

Economic and Welfare Impacts of the EU-Africa Economic Partnership Agreements

Concept Paper

Economic Commission for Africa

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Introduction

Background

The Cotonou Partnership Agreement (CPA) between the European Union (EU) and the African, Caribbean and Pacific (ACP) countries expected to succeed the expired Lomé Agreement, envisages the signing of Economic Partnership Agreements (EPAs) by December 2007 between the EU and the ACP countries. The EPAs will be the new cooperative framework under the CPA and are expected to adopt an integrated approach based on partnership and promoting cooperation, trade and political dialogue between the EU and the ACP countries. One of the essential characteristics of this multilateral partnership is that it hopes to combine trade (to respond to the challenge of globalization), development aid (essential to ACP countries), and a strengthened political dimension. The key CPA principles are reciprocity; differentiation; deeper regional integration; and coordination of trade and aid.

The EPAs, which are to be CPA development vehicles will address trade barriers, supply-side constraints in the ACP countries, and World Trade Organisation (WTO) compatibility question. EPAs will essentially be Free Trade Area (FTA) arrangements to replace the non-reciprocal trading preferences currently advanced to the ACP countries under the Lomé Agreement with reciprocal arrangements in compliance to the WTO rules of non-discriminatory trading arrangements.

Ideally, in order for the ACP-EU arrangements to be WTO-compatible, the EU would be expected to advance similar preferences to non-ACP countries that are at the same level of development just as the ones being enjoyed by the ACP countries. Thus, unless the EU is willing to extend similar preferences to both ACP and non-ACP countries, then in order not to be challenged on the grounds of discrimination under the most favoured nation (MFN) clause of the WTO the ACP countries under the EPAs will be expected to grant EU originating imports of goods, duty free access into their markets. This will be similar duty free access granted by the EU on selected goods from those countries under the expired Lomé Agreement.

WTO-compatibility requirement does not however mean that the EU cannot unilaterally establish a preference system that favours developing countries without necessarily the requirement for reciprocal treatment for EU goods. The Everything-But-Arms (EBA) initiative is one such arrangement granted under the enabling clauses of the GATT/WTO rules that allows developed countries to have favourable preference systems for developing countries without reciprocity. The EBA grants duty-free access to all imports from developing countries that meet the least developed countries criteria. The critical difference between the EBA initiative and the EPAs in terms of trade is that the EBA initiative is non-discriminatory as its preferences are accessible globally to all least developed countries (LDCs) at the same level of development while the EPAs are just for the ACP countries. Further, EPAs envisage a wider level of cooperation other than just trade.

The interim period between the signing of the CPA on 23 June 2000 and the launch of the EPAs by 1 January 2008 is supposed to be the time for the negotiation process about the final form and undertakings in the respective EPAs. There are two phases in the negotiation process. The first phase was launched on 27 September 2002 and has been concluded without any bindings as sought by the ACP countries.

During phase I of the negotiation process, the CPA presupposed that ACP member countries will self-determine an appropriate regional trading arrangement, preferably a regional economic community (REC) under which to negotiate with the EU for a new EPA. The REC could either be a free trade area (FTA) or a customs union (CU). EU's preference for RECs in the negotiations is justified under its stated objective of wishing to use the EPAs in the CPA to deepen the regional integration processes in the ACP countries in the hope that deeper regional integration will facilitate eventually the maximisation of these countries gains from the multilateral trade liberalisation and globalisation. In addition to identifying the membership of countries into rationalised RECs for purposes of EPAs negotiations with the EU, the ACP countries expectations under phase I were actually not met since their desire to have a binding common framework from this phase of the negotiations was not attained. Instead, the framework for negotiation of ACP-wide issues remained unresolved. The key issues remain: compatibility with the WTO rules; treatment of non-LDCs at the expiry of the Cotonou Agreement if the EPAs are not concluded; liberalisation of rules of origin; technical barriers to trade and the sanitary and phyto-sanitary issues; safeguards, anti-dumping, and dispute settlement; EU-ACP existing commodity protocols; economic and social implications of the EPAs; and the EPAs implementation mechanisms.

The second phase is to be undertaken on regional basis and began on October 2003 in Western and Central African regions and is expected to start any time in 2004 for the other African regions (East and Southern Africa). In April 2004, the EU held a meeting in Mombasa, Kenya with the Eastern and Southern Africa group with a view to launching the negotiations.

Although the EPAs are expected to generate enormous benefits to ACP countries, these will not materialise spontaneously and instantaneously. Moreover, the implementation of EPAs is deemed to impose a number of severe challenges for ACP countries that include:

- (a) How to manage the expected losses of fiscal revenue in some of the ACP countries;
- (b) How to cope with more competition expected to be entailed under the principle of reciprocity of the EPAs;
- (c) How to ascertain net benefits from the EPAs, especially in LDCs, that is, incentive compatibility between EPAs and the EBA provisions that do not require reciprocity;
- (d) How to deal with limited negotiations capacity because EPAs negotiations will stretch the already limited resources available to the ACP countries;
- (e) How to ensure consistency between the negotiations under the EPAs and that under the Doha Work Programme (DWP), in particular, how to improve market access for agricultural and non-agricultural products that continue to impose difficulties in trade negotiations at the multilateral level.

Given this background, it is evident that there is need for in-depth analytical works, among other things, if African member States in RECs and the RECs themselves are to reap maximum benefits from the new cooperating framework. This study is therefore designed to contribute in this required analytical work in order to seek ways for maximising gains for Africa from the EPAs. Moreover, the study will play a crucial role as an indispensable building block for eliciting common negotiating positions of Africa both at sub-regional and regional level as the EPA negotiations pick momentum. While the study will mainly

contribute to effective participation of African countries in the new ACP-EU framework, it will also expedite Africa's participation in the EPAs trade negotiations.

Problem Statement

As can be seen from the background, there are many questions that arise. The focus of this study will be to quantify the economic and social impacts of the trade liberalisation aspects of the proposed EPAs. More precisely, the study will provide a quantitative assessment of the likely implications of the implementation of the EPAs establishing FTAs between EU and the various RECs. The study will aim to provide suggestions to the specific issues raised in the background to the study, which African negotiators must deal with in the negotiations with their EU counterparts on the form and nature of the respective EPAs within the different RECs. The issues are particularly of concern to policymakers in Africa as they are faced with the challenge of ensuring that the outcomes of the EPAs will be beneficial to the people of Africa, and will have something to show for any sacrifices that Africa needs to make compared to the outcomes of the expired Lomé Convention which has been argued in the literature to have been sub-optimal.

One limitation to being able to carry out the envisaged empirical analysis is the multiplicity of RECs in sub-Saharan Africa (SSA). According to the CPA, it is expected that individual African countries will self-determine under which REC they will wish to negotiate for an EPA with the EU. This self-determination of membership to the RECs is complicated by two current factors. First, most countries in SSA are members of more than one REC. As a result, there is the initial difficulty of rationalising the RECs definition for the purposes of the EPAs negotiations. Second, under the CPA country nomenclature, some of the African countries are identified, as LDCs while others are non-LDCs. Within the existing RECs, some members are LDCs while others are non-LDCs. In which case, the non-LDCs may not be under pressure to conclude an EPA by December 2007 since come 1 January 2008, they will still be able to enjoy non-reciprocal preferences for their exports to the EU through the EBA initiative. However EBA does not involve aid, which means they need to weigh the benefits and costs of increased trade possibilities against the loss of aid.

For the purposes of this study, three propositions are made to justify further the need for empirical analysis. Firstly, it is proposed that it is in the interest of all SSA countries including the LDCs¹ that are guaranteed of EU market access through the EBA to wish to see EPAs concluded in which they are members. The reason behind this proposition is that unlike EBA initiative which focuses on trade aspects mainly, the EPAs are an integrated framework which have development aid component which countries may not wish to lose out on, particularly the elements that deal with addressing the supply-side constraints of the ACP countries. The EBA initiative does not commit to address the supply-side issues² that saw the

¹ It is important to note that when free trade of goods and services eventually becomes a reality, the non-LDCs may be at a stronger position than the LDCs that remain simply under EBA, as the non-LDCs will have been forced to restructure more deeply under EPAs. It is reasonable therefore to assume that EPAs may have more positive effects when compared to EBA initiative with respect to encouraging continuous structural adjustments that enable producers to restructure and hence be more competitive in the various economies that form EPAs.

² Whether an LDC country chooses EBA over EPA, it will still be faced with supply-side constraints. These will even be more pronounced by the fact that whether under EPA or EBA, preference erosion will be a reality when the Doha Round is concluded. Therefore, in order to resolve the supply-side constraints, adjustment will be required in the respective economies. Such adjustment is likely to be delayed under EBA when compared to the

ACP countries being unable to exploit the preferences granted to them under the Lomé Agreement. Thus, there are potentially additional significant developmental gains from the EPAs likely to be inbuilt in the financial and technical cooperation component of the EPAs.

The second proposition is that under the EPA negotiations, agreement is likely to be reached on issues that are of interest even to the LDCs. There is scope under the EPAs for agreements in areas such as the EU commodity protocols on bananas, rice and sugar that the LDCs might also be interested in. Other areas include reduction in agricultural export and production subsidies; more liberal rules of origin compared to those under the EBA; and financial support to deal with revenue losses due to trade liberalisation.

The third proposition is with respect to the question of RECs rationalisation. It is proposed that once both LDCs and non-LDC countries in SSA accept that there is merit beyond trade in concluding EPAs then geographical proximity is an acceptable criterion for determining the member country composition of the RECs to negotiate with the EU. Thus, this study proposes to carry out quantitative analysis of the social and economic impacts of the EPAs at the following regional levels, with each region representing a REC: East and Southern Africa; Southern Africa; Central Africa; and Western Africa.

Research questions

The preceding section has outlined broadly the problem that the study will address. This subsection details the specific questions that the study will seek to empirically provide suggestions on. The focus of the empirical analysis will be on the trade liberalisation component of the EPAs. The following are the specific questions to be addressed.

First, in each REC, how do countries gain and lose based on the impacts on GDP, employment and other macroeconomic aggregates from the bilateral trade liberalisation between the REC and the EU in the EPA.

Second, what sectors lose and what sectors gain for each of the member countries in the EPA. And based on the empirical evidence on the industry structure likely to result under the different EPAs, what can be said on the phasing in period of the trade liberalisation for the goods from the EU? Would application of the asymmetry principle in the EPAs provide sufficient lead-time for the nascent manufacturing sectors in African economies? Article XXIV of the WTO under which the EPAs will be negotiated, requires that any FTAs formed liberalise “substantially all trade” (which has been interpreted to mean at least 90% of the intra-FTA member countries trade) and this has to be done within a reasonable amount of time (interpreted to imply 10 years or so). This study will seek to provide empirical evidence as to whether the 90% intra-regional bloc trade liberalisation for each of the African EPAs is a reasonable proposition and whether the 10 years suggested for this to take place is sufficient³. This will be possible by having sufficient disaggregation of the economic sectors of industries.

EPAs. The important issue then is to note that long-term competitiveness of economies under EBA may be delayed compared to those under EPA.

³ The Cotonou Partnership Agreement aims at reciprocity in trade policy for the EU and the ACP countries. Hence, the EPAs are expected to aim at the final products being FTAs. However, the European Union recently offered (see EC letter by Pascal Lamy and Franz Fischer dated 9 May 2004) to have the developing countries

Third, what are the welfare implications for the African countries and which of them gains and which lose from the EPAs? And what does this portend for the need to have compensatory funds over and above the existing but unutilised European Development Fund (EDF). The welfare implications analysis will further be combined with the potential changes in the economic structure, providing the basis for investigating what it means to have the preferential elimination of SSA tariffs on imports from the EU not cover all the sectors. The issue of which sectors are exempted from preferential trade liberalisation in the EPAs is seen as important as it fits within the infant industry argument that some of the SSA countries would like to see develop. By linking the welfare implications to the sectors exempted from the preferential liberalisation it will be possible to determine which sectors are likely to lead to pro-development outcomes and which should not be exempted simply due to protectionist interests.

Fourth, how does the formation of EPAs affect trade expansion through the trade creation and trade diversion effects? Scepticism with the EPAs has been raised in that they have the possibility of causing significant trade diversion. As a result, proposals have been made for the need to have the SSA countries reduce their applied MFN tariffs concomitantly with their bilateral reduction of tariffs for the EU imports. This study will aim to quantify the trade expansion effects of the bilateral reduction of tariffs with the EU under the EPA both with and without concomitant reduction in the MFN tariffs by the SSA RECs. This analysis will also provide empirical evidence on how the SSA countries can possibly insure consistency between the tariff reductions related to the EPAs and those that may be agreed at the conclusion of the Doha round of trade negotiations. The World Bank has suggested that a pro-development outcome of the Doha round would need to achieve average tariffs of 5% for manufacturing, with a maximum of 10% and an average of 10% for agriculture, with a maximum of 15% (World Bank 2003). It will therefore be possible to have scenarios of EPAs with each REC where maximum MFN tariffs are around the World Bank recommendation.

Fifth, the fiscal implications of the EPAs are seen to be one of the key negotiation issues. Indeed, the development aid component of the CPA in addition to addressing the supply-side constraints of production in the ACP countries is also predicated on the expected loss of revenue. There are two ways that the loss in revenue is viewed to occur. The first is a direct effect due to the zero rating of the imports from the EU. The second effect is through the trade diversion effects, which lead to further losses in revenue. Consequently, this study will also try to quantify the direct revenue implications under each of the EPAs for the REC member countries. The quantification of the trade expansion will provide a basis for estimating the revenue effects resulting due to trade diversion from non-EU to EU producers and suppliers.

Methodology of the study

Trade issues by nature require an analytical framework that allows a holistic view of the world economies. This is not only because of the inter-linkages between the various sectors in any given economy but also because of the relationships between sectors in one economy to the rest of the world economies. These national, regional and global linkages may occur

have the “Doha Round for free” meaning that they will not be expected to implement the agreements on tariff reductions in the on-going multilateral trade negotiations. If this proposal is accepted and forms part of the Doha Round agreement, then the architecture of the EPAs will have to change from what the CPA expects them to be.

either in the inputs or products markets. Therefore, in order to avoid ignoring these linkages, a general equilibrium methodology using the Global Trade Analysis Project (GTAP) model (to be discussed in details in Section V) will be the main analytical instrument to be used in the study⁴. The GTAP methodology uses a multi-country multi-commodity model that requires data on each and every country (see Hertel 1997). However, most African countries do not have up-to-date input-output tables that can be included in the GTAP database. To overcome this challenge, the study will use the limited data available but as much as possible, for each of the RECs, will try to draw parallel between the countries included in the database and those that are not. This is a common approach to resolving the data limitation issue (see Karingi et al. 2002 and ECA forthcoming). As argued in Karingi et al. (2002) in a study of COMESA, an initial look at COMESA member countries may show homogenous agricultural economies. However, when the countries are closely examined, three groupings of countries emerge to constitute COMESA. First group are the purely agricultural economies such as Malawi. Second group comprises of economies with some significant level of manufacturing base such as Zimbabwe. And the third group are those countries rich in mineral resources such as Zambia and Zimbabwe. This meant that, through appropriate disaggregation of sectors (or commodities) in the database, these three characteristics could be captured in detail. Hence, inference could be made on a country that is not part of the database such as Kenya from outcomes of a similarly structured economy such as Zimbabwe. The inference results in the study will be strengthened by the trade statistics analytics (to be done in Section III) for the countries not included in the GTAP database to ensure a current and consistent story.

In using the GTAP model whose database benchmark is 1997, the study will face the challenge of the parallel multilateral negotiations taking place even as the EPAs negotiations proceed. This challenge can however be overcome in the GTAP simulations in the same way that ECA (forthcoming) study on agriculture in the Doha Round did. Essentially, the ECA study simulated the changes that have taken or are expected to take place between 1997 and 2005. Thus, a baseline that captured all the Uruguay Round commitments, the reform of the Common Agricultural Policy of the EU Agenda 2000, China's WTO accession, the implementation of the Agreement on Textiles and Clothing expected in 2005, and the EU eastwards enlargement was constructed. This study, will add to this baseline the policy options in the Doha Round that are relevant to sub-Saharan Africa.

The revenue implications of the EPAs as already pointed out are major concerns for the African countries as majority of them raise a significant proportion of their ordinary revenues from import duties. This then justifies the case for the complementary partial equilibrium analysis using trade statistics to shed more light on the EPAs possible implications. Tekere and Ndlela (2003) have developed scenarios for SADC using this methodology (see more details below) to analyse revenue implication for SADC member countries of different levels of opening up of trade to EU-sourced imports into SADC.

⁴ The GTAP methodology will need to be complemented by partial equilibrium analysis, particularly with regard to revenue implications of the EPAs. Several studies that have looked at this issue of the EPAs to date have tended to employ the partial equilibrium methodology (see Morrissey et al.; Tekere and Ndlela 2003).

Outline of the Study

Section I: Introduction

The study introduces first its motivation, defining the scope through the specific research questions to be addressed.

Section II: Lome Convention to Cotonou Partnership Agreement

This section will review the key issues surrounding the EPAs. This will include first a critical review of the performance of the Lome Agreement in order to put in context the EPAs. Then the vexing issues that the EPAs negotiations will have to contend with such as convergence and/or divergence with the Doha Round; the conflict with the EBA initiative in terms of RECs composition will also be reviewed.

Section III: Intra-African and Africa-EU Trade – The Stylised Facts

Section III will look in details at the different SSA RECs trade issues. In particular, the issues of trade liberalisation under each of the RECs will be focused on emphasising how intra-REC trade has evolved over the years. This will draw heavily from Economic Commission for Africa forthcoming report on the assessment of regional integration in Africa (ECA forthcoming). The section will be reinforced by analysis of the level of trade with the EU by each of the member countries in each of the RECs. This will provide the background necessary for a comparative analysis of the expected trade growth from the EPA with the reality of the Lome Agreement outcomes on trade.

Section IV: Empirical Evidence on EPAs to Date – What do Others Say

Section IV will review the available evidence from the literature on what other studies have done with respect to the EPAs for individual or combination of ACP countries and not just the SSA countries. This will enable us to see what the other studies have found out on the issues that are raised in the current study.

Section V: The Analytical Methodology – Model(s) and Data

This section will discuss in details the methodology to be applied in the empirical analysis. In particular, the GTAP modelling and data framework will be outlined. As much as possible, the initial condition in the RECs as can be deduced from the GTAP database before simulation experiments will be highlighted. As highlighted above, the GTAP model will be complemented with partial equilibrium analysis. The World Bank and UNCTAD have developed a static partial equilibrium model (SMART, see Tekere and Ndlela 2003) that relies on trade data from sources such as individual REC members, TRAINS, COMTRADE and EUROTRACE. The SMART model will therefore be discussed in this section together with the GTAP model. The partial equilibrium analysis will help to overcome some of the shortcomings of the GTAP methodology given that the majority of African countries are not included in the database. The most important thing at this point will to ensure that the benchmark for both the GTAP and partial equilibrium analysis are similar hence the data challenge.

Section VI: Economic and Welfare Effects of the EPAs on sub-Saharan African Countries

This section will be the gist of the study and will provide empirical results on the various questions that were raised in the background to this study. The section will be divided into five sub-sections with each of the first four representing a possible EPA between a given REC and the EU. Similar experiments will be undertaken for each EPA although it is expected that because of the different phases in regional integration (FTA versus customs union) the benchmark is likely to be different for each EPA. The results from the individual EPAs will then be compared with the fifth sub-section that will form an SSA wide EPA with the EU. The objective of this comparison is to indirectly answer the question regarding the importance of rationalising RECs in the continent. The comparative analysis of the results will also provide insights to the debate whether in fact African Economic Community is an attainable deal. In undertaking the empirical analysis on the EPAs, the study will as much as possible take account of dynamic aspects of the move to the FTA with EU. The consideration of the dynamics will probably be the best way of answering issues related to supply side constraints⁵.

Section VII: Conclusions and Policy Recommendations

Section VII will conclude by drawing out the main results from the empirical analysis and will also provide the key issues the African negotiators will need to be conscious about as they engage their EU counterparts. In particular, the link between those issues and the current negotiations under the Doha Round will also be highlighted.

⁵ The EU believes ACP supply side constraints can be adequately addressed through increased openness. The ACP countries on the other hand do not see how the constraints can be addressed without more aid.

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