselves into six regional blocs. Each group of countries will agree a free trade agreement amongst themselves and with the EU.
- Such bilateral free trade agreements are compatible with WTO law as long as “substantially all trade” is liberalised between the partners within a reasonable period of time. This is generally thought to mean getting rid of tariffs on 90% of all products over the course of 10-12 years. This can be unevenly split between the parties – so the most commonly discussed scenario is that the EU would get rid of all of its tariffs while ACP countries would remove 90% of theirs.

### Economic Partnership Agreements – the issues at stake

- **Risks to developing countries from over-rapid liberalisation with limited gains in market access.** Some ACP ministers are worried that they will be compelled to liberalise trade in goods and services too much, too fast, the main risk being the effect of rapidly opening up trade to the EU. There are fears that ACP exporters will not significantly increase their exports to the EU, while European exporters largely increase their shares on the ACP markets, meaning that ACP countries will undergo major trade imbalances, drops in industrial output and job losses.
- **Insufficient harmonisation in tariff regimes of EPA regional groupings could damage existing efforts towards regional integration.** As the ODI argues, “If regional partners do not have identical tariffs towards the EU the effect will be to give new impetus to maintaining border controls between them – to intercept European goods entering an EPA state with a low tariff and being transhipped to one with a high tariff.”<sup>1</sup> On the other hand, the EU argues that the new regime will help to foster regional integration, and increase south-south trade, aiding the integration of developing countries in the global economy.
- **Potential impact on tariff revenues, a serious issue in developing countries where these revenues often form a key part of state income.** Tariff reductions by developing countries, as prescribed by the EU’s EPAs, could have a highly negative effect in this regard. There are over 30 countries, generally poor and small, that derive more than 25% of their total revenues from tariffs. Tariffs account for 62% of revenue in the Bahamas and 75% in Guinea. Whereas for the developed countries of the OECD tariff revenues are of negligible economic importance, for Africa they are far more important, and these countries will face a number of costs and difficulties in setting up new replacement tax systems.

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<sup>1</sup> Overseas Development Institute Briefing Paper 4 (June 2006)

- **‘Behind the border’ agreements remain controversial.** The EU has pushed hard for the inclusion of the so-called “Singapore issues” – which touch upon issues such as investment policy, competition policy and government procurement rules – in the EPA negotiations, while the ACPs have resisted such inclusion just as fervently. Developing countries fear that inclusion of the Singapore Issues will result in loss of “policy space”, consequently limiting the range of development tools available to them.
- **ACP countries are concerned that aid will be made conditional on the acceptance of EPAs, and may not be sufficient to cushion the liberalisation process.** Several developing country governments see the current shape of the negotiations as the worst of both worlds: the EU will not agree formal aid commitments within the EPAs, but will make future aid conditional on the degree to which countries accept the EU’s negotiating objectives.

### **An alternative approach to EPAs is essential**

- **Flexibility still exists in EPA negotiations.** 2007 is the crucial year for EPAs. It seems certain that the end of the year deadline for an agreement will not be met in several regions, and that EPAs are unlikely to be agreed in the manner originally conceived by the Commission. Attempting to radically force the pace of liberalisation in ACP countries using EPAs may not be the most effective way to reduce south-south barriers.
- **The EU should now pursue “EPA light”.** In terms of developing countries’ own commitments to liberalise, “EPA light” should mean:
  - (i) a longer time frame for liberalisation (20 years);
  - (ii) as much room for discretion as possible within WTO rules in terms of the scope of liberalisation;
  - (iii) allowing individual country timetables for liberalisation, rather than a single schedule for EPA regions, to allow regional integration to proceed at its own pace.
- **The EU should take the threat of higher tariffs off the table.** In the near term, the EU should take the threat of higher tariffs after 2007 (if no agreement is reached in EPA negotiations) off the table. The EU should make it clear that if no agreement is reached before the deadline there is an alternative, and that it will provide GSP+ access for non-LDCs to sustain their current level of access.
- **The EU should spell out how it will allocate short term aid to support tariff reductions.** It should make clear that aid for trade, and aid more generally, will not be conditional on accepting an EPA. As part of the EPA process the EU should offer developing countries assistance to simplify and streamline their customs procedures and to reduce other non-tariff barriers.
- **An integrated deal on preferences for developing countries.** The UK and EU should seek to make sure that generous and deep preferences, with liberal rules of origin, are taken up by all developed countries (and ideally also harmonised) through WTO agreements. This would be good in itself, and also offset the trade-diverting effects of EPAs.

## Introduction

Bringing down the EU's trade barriers against developing countries is the one thing that all developing countries and anti-poverty campaigners agree on. There is less agreement about whether there should be pressure to bring down barriers in developing countries.

Even if the case for promoting liberalisation in general is accepted, there is a subsequent question as to *how* developed countries should encourage developing countries to reduce their own trade barriers.

Some of the more protectionist NGOs and developing country governments are sceptical about trade liberalisation at all. Others think that some "strategic" tariffs are helpful to "protect" so-called "infant industries".

Others think that bringing down trade barriers in poor countries is a good idea, but that trying to put pressure on poor countries to liberalise too fast, or according to an externally imposed timetable, would simply backfire.

So NGOs and developing country governments have tended to converge on the idea of "policy space" – jargon for the idea that developing country governments should be allowed to run whatever policy they think is right. In the case of the EU, the debate about trade liberalisation has become intimately entwined with the question of reform of the EU's preference systems.

## Economic Partnership Agreements (EPAs) – the origins of the debate

- After the EU introduced a Common Agricultural Policy on bananas in the early 1990s the EU's preferential tariffs for ACP bananas were challenged by Latin American producers. In 1993, the GATT panel on the issue ruled that the EU preference was illegal, essentially because it was based on geographical discrimination, rather than being 'generalised' according to some objective criterion. This led to a series of ongoing disputes.
- More generally, the rulings implied that countries can run non-reciprocal preference schemes only under certain circumstances based on equal treatment for recognised groupings of countries at the same income level. So for example, the WTO would allow a scheme which extended further to all developing countries (called the Generalised System of Preferences) or a less extensive scheme for all Least Developed Countries. However, the ACP group which the EU currently gives its preferences to is not based on having the same income level, but on having a former colonial link to one or more of the EU member states.
- Obviously it was going to take time for the EU and ACP countries to come up with a new system, so the EU was given a temporary waiver period to come up with new agreements. The waiver was renewed but runs out at the end of 2007 – now just 9 months away.
- In a green paper in 1996 the Commission argued that the non-reciprocal agreements with the ACP would have to be replaced with bilateral free trade deals (a) to comply with WTO law, but also (b) because the non-reciprocal

preferences had failed to deliver. These trade deals could be reinforced with other pro-development measures to form Economic Partnership Agreements.

- Since then all kinds of suggestions have been put forward for alternative arrangements which would be compatible with WTO law – and some suggestions based on the idea that the WTO rules should instead be changed. The proposal to negotiate such agreements was agreed by the ACP countries in the Cotonou agreement in 2000 and negotiations began in 2002.

## The current state of the debate

- The main source of controversy in the debate about EPAs hinges on whether developed countries should allow developing countries “policy space”, or should pressure them to reduce their own trade barriers using the threat of reduced market access.
- Obviously there is a sliding scale of different degrees of pressure that might be applied. However, there are also other issues raised by the particular design of EPAs – including questions about their effect on attempts at south-south regional integration, and questions about what should or should not be included in such agreements.
- Current UK policy both backs the idea of “policy space” and also (to some extent in contradiction with this) backs EPAs. However in its white paper on Trade and Development, the Government insists that: “the EU as a whole has made clear that we do not have ‘offensive’ market access interests, and the UK will seek to hold our EU partners to this”. The UK was also behind the provision in the Cotonou Agreement that any ACP country that did not want to sign an EPA should be offered some kind of alternative.
- In one sense there are two intertwined debates: the first about the pros and cons of EPAs in themselves, the second about how critics of EPAs would solve the problem thrown up by the WTO incompatibility of existing rules.

## Outline of EPAs

- The basic goal of EPAs is for ACP countries to form themselves into six regional blocs, which will liberalise trade both amongst themselves and with respect to the EU. The Commission hopes that the EPA regions will agree to form free trade areas or even customs unions.

### The six EPA groups

<b>Caribbean (15)</b>	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
<b>Central Africa (7)</b>	Cameroon, Central African Republic, Chad, Congo Republic, Equatorial Guinea, Gabon, São Tomé and Príncipe
<b>East and Southern Africa (16)</b>	Burundi, Comoros, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia, Zimbabwe

<b>Pacific (14)</b>	Cook Islands, Fed. Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu
<b>SADC-minus (7)</b>	Angola, Botswana, Lesotho, Mozambique, Namibia, Swaziland, Tanzania
<b>West Africa (16)</b>	Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo

- The European Commission would like the agreement to include issues such as technical and safety standards, investment, trade facilitation, competition policy, government procurement, environment and labour standards and policy, intellectual property and data protection. The specific inclusion of each of these items depends on the outcome of the negotiations for each regional EPA.
- One reason the debate about EPAs has been so controversial is that their final shape is unknown, and negotiations are being conducted largely in secret. One issue which clearly defines the likely scope of EPAs are the rules of the WTO.
- Under Article XXIV of the WTO a free trade area may be allowed as long as “substantially all trade” is liberalised. The meaning of these words is widely discussed, both in terms of how much trade need be liberalised on either side, and over what period.
- The consensus view of WTO law is that 90% of all trade between the two countries would need to be liberalised. However, if the EU liberalised 100% of its trade then ACP countries might only need to liberalise 80% of their trade to get to an average of 90%. Such an asymmetric relationship was agreed as part of the EU-South Africa FTA, under which the EU liberalised 95% of its trade and South Africa 85%.
- On top of this, a representative of the European Commission suggested that because the EU had been running a small deficit with respect to some ACP countries, there could be potential for the proportion liberalised by the ACP to be lower than 80% as their exports to the EU accounted for more than half of the two-way trade. However, by the same the logic, other regions might need to liberalise more than 80% of their trade.

#### **Proportion of trade that might have to be liberalised by EPA groups**

<b>EPA regions</b>	<b>Value of trade to be liberalised</b>
Caribbean	83%
West Africa	81%
East and Southern Africa	80%
Central Africa	79%
Southern Africa	76%
Pacific	67%

Maerten (2005)

- The amount of time over which such trade might have to be liberalised is also widely debated. The consensus is that WTO rules would require it to happen over

10-12 years. However, other agreements around the world have taken very different lengths of time.

- It is unclear exactly what the WTO rules are in this respect, and much would depend on whether or not an agreement which interpreted the idea of “substantially all trade” in a minimal way would be subject to legal challenge at the WTO.

#### Time taken to liberalise in other FTAs

Implementation period	FTA	Parties concerned
12 years	EU – South Africa	South Africa only
	EU – Morocco	Morocco only
	US – Chile	Both parties
15 years	Canada – Costa Rica	Costa Rica only
16 years	Korea – Chile	
18 years	Canada – Chile	Chile only
	US – Australia	US only
20 years	Australia – Thailand	Thailand only
	New Zealand – Thailand	Thailand only

Source: Scollay (2005).

### What are the main issues in the EPA debate?

- The debate about EPAs has spawned a vast literature. There are three recurring questions; the basic question about liberalisation by the ACP; EPAs effect on regional integration efforts; and the cost to governments in terms of loss of tariff revenue.
- In addition, a range of other questions are frequently being discussed: plans to include “behind the border” issues like investment and competition in the agreements; EPAs relationship to multilateral liberalisation; questions about whether there will be aid to cushion the EPA process; and the issue of whether the EU should offer ACP countries an alternative “up front” rather than only presenting an alternative if an ACP country asks for it.

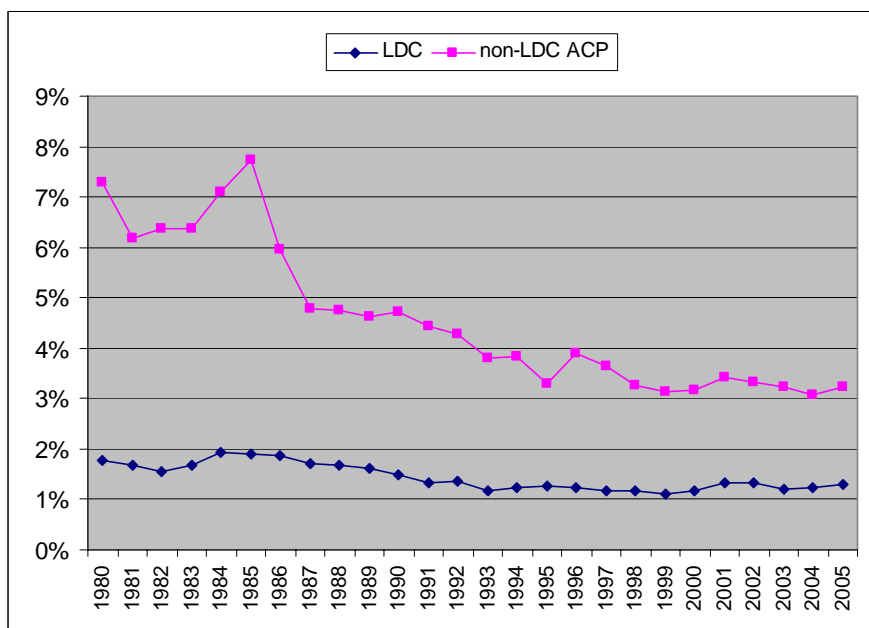
### (1) The consequences of greater trade liberalisation by the ACP

- The fact that EPAs will force developing countries to bring down their own trade barriers is also the most fundamental criticism of EPAs by their opponents. Some ACP ministers are worried that they will be compelled to liberalise trade in goods and services too much, too fast.
- Senegalese Trade Minister Mamadou Diop has called for the deadline for signing the EPAs to be postponed past 1 January 2008. He said, "We are harnessing the carriage in front of the horses. We still don't have a good impact study of the EPA for West Africa. And we still don't know which flexibility ACP countries can count with regarding general trade rules in two years time. Until now, we do not

see a clear commitment to increase competitiveness and production capacity in the ACP countries and to agree on transition periods that are long enough."

- Kaliopate Tavola, Fiji's trade minister, said that "a pessimistic mood prevails" in his own Pacific region. "At the beginning of negotiations, we expected a lot of the idea of the EPAs becoming a tool for development. But as things stand now, the agreement is threatening to overwhelm our fragile economies. Some small islands may just opt out of the agreement altogether."<sup>2</sup>
- However, the European Commission argues that the existing arrangements have not worked and ACP countries now need to liberalise their own trade.
- EU Trade Commissioner Peter Mandelson has said that, "Put simply, after more than thirty years of bilateral trade with Europe, the ACP still exports just a few basic commodities. Most of those basic commodities fetch lower prices than they did twenty years ago. The benefits of preferential access are eroding fast and the risk – the looming risk - is that ACP economies will be stranded outside a global economy on a shrinking island of commodity trade."<sup>3</sup>
- The Commission frequently cites the fact that Africa has lost market share within the EU over the period of previous agreements. It argues that EPAs should be seen as a "first step towards gradual integration into the world economy".

#### ACP share of EU trade



- The ACP countries lost market share very quickly in the mid-80s. They appear to have flatlined since the mid-90s. Whether this is a success or a failure depends on the context. One argument would be that given the huge increase in the share of China, holding constant is not bad. Indeed, the share of developed countries in EU imports fell from 68% to 59% from 1995 to 2005.

<sup>2</sup> Bridges vol. 10, 2006

<sup>3</sup> Speech to PSE conference (19 October 2006)

- Stevens (2006) questions both (a) whether there is a strong link between ACP countries underperformance and their trade integration and (b) whether EPAs will indeed lead to substantial reductions of barriers either against the EU or within EPA regions. He argues that there is little discernable link between ACP countries' trade exposure and growth.
- Stevens and Kennan (2005) also question how far the likely contents of EPAs will make LDCs liberalise. They argue that only a few ACP countries would have to eliminate substantial barriers that they currently maintain on imports from the EU. The paper presents figures for the highest tariff different countries would have to cut if they worked upwards, eliminating the smallest tariffs first until they covered 80% of their trade:

Region	Average highest tariff to be cut (%)	Range within region	High outliers
Caribbean	20	15–30	St Kitts, St Lucia, Surinam
Central Africa	30	20–30	None
East and Southern Africa	25	5–100	Burundi, Djibouti, Ethiopia, Seychelles
SADC	5	0 – 42.5	Angola, Botswana, Mozambique, Tanzania
West Africa	20	20–30	Nigeria

- The likely consequences of trade liberalisation have been the main focus for economic assessments of the costs and benefits of EPAs (see below).

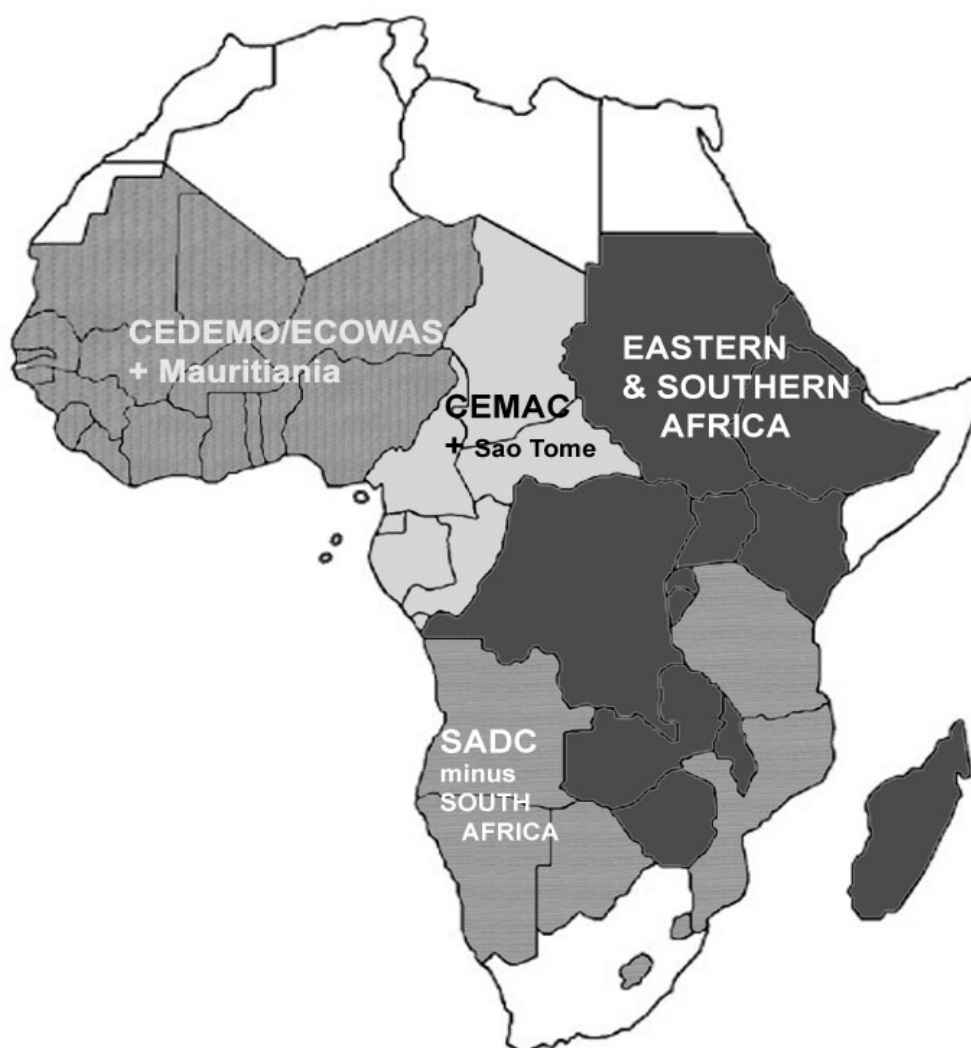
## (2) Regional integration – fostered or hindered?

- Oxfam argues that “because ACP countries have different priorities regarding the sectors they wish to protect from import competition and to preserve for the generation of tariff revenues, it is possible that each member of an EPA will select different products on which to liberalise. If regional groupings are not sufficiently harmonised before an FTA is launched, the EPAs will create new barriers to intra-regional trade.
- The ODI have argued that unless the EU succeeds in obtaining a ‘big bang’ agreement for all countries to adopt a common liberalisation schedule, then the result of lower tariff barriers against EU imports could be to create pressure for trade barriers between countries to be increased: “If regional partners do not have identical tariffs towards the EU the effect will be to give new impetus to maintaining border controls between them – to intercept European goods entering an EPA state with a low tariff and being transhipped to one with a high tariff.”
- Oxfam argues that there is also a “splintering” effect simply due to the lack of overlap between existing regional integration efforts and the boundaries of the EPA regions. For example, of the members of the existing SADC trade protocol six are in the SADC EPA group, six are in the ESA group, one is in the Central Africa group and one is not negotiating an EPA at all. However, supporters counter that this is merely creating pressure for a ‘rationalisation’ of the existing groups, which, they argue, have made little progress. Certain countries like the DRC and Tanzania will face difficult choices about which group to join, with different parts of those countries potentially benefiting from being in different

groups. Tanzania, for example, is part of the Southern African EPA but Uganda and Kenya (which together with Tanzania make up the East African Community) are in the East African EPA. People in the east of the DRC will benefit from being part of the East Africa group, while people in the west might benefit more from being part of the CEMAC or even SADC groupings.

- As well as the general question about whether attempting to force the pace will help or hinder regional integration, there is a secondary question about what might happen in the event that several countries drop out of the EPA negotiations. All LDCs have the right to keep their current unilateral preferences. Given the geography of several regions in Africa, and the large number of LDCs in the groups, there could be problems for intra-regional trade if key LDCs drop out.

### EPA Groups in Africa



### (3) Customs revenue dependence

- Another major problem connected with liberalisation more generally is the potential impact on tariff revenues, a serious issue in developing countries where these revenues often form a key part of state income. Tariff reductions by

developing countries, as prescribed by the EU's EPAs, could have a highly negative effect in this regard.

- There are over 30 countries, generally poor and small, that derive more than 25% of their total revenues from tariffs. Tariffs account for 62% of revenue in the Bahamas and 75% in Guinea. The table below shows that dependence on tariff revenue is not distributed at all evenly. Whereas for the developed countries of the OECD tariff revenues are of negligible economic importance, for Africa (and to a lesser extent the Middle East), they are a far more significant consideration.

Country	Tariff revenue, 1995 (% of GDP)
OECD	0.37 (Avg.)
Australia	0.65
US	0.27
Turkey	0.76
Middle East	3.48 (Avg.)
Egypt	3.59
Morocco	4.27
Syria	2.48
Africa	5.39 (Avg.)
Lesotho	32.27
Gambia	8.76
Gabon	4.47

Source: Ebrill, Stotsky and Gropp (1999)

- Tax will have to be raised in other areas, and this fiscal restructuring is costly and will absorb a lot of these countries limited administrative capacity. These tax reforms will have to be carried out at the same time as the difficult trade reforms.
- This can be very challenging. In the case of Cote d'Ivoire in the late 1990s, it even contributed to a breakdown in political stability – a hugely damaging scenario in terms of development. Senegal suffered large shortfalls in its revenues after liberalising in the 1980s, creating serious fiscal difficulties. Eventually, the liberalisation process was abandoned and tariffs raised again.

#### **(4) Behind-the-border agreements**

- The EU has pushed hard for the inclusion of the so-called 'Singapore issues' in the EPA negotiations, while the ACPs have resisted such inclusion just as fervently. In April 2006, the African Union stated: "On the issues of investment policy, competition policy and government procurement, we reiterate the concerns we have raised at the World Trade Organisation, leading to them being removed from the Doha Round Programme. We reaffirm that these issues be kept outside the ambit of the EPA negotiations."<sup>4</sup>
- Concerns over Singapore issues pertain, amongst other things, to fears of losing "policy space", consequently limiting the range of development tools available to the ACP governments. In addition, administrative and institutional adjustment costs threaten to swamp the benefits that may accrue from liberalisation. This was precisely why these issues were taken off the Doha agenda.

<sup>4</sup> "African Union Trade Ministers' Statement on EPAs", Nairobi (14 April, 2006)

- Several ACP governments and observers now argue that the EU is trying to reintroduce Singapore issues through the EPAs.<sup>5</sup> The Africa Trade Network states: “through proposals to negotiate such issues as investment, competition, government procurement, and trade facilitation, the European Union seeks to introduce agreements to de-regulate the entry and operation of European investors and businesses in ACP economies which are more aggressive than anything that the European Union has been able to get in the WTO, and which ACP countries have resisted in the WTO.”<sup>6</sup>
- Peter Mandelson and the European Commission often claim that the ACP nations themselves want new rules on trade deals and underscore the development characteristics of the Singapore issues, such as the effect these will have on transparency and predictability in ACP countries.<sup>7</sup> The best evidence that these rules would be helpful, Mandelson has said, “is the observation made to me by relevant ministers in the developing countries concerned”.<sup>8</sup>
- Some ACP trade ministers openly disagree, however. Dipak Patel, the Zambian Trade Minister, says: “We are worried over this backdoor approach. Where is the convergence between the WTO . . . and the EU approach in the EPAs?” Mukhisa Kituyi, the Kenyan Trade Minister likewise says: “I will be opposed to any progress being made if we get less than we got in the WTO negotiations.”<sup>9</sup>
- A report from the UK Parliament's International Development Select Committee argued that “The ACP states are already negotiating with limited capacity and under considerable duress. In respect of the Singapore issues we were told: ‘what they fear is that the EU will twist their arm to accept with the EPAs things that they would never have to accept on a more level playing field.’ The assumption is being made by both the UK Government and the EU that the ACP can reject these issues if they wish and that agreements will not be imposed on the ACP if they do not have the capacity to negotiate them. But this is not the case.”<sup>10</sup>
- Most of the ACP regions appear to have rejected inclusion of the Singapore issues, apart from trade facilitation.

## **(5) Aid conditionality and the sufficiency of aid to cushion liberalisation**

- The debate about aid and EPAs involves the question of whether aid *should* be linked to or made conditional on the acceptance of trade deals. The specific question of whether aid commitments will be built into EPAs is also discussed. Several developing country governments see the current shape of the negotiations as the worst of both worlds: the EU will not agree to tie formal aid commitments to the EPAs, but there is a perceived threat that future aid may be

<sup>5</sup> Solano, O. and Sennekamp, A. “Competition Provisions in Regional Trade Agreements, *OECD Trade Policy Working Paper*, No. 31, Paris.

<sup>6</sup> Africa Trade Network, “Statement of the 6th Annual Review and Strategy Meeting of Africa Trade Network”, (12/20/2003).

<sup>7</sup> European Commission Press Release, “Economic Partnership Agreements” putting a rigorous priority on development (20/01/2005)

<sup>8</sup> Financial Times (4/04/05).

<sup>9</sup> Ibid.

<sup>10</sup> House of Commons International Development Committee Fair trade? “The European Union's trade agreements with African, Caribbean and Pacific countries” (23 March 2005)

conditional on the degree to which countries accept the EU's negotiating objectives.

- Correspondence leaked to the Financial Times in November 2006 revealed that the EU is resisting incorporating aid commitments into EPAs. A letter from the Commission to the Fijian Trade Minister stated that: "In your draft EPA submission, detailed development cooperation provisions form an integral part of the text. As you know this is not acceptable to us". The Commission said trade and aid should be "mutually reinforcing", but kept separate.<sup>11</sup>
- Members of other negotiating groups have said they will insist on similar provisions within their groups. For the ESA group, Mauritius wrote to the Commission saying that they would "insist [on writing aid conditions into the agreement] in order to ascertain whether the EU is honouring its own commitments." The Commission rejected the idea. The Commission's chief EPA negotiator Peter Thomson argued in response that "with such a clause you are trying to micromanage trade rather than rules in trade".
- The UK Government's White paper "Partnerships for poverty reduction" (March 2005) rejects the idea of making aid conditional on trade liberalisation: "The UK Government accepts the evidence that conditionality cannot 'buy' policy change which countries do not want. Reforms will not be implemented – or will not be sustainable – if a partner country is acting purely in order to qualify for financial support and does not consider that the reforms are in its own interest. The UK will not make our aid conditional on specific policy decisions by partner governments or attempt to impose policy choices on them (including in sensitive economic areas such as privatisation or trade liberalisation)."
- Barbados Trade Minister Dame Billie Miller has said: "In the Caribbean, the feeling is that the EU is neglecting the problems of small countries. Until now, we only see a limited offer of trade-related support. The EU should invest much more in capacity building and the enhancement of competitiveness before trade is opened up."
- In a letter to the Financial Times, Peter Mandelson and Louis Michel stated that much of the €2bn that EU members had committed to aid for trade will be spent in support of EPAs. They wrote that, "EPA-related needs are discussed country by country. In addition, member states have agreed to support the Aid for Trade initiative, under which the EU is committed to aim for a trade development package of €2bn a year by 2010. A substantial part of it will go to ACP countries to assist them with implementing the EPAs."<sup>12</sup> Opinions differ about whether such aid should be conditional on accepting EPAs.

## **(6) The offer of an alternative, as specified in Cotonou**

- The Cotonou Agreement promised, without specifying any detail, that countries which ultimately chose not to sign an EPA would be offered an alternative which would leave them no worse off than before.
- However, the Commission has repeatedly made it clear that it will only spell out an alternative arrangement if ACP countries officially ask for it. Many countries

<sup>11</sup> Financial Times, "Brussels rejects moves to link aid with trade" (28 November)

<sup>12</sup> Financial Times (29th November)

are concerned about being the first to ask for an alternative – particularly in terms of its implications for aid receipts.

- Some NGOs argue for alternatives to be considered as soon as possible, to provide a choice of possible trade regimes to ACP countries. This is the position of ActionAid, for instance, which insists that “ACP countries must have a real choice between an EPA and a pro-development alternative up-front. They should not have to reject an EPA first in order to find out what the alternative might be”.<sup>13</sup>
- The Commons International Development Committee stated its concern about the Commission’s lack of work on alternatives: “We are concerned that in presenting the alternatives as a second best option, with no developmental component, the Commission is going against the spirit of what was agreed in Cotonou. It places the ACP in the position of having no real choice, and reinforces their unequal position in the negotiating process. Development should be integral to any trade options presented to the ACP, even when they are not the first choice of the EU. The UK Government should continue to work to ensure this is the case.”<sup>14</sup>

## The debate about alternative EPAs and alternatives to EPAs

- In a widely discussed paper for the European Centre for Development Policy Management, Bilal and Rampa (2006) summarise the debate about various alternatives to EPA, and look at the strengths and weaknesses of each distinct idea from the point of view of: (a) how much discretion or policy space it would give ACP countries, (b) whether it would help or harm regional integration (c) whether it would be WTO compatible and (d) whether it is politically feasible.
- They identify a number of distinct positions in the debate, which they categorise as calls for either “alternative EPAs” or more radical options which are “alternatives to EPAs”.

The **benchmark scenario** is the basic EPA currently proposed by the European Commission. It is a reciprocal WTO-compatible FTA where ACP countries would have to liberalise around 80% of their trade with the EU (with differences between regions due to different trade balances between the parties), and the EU would probably offer duty-free access to ACP countries over a period of around 12 years, according to the standard interpretation by the EU of ‘substantially all trade’ and ‘reasonable length of time’ as per GATT article XXIV. The agreement would strengthen regional integration initiatives (based on the EU integration example) and would also include liberalisation of services, as well as investment, competition, trade facilitation and other ‘behind the border’ provisions (which would make it an FTA+).

### Alternative EPAs

‘**EPA light**’, would mean agreeing a reciprocal FTA focusing, in a first stage, on the opening of ACP markets only to the minimum level necessary to secure WTO compliance while seeking to limit the potentially negative effects of any significant liberalisation by the ACP. Provided the EU granted duty-free access to all ACP countries, these countries could commit to liberalising only 50%-60% of their trade

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<sup>13</sup> ActionAid, 2005

<sup>14</sup> IDC, 6<sup>th</sup> report, 2004-5

with the EU, and over a longer transition period (20 years or more). Liberalisation might also be back-loaded over the 20 year period.

This would stretch but not break WTO rules and some would argue that the relative insignificance of the ACP in trade terms coupled with their political significance would make other WTO members unlikely to challenge such an agreement. ACP countries could then return to deeper tariff cuts and 'deeper' behind-the-border measures at a later stage once progress had been made on economic reform.

Going further in the same direction is the idea of an EPA with **explicitly recognised special and differential treatment (SDT)**. This reciprocal FTA+ would include services and 'behind the border' provisions, as in the benchmark scenario, but with flexibility for the ACP to liberalise much less and over longer implementation periods than the EU. This might be done either in the context of the existing WTO rules (convincing the EU to change its self-defined criteria for WTO compatibility) or by amending GATT Article XXIV in the negotiations of the Doha Round. The major drawbacks of this scenario are the uncertainty related to the first option (the greater the flexibility introduced in an EPA, the greater the risk that an aggravated WTO member would challenge it under the WTO dispute-settlement mechanism) and the unlikely possibility of a consensus at the WTO on reform of article XXIV.

Another unusual type of market opening characterises an **EPA with binding provisions for development-related liberalisation**. This scenario would envisage binding provisions in the new trading arrangements, making successive stages of tariff reduction for the ACP conditional upon the achievement of development thresholds (once an ACP country reached a certain development level, it would be deemed ready to further open its markets) and/or the delivery by the EU of EPA-related development cooperation. Such conditional reciprocal FTAs fall outside the definition of a free-trade area or regional trade agreement as currently envisaged in the WTO.

A fifth scenario could be an **EPA for ACP non-LDCs only** and the 'everything but arms' (EBA) initiative for the ACP LDCs (i.e., duty- and quota-free access to the EU). Considering the negative effects of reciprocal trade liberalisation, ACP LDCs already benefiting from EBA under the EU GSP (WTO compatible under the Enabling Clause) may decide not to provide reciprocity. ACP Non-LDCs need, instead, to find an alternative trade regime to the current Lomé/Cotonou preferences, and assuming that the GSP does not offer market access as advantageous as the current regime, the only option for ACP non-LDCs to maintain or improve on their level of preferences for the EU market would be to enter into an EPA. It would be difficult under this approach for any ACP region to effectively implement regional-integration programmes because the group would be split between the (non-LDC) countries that enter an FTA+/EPA with the EU, and those (the LDCs) that maintain their trade barriers against the EU.

In the '**menu approach**', the different components of an EPA (trade in goods and in services, investment, possible sector-specific arrangements as in fisheries, and so forth) could be covered under separate individual agreements, and countries in one region would be offered a 'menu': all would sign a 'master agreement' establishing the principles to govern the EPA relationship but individual countries would be allowed to join only those specific 'subsidiary agreements' they are prepared to commit to. Potentially very different treatment of different countries under market-access arrangements (as well as non-trade areas) risks breaking up the ACP regions, and the WTO compatibility of such a scenario is, at best, uncertain.

Although ACP countries have all opted for a regional configuration to enter EPA talks, negotiations might lead to the conclusion of **country-specific EPAs**. These would be reciprocal FTAs+ with the EU at the national level, in line with article XXIV, with country-specific levels of reciprocity, implementation schedules and treatment of trade-related issues. This could provide greater flexibility for some countries that seek SDT in an EPA or it could impose more rigorous constraints, depending on a number of factors, including bargaining power and particular country characteristics like the size of the economy. Unless coordinated at the regional level, country-specific EPAs may seriously disrupt regional integration.

At the opposite extreme of the range of available geographical EPA configurations is an **all-ACP EPA**, a unique reciprocal FTA+ that would be conducive to both regional integration and ACP unity on issues of common interest. The feasibility of such a scenario is questionable given that regional EPA negotiations are currently entering into the details of a possible agreement, with marked differences between regions in terms of both progress and content.

### ***Alternatives to EPAs***

There are also a number of ideas which have been discussed which would really be alternatives to EPAs – in the sense of either requiring changes to WTO rules or abandoning the attempt to treat ACP countries differently to other developing countries.

One option is an **incomplete FTA with embodied liberalisation vis-à-vis the rest of the world**, not only the EU. ACP countries would enter into EPAs with the EU but would be required to liberalise against all trade partners (MFN liberalisation) and not fully (liberalise, for instance, to a uniform 10% MFN duty). Although this would avoid the trade-diverting effects of an EPA, for this scenario to be feasible, WTO rules would have to be changed, either Article XXIV or the Enabling Clause, because this proposal is obviously in violation of both provisions.

A different scenario is the modification of the **EU GSP**, since the existing scheme (that many, especially EC officials, consider the only real alternative to EPA) would offer worse preferential access to ACP non-LDCs than Lomé/Cotonou, thereby violating the provisions of the Cotonou Agreement. An 'enhanced' GSP to incorporate all ACP exports and (where they are inferior) to improve market-access preferences to the Cotonou level would constitute a WTO-compatible alternative to EPAs, with definite appeal for ACP non-LDCs as well. One of the main advantages of this scenario is that the EU would justify it at the WTO—not under Article XXIV but under the Enabling Clause. On the other hand, ACP non-LDCs would be treated as other developing countries and face problems of preference erosion.

A simpler scenario is the extension of **EBA** (6.2.3), whereby non-reciprocal free market access could be granted to all ACP countries, the G90 group of poorer countries, or all developing countries. The first two options violate the existing Enabling Clause because they discriminate among developing countries (since both ACP and G90 are arbitrarily defined groups, not recognised by the WTO); the third does not, but it is an unrealistic outcome because it would open the EU market also to large and highly competitive developing countries.

## Assessing the impact of EPAs

### Impact Studies

- Almost all studies tend to suggest that EPAs will have a significant impact on ACP economies, but their estimates vary widely across regions, countries (including countries from the same region) and studies. This seems to imply a high level of heterogeneity in the regions and the need to differentiate between countries within the same region.
- Due to methodological constraints and the limited availability of data, impact studies have not really assessed the 'dynamic' effects of trade liberalisation. This is a major shortcoming since most of the anticipated impact of EPAs on development should come from these dynamic effects. Most of the early work on the subject involved limited partial equilibrium analysis.

### Early studies

- In 1998, with the start of the negotiations between the EU and the ACP, the Commission had already contracted six studies for six ACP regions. These studies have unfortunately not been made publicly available, arguably because their methodology was criticised by the EC and their results were generally unfavourable to EPAs.<sup>15</sup> Key observations from these studies are:
  - I. In most cases, LDCs have little to gain from EPAs. They can keep non-reciprocal trade preferences anyway;
  - II. the replacement of non-reciprocal tariff preferences with the GSP would adversely affect some products exported by some non-LDC ACP countries, but most ACP exports would be barely affected;
  - III. by contrast, the effects of not renewing the commodity protocols could dramatically affect the exports of some ACP countries. However, none of the studies estimated these effects as this would have required separate studies;
  - IV. the negative impact on customs revenues varies considerably, but could be substantial for some countries, which may thus ask for adequate financial support;
  - V. lower import taxes would benefit customers as well as importers of capital goods, but it is difficult to say to what extent these welfare gains would offset the losses mentioned above.<sup>16</sup>

### Mixed evidence

- Indications on the welfare effects of EPAs are scarce and incomplete. UNECA (2005) and CAPE (2003) provide some indications that ACP consumers could gain from the lower prices resulting from trade liberalisation but this gain is generally low (when compared to the loss of tariff revenues).
- UNECA (2005a) also notes that ACP producers would lose out as a result of EU imports supplanting domestically produced goods.

<sup>15</sup> The six studies are CERDI (1998), CREDIT (1998), IDS (1998), IMANI (1998), NEI (1998) and Planistat (1998). For an overview, see Bilal (2002), European Commission (1999) and McQueen (1999).

<sup>16</sup> McQueen, 1999.

- Te Velde and Bezemer (2006) have found that Regional Investment Provisions in RTAs have helped to attract FDI from outside the region, with implications for the preliminary provisions in the EPAs.
- The ODI present a summary of the findings of various regional studies, which finds broadly positive welfare effects, although with some countries losing out:

<b>Region and source</b>	<b>Trade creation (TC) / Trade diversion (TD)</b>	<b>Fiscal effects (loss of tariff revenues)</b>	<b>Average welfare effect for the group</b>	<b>Major gainers and losers</b>
<b>Sub-Saharan Africa (as a whole) (a)</b>			Negative for EPA with no regional integration Positive for removal of intra-SSA barriers or EU-SSA Free Trade Area)	
<b>West Africa</b>	TC larger than TD	Negative	Positive	Nigeria and Ghana (gainers); Cape Verde and Gambia (losers)
<b>Central Africa (a)</b>	TC larger than TD	Negative	Positive	Cameroon, Gabon and DRC (gainers)
<b>East Africa (c)</b>	TC smaller than TD for Tanzania and equal to TD for Uganda	Large negative	Small negative for Tanzania; Negligible for Uganda	Tanzania (loser)
<b>COMESA (a)</b>	TC larger than TD	Negative	Positive	Kenya, Mauritius, Sudan and Ethiopia (gainers)
<b>SADC (d)</b>	TC larger than TD	Large negative	Large positive (EPA with regional integration) Small positive (EPA with no regional integration)	South Africa, Zimbabwe and Mauritius (gainers); Zambia, Tanzania, Mozambique Swaziland (losers)
<b>Caribbean (e)</b>	TC smaller than TD (for simultaneous MFN tariff cuts < 50%) TC larger than TD (for simultaneous MFN tariff cuts > 50%)	Small negative	Small negative (for simultaneous MFN tariff cuts < 20%) Small positive (for simultaneous MFN tariff cuts < 20%)	
<b>Pacific (f)</b>	TC larger than TD	Small negative	Small positive	Papua New Guinea and Fiji (gainers)

Based on:

- Karingi, et al (2005)
- Busse M. and H. Großmann (2004)
- Milner C., O. Morrissey and A. McKay (2005)

- d. Tekere, M. and D. Ndelela (2003) and Keck A. and R. Piermartini (2005)
- e. Evans D. et al. (2006) and Gasiorek and Winters (2004) and Greenaway D. and C. Milner (2003)
- f. Roza, V. and S. Szepesi (2003)

## Some recent views

- A study by Romain Perez of the United Nations Commission for Africa (forthcoming) is one of the few to assess alternative versions of EPAs. It argues that, based on simple considerations of *market access*, ACP countries would be better off opting for the EU GSP (i.e., EBA for ACP LDCs and the GSP or an enhanced GSP option for non-LDC ACP countries) than concluding an EPA.
- Perez runs a general equilibrium analysis, which he argues captures terms of trade effects missed by many other studies. His paper separates out the question of intra-ACP regional integration and the issue of ACP liberalization to imports from the EU. It finds positive effects from the former and strongly negative effects from the latter.
- Perez suggests that: “Despite the lower levels of commitment of the ACP countries, ACP exporters, which already benefit from near-duty free access to the European markets and suffer from supply sides rigidities, will not significantly increase their sales on the European markets, while European exporters largely increase their shares on the ACP markets. As a result, ACP countries will undergo major trade imbalances, while the intra ACP regional trade will shrink to the benefit of ACP-European trade. Additionally, these countries will face a major drop in their industrial output, associated with a large reallocation of their workers, which could create social difficulties. Added to a deterioration of their terms of trade, this drop in output will lead to welfare losses in every group of ACP countries, especially in the non-SADC countries in Sub-Saharan Africa and Asia.”

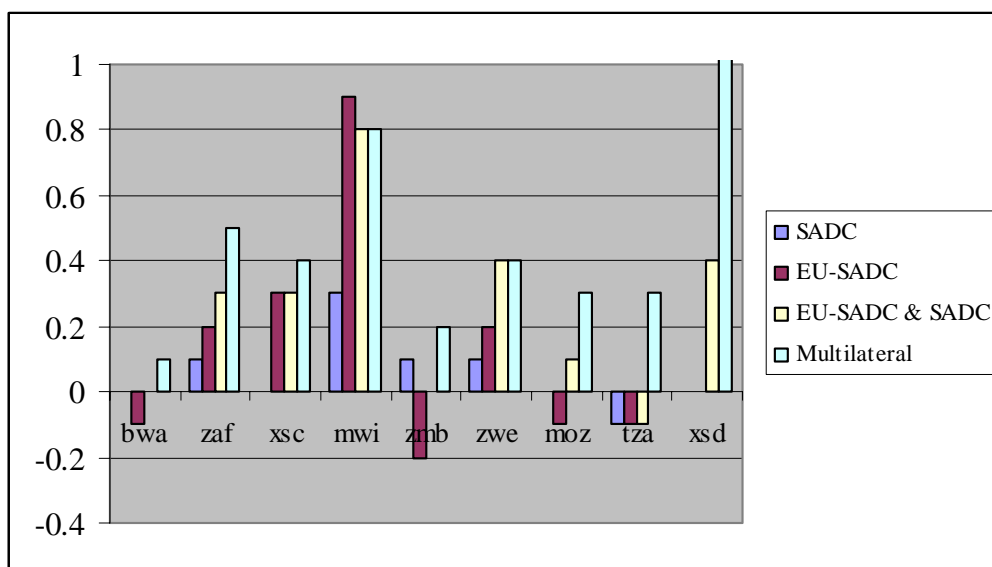
**Effect on ACP countries**

	'Standard' EPA	GSP	Enhanced GSP
<b>Welfare</b>	-851	-459	-51
<b>Real GDP</b>	-183	-79	-9
<b>Trade balance</b>	-1,223	234	26
<b>Fiscal imbalance (%GDP)</b>	0.70%	0%	0%
<b>Regional trade</b>	-407	60	7

Perez (forthcoming)

- Keck and Piermartini (2005) also run a general equilibrium analysis, and suggest that an FTA between SADC and the EU is overall welfare enhancing, although it would not benefit all countries.
- They compare four scenarios – free trade within SADC, a full EPA between SADC and the EU, a combination of an EPA and full regional free trade and, as a benchmark, multilateral liberalisation. While multilateral liberalisation would boost growth in all cases, an EU-SADC EPA would reduce GDP in Botswana, Zambia Mozambique and Tanzania. However if the EPA led to full regional integration

this would cancel out these losses for all but Tanzania. On the other hand there are gains for South Africa, the rest of SACU, Malawi, Zimbabwe and Angola



- In contrast to previous work, both Stevens and Kennan (IDS 2005) and Hinkle and Newfarmer (World Bank 2005) suggest that the likely margins of discretion with EPAs will allow countries which sign them to maintain most high tariffs.
- Hinkle and Newfarmer argue that: “Line-by-line negotiation of which specific imports are to be excluded from free trade with the EU are likely to be dominated by protectionist interests and will not lead to pro-development outcomes. Preferential liberalization may well be restricted to sectors with little or no domestic production, while the main import-competing industries (where the largest efficiency gains might occur) may be excluded because of opposition from currently protected firms, as happened in the case of the EU-South Africa FTA. Furthermore, elimination of tariffs on inputs imported from the EU would raise effective protection rates for import competing industries and reduce the incentive to export, even to the EU. Thus, the EPAs could create a distorted tariff regime that would actually increase the already high effective protection rates for import-competing domestic industries while eliminating the revenues from tariffs on imports from the EU that do not compete with domestic production.”
- Stevens and Kennan (2005) argue that it means that EPAs “are likely to harm regional integration between developing countries, without achieving significant liberalisation of trade between the EU and ACP countries.”
- Both Stevens and Kennan and Hinkle and Newfarmer reach similar conclusions: that the GSP+ or an enhanced GSP could provide market access broadly similar to the existing Lomé/Cotonou trade regime, with only limited erosion of preferences.

## Conclusion

- The only thing clear so far is that the academic evidence suggests a mixed picture. Several of the studies seem to suggest a mix of “winning” and “losing” countries.

- Many of the potential benefits of EPAs appear to turn on the question of whether EPAs will promote regional integration. The main risk seems to be the effect of opening to the EU.
- Several of the studies suggest that if EPAs were merely about promoting integration within the ACP the net effect would be clearly positive. Therefore a less demanding set of commitments in terms of opening to the EU might mitigate the risks. However even then, as Stevens argues, EPAs might undermine regional integration and still lead to a negative outcome for ACP countries.
- Hinkle and Newfarmer and also Keck and Piermartini's work suggest that lop-sided liberalisation with respect to one large trading partner is clearly a second best option compared to balanced multilateral liberalisation.

### **An alternative approach is necessary... and still feasible**

- 2007 is the crucial year for EPAs. It seems certain that the end of the year deadline for agreement will not be met in several regions, and that EPAs are unlikely to be agreed in the manner originally conceived by the Commission.
- If the EU were proposing to make aid conditional on the acceptance of liberalisation, with few or no reciprocal concessions from the EU, it would be unlikely to attract widespread support – at least in the absence of the need to comply with WTO rules
- The UK should press for an alternative approach to EPAs, which would involve giving developing countries as much policy space as possible while complying with WTO rules. This would involve several elements:

#### **(1) The EU should now pursue “EPA light”**

- Attempting to force the pace of liberalisation in ACP countries using EPAs may not be the most effective way to reduce south-south barriers.
- In terms of developing countries' own commitments to liberalise, “EPA light” should mean:
  - (i) a longer time frame for liberalisation (20 years);
  - (ii) as much room for discretion as possible within WTO rules in terms of the scope of liberalisation;
  - (iii) allowing individual country timetables for liberalisation, rather than a single schedule for EPA regions, to allow regional integration to proceed at its own pace.

#### **(2) The threat of higher tariffs should be taken off the table**

- In the near term the UK should call for the EU to take the threat of higher tariffs after 2007 (if no agreement is reached) off the table. The EU should make it clear that if no agreement is reached before the deadline it will provide GSP+ access for non-LDCs to sustain their current level of access.

### **(3) Make it clear that aid will not be made conditional on accepting EPAs**

- The EU should spell out how it will allocate short term aid to support tariff reductions. It should make clear that aid for trade and aid more generally will not be conditional on accepting an EPA.
- On the other hand as part of the EPA process the EU should offer developing countries assistance to simplify and streamline their customs procedures and to reduce other non-tariff barriers, which are likely to be far greater impediments to south-south trade. (see section on making trade work for developing countries)

### **(4) Reform the global system of trade preferences**

- In the longer term, all developed countries in the WTO should offer duty free and quota free access to all LDC and ACP countries and - if politically possible – all other low income countries.
- Rules of origin should be dramatically liberalised and the value added requirement reduced. At the same time the range of different ways to qualify should be maintained rather than and the UK should oppose plans to reduce it to value added only. The list of non-qualifying activities should be deleted.
- Countries granted such preferences should be allowed full cumulation of origin with *all* other low income countries, as defined by the OECD. If this is unacceptable at the WTO then they should be allowed to use inputs from all developing countries.
- This will enable large developing countries to act as a 'locomotive' for the development of smaller low income countries. The UK should attempt to ensure that South Africa is also included within this system of cumulation of origin for similar reasons.
- The EU should not use preference erosion as an excuse to avoid multilateral liberalisation.
- In fact the UK and EU should seek to make sure that generous and deep preferences with liberal rules of origin are taken up by all developed countries (and ideally also harmonised) through WTO agreements.

## Appendix: the overlap of ACP and LDC status

Non-LDC ACP	ACP LDCs	Non-ACP LDC
Antigua and Barbuda	Angola	Afghanistan
Bahamas, The	Benin	Bangladesh
Barbados	Burkina Faso	Bhutan
Belize	Burundi	Cambodia
Botswana	Cape Verde	Lao People's Dem. Rep.
Cameroon	Central African Republic	Maldives
Congo, Rep. of the	Chad	Myanmar
Cook Islands	Comoros	Nepal
Cote d'Ivoire	Dem. Rep. of the Congo	Yemen
Dominica	Djibouti	
Dominican Republic	Equatorial Guinea	
East Timor	Eritrea	
Fiji	Ethiopia	
Gabon	Gambia	
Ghana	Guinea	
Grenada	Guinea-Bissau	
Guyana	Haiti	
Jamaica	Kiribati	
Kenya	Lesotho	
Marshall Islands	Liberia	
Mauritius	Madagascar	
Micronesia, Federated States of	Malawi	
Namibia	Mali	
Nauru	Mauritania	
Nigeria	Mozambique	
Niue	Niger	
Palau	Rwanda	
Papua New Guinea	Samoa	
Saint Kitts and Nevis	Sao Tome and Principe	
Saint Lucia	Senegal	
Saint Vincent and the Grenadines	Sierra Leone	
Seychelles	Solomon Islands	
Suriname	Somalia	
Swaziland	Sudan	
Tonga	Togo	
Trinidad and Tobago	Tuvalu	
Zimbabwe	Uganda	
	United Republic of Tanzania	
	Timor Leste	
	Vanuatu	
	Zambia	

Cuba is an ACP member but receives GSP treatment, South Africa is in the ACP but has a bilateral FTA with the EU (the TDCA)