

2. Challenges Facing the Caribbean During EPA Negotiations

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Introduction

ACP-EU negotiations on Economic Partnership Agreements (EPAs) represent a step into uncharted territory for ACP countries. The preceding five trade cooperation pacts between the two groupings of countries (Lome I-IV and Cotonou) were based on the EU granting non-reciprocal trade preferences. From the perspective of EC, reciprocity is one of the pillars on which EPAs stand.

As stated in its mandate, the EU will seek “*the elimination of customs duties on imports from the EC for substantially all trade over the course of a transitional period*” (Para. 3.2) Both parties already implicitly accept that taking into account the different levels of development between the ACP and EU, the concessions to improved market access will be asymmetric. For example, ACP countries should be granted a longer transitional time period to remove barriers to EU imports.

The ACP conducts these negotiations with two primary goals. Firstly, to halt the decline in the value of their preferential access to EU markets (exacerbated as a result of MFN liberalization, the EU granting other developing countries trade preferences and Agenda reform of the CAP). Secondly, and associated with the first objective, is to strengthen their productive capacity in order to seize marketing opportunities stemming from preferential access to EU markets.

The major fault line in the upcoming negotiations can be generalized as follows: – the EU wants to integrate the ACP into the world economy on the twin basis of strict adherence to tight WTO rules and liberalized markets. The ACP countries seek to carve out a greater policy space in order to pursue their own developmental agenda and appropriate policy measures.

The Costs of Reciprocity

Caribbean economies are extremely open, that is, the ratio of foreign trade to GDP is rather high. The region’s trade regimes are also open with trade-weighted average tariffs pitched at just above 8%. Furthermore, imports on most capital and intermediate goods tend to enter duty free. Any further liberalization of the trade regime might generate welfare gains for consumers, but also welfare losses for both producers and government.

One major component of the cost of granting reciprocity is the loss of fiscal revenues. According to Eastern Caribbean Central Bank Annual Report of 2000, border taxes as a share of recurrent fiscal revenues in six OECS countries area as follows: Antigua (66.1%), Dominica (54.8%), Grenada (61.2%), St. Kitts and Nevis (50.7%), St. Lucia (55.4%) and St. Vincent (50.2%). The options facing the loss of a source accounting for greater than one-half of all fiscal receipts are very limited. Obviously, VAT is an option – either introducing it or hiking its rate. This potential course of action comes with a hefty political, economic and administrative price tag.

Admittedly, the granting of reciprocity is mitigated by the fact that the EU is not the major source of imports. However, the Caribbean is part of two processes – one multilateral and the other hemispheric - that threaten sources of fiscal revenues. The Doha Round is scheduled to conclude in 2005 with all WTO members committing themselves to lowering the bound rates. Similarly, as FTAA negotiations drift towards a conclusion in 2004, parties are presently preparing to table offers. The hemispheric process poses an even greater threat to government revenue given the fact that the United States is the major source of the region's imports.

The cost of reciprocity goes far beyond the loss of fiscal revenue. Granting EU products increased access to Caribbean markets promotes the displacement of national producers with the attendant loss of jobs, productive capacity and growth potential. Under such circumstances, the retraining of workers and instituting appropriate anti-dumping and safeguard measures are required but are also taxing on a small and resource-constrained economy. The net welfare effect of granting reciprocity can be exacerbated in an environment where there is a fiscal deficit depriving governments of the means to cushion economic shocks.

Caribbean Configuration of EPA

The second fundamental difference posed by EPAs vis a vis previous ACP–EU trade pacts is the configuration of the ACP side. Both Lome and Cotonou were hinged on the same trade preferences granted to all ACP. The EU has argued that this one-size fits all approach is responsible for the halving of the ACP share of EU imports over the last decade. This argument ignores other important considerations. Falling ACP market share is the result of a combination of factors, for example, increased role of Eastern Europe in the world trading system, the declining value of preferences caused by multilateral reduction of MFN rates and the EU granting trade preferences to a raft of non-ACP developing countries. Loss of market share might also be testimony to the failure in Lome Conventions to seriously tackle ACP countries systemic supply side constraints.

According to Article 37(5) of CA, the configuration of the ACP side to negotiate EPAs falls within the remit of the ACP group itself. Paragraph 12(b) of the ACP Negotiation Guidelines also addresses this issue by offering regions the chance to discuss region-specific issues during Phase II of EPA negotiations. The EC has made no secret of its preference for negotiations on regional EPAs (REPAs), preferably with the six constituent regions of the ACP. In the animated exchange leading to the adoption of its negotiation guidelines, a host of alternatives to REPAs were floated. For example, EPAs based on specific product lines, e.g. sugar and services. Another proposal, championed by Mauritius and favoured by the Caribbean, called for an all-ACP EPA. A third alternative would be the avoidance of warding the EC reciprocity by settling for GSP. An inability to forge consensus on either one of these proposals left REPAs as effectively the only proposal on the table.

The EC sees EPAs building on regional trade integration efforts. 13 of 16 members of the Caribbean Forum of ACP states (CARIFORUM) are members of a regional integration movement – the Caribbean Community (CARICOM). Cuba and the Dominican Republic – two non-CARICOM members have signed FTAs with CARICOM. Recall however, that Cuba is not a signatory to the Cotonou Agreement and resultantly not a direct participant in EPA negotiations. Bahamas enjoys membership of CARICOM's political institutions but is not a signatory either its Single Market and Economy or Common External Tariff (CET).

EPA negotiations pose a number of challenges to the Caribbean, including regional configuration. Would the Dominican Republic and Bahamas, not members of CARICOM, be compelled to join ranks with all CARIFORUM (except Cuba) to form an FTA with the EU? If the Dominican Republic and the Bahamas negotiate with CARICOM, what would be the economic logic of two constituent parties to an FTA (DR and CARICOM) granting the EU (a block of industrialized countries) enhanced market access conditions that they themselves do not grant each other? Another element of the difficulty of regional configuration revolves around the status of Haiti. This country ranks among the LDCs and accordingly benefits automatically from duty- and quota-free provisions of the EBA. Haiti therefore has the choice of (a) opting out from negotiating a Caribbean-based REPA and therefore relying solely on unilateral market access provisions, or (b) joining CARIFORUM in REPA negotiations with the obvious price of granting the EU reciprocal and preferential access to its market. The choice facing Haiti assumes a regional dimension with that country recent conferral of full CARICOM membership.

EPA negotiations present a second substantive challenge to the Caribbean, namely, how to devise a negotiation strategy for an economically diverse set of countries. The Bahamas' per capita income stood at US\$ 15,000 in 2000,

compared with Haiti's commensurate figure of US\$510. Even if the figures were distorted by Haiti opting out of EPA negotiations, a non-LDC, Guyana, records the region's second lowest per capita income of US\$ 760. Caribbean countries are all small economies by WTO and UN standards. But even here the variance is wide with the Dominican Republic posting the region's highest GDP in 2000 of US\$19.7 billion while at the other pole of the gamut, St. Kitts and Nevis' GDP was US\$310 million.

Changing Profile of Caribbean Economies

The region's recent export performance to the EC compounds the dilemma of shaping a Caribbean agenda for EPA negotiation. For example, the structure of the region's exports to the EC has changed radically in the last decade. According to EUROSTAT data, total Caribbean exports to the EU grew in value from •1.42 billion in 1990 to •3.12 billion in 2001 – a growth rate of 120%. Specifically, Caribbean agricultural exports grew in value from •0.69 billion in 1990 to •1.42 billion in 2001 – an increase of 51%. Faster growth of non-agricultural exports to the EU has pushed the share of agricultural exports from 50% of total exports in 1990 to 33% in 2001.

The data support the anecdotal evidence of the Caribbean no longer an exporter of labour intensive agricultural products facing mature international markets and prices that are both low and volatile. A further signal of this altered trade profile is provided by a cursory glance of the top ten Caribbean exports (measured in terms of value) to the EC in 2001. Only three agricultural products – contributing to 25% of total exports – rum, sugar and bananas, featured among the top ten Caribbean exports to the EC. (The data highlight the high degree of export product concentration within the region. The aforementioned ten product lines generated a staggering 75% of total Caribbean exports in 2001).

Caribbean economies are not only defined by the falling value of agricultural exports. The region's economies are increasingly dominated by services – tourism, finance, IT and distribution. In 2000, Services contributed 73% of GDP in Barbados, 52% in Belize, 55% in the Dominican Republic, 62% in Jamaica, 83% in St. Lucia and 55% in Trinidad and Tobago. Guyana with its dominant agricultural sector was the sole Caribbean country where services was outstripped.

While a Caribbean-EU EPA must reflect the altered economic profile of its constituent members, and in particular the export opportunities, it would be foolhardy not to give due consideration to some of the mature (traditional) industries. Obviously, the rise of the services sector mirrors the decline in agriculture. But statistics can mask more than it reveals. For example, St. Kitts remains dependent on exports of sugar, St. Lucia, St. Vincent and

Dominica on bananas and Guyana's on sugar, rice and rum. While Jamaican exports have diversified in the last decade, sugar and bananas still feature heavily. The imperative of granting due consideration to agriculture (apart from the obvious reference to multi-functionality) – this sector generates one in every three jobs within the region.

The lack of two instruments – financial clout and subscription to appropriate WTO safeguard measures dictates that the region has no recourse to subsidizing agricultural exports à la the US Farms Bill or EU CAP. While the region recognizes the declining value of trade preferences along with bilateral, hemispheric and multilateral processes that reduce MFN rates, creative approaches to improving current conditions of market access for the region's major agricultural exports are urgently required.

ACP preferences on agricultural exports to the EU are linked to the CAP, the mechanism responsible for above world market prices in agricultural products and, in consequence, the source of attraction for Caribbean exports. The two major agricultural commodity exports from the Caribbean to the EU are sugar and bananas. However, in an era of reciprocal trading arrangements, the region might be forced to review its traditional embrace of the CAP. Under an EPA, for example, while the CAP encourages the region's sugar exports, this mechanism simultaneously subjects Caribbean domestic producers to unfair competition from subsidized EU agricultural exports into their own economies.

Improving Market Access Provisions

As stated earlier, Caribbean exports to the EU have more than doubled within the last decade. In spite of this laudable performance, the challenge remains on the matter of retaining market share to the EC. The task is made more onerous by the marked decline in the margins of tariff preference. In order to increase the supply of exportables, improved market access terms form a prerequisite. The altered profile of Caribbean exports offers proof of the pivotal role played by preferences. Methanol from Trinidad and knitted sweaters from Jamaica are two further success stories. The region also benefited from the Multi-Fibre Agreement that effectively capped the volume of low cost exports from Far Eastern countries.

One important area where access to the EU can improve is reviewing existing rules of origin. Like in any other trade agreement, copious pages are reserved for explaining rules of origin under the CA. Both the EC and the ACP recognize the need to simplify such rules. Yet previous commitments to simplify rules of origins have not been fulfilled.

Here, the Caribbean must focus on two core pursuits. The first concerns constructing a rule of origin that is itself a vehicle for the delivery of preferences. The difficulty of succeeding on this front is highlighted by the EC's recent

posture on “harmonizing” rules of origins, irrespective of the level of development of its trade partner. The second pursuit refers to simplifying the law on cumulation. Under existing rules, inputs imported from a list of neighbouring countries can qualify for preferential treatment. This provision could spur increased CARICOM imports from Cuba. Sadly, the experience of potential importers points to this arrangement’s administrative complexity and opaqueness.

Special and Differential Treatment

One of the elements that will determine the success of EPA negotiations will be the kind of special and differential treatment granted to ACP members. There is a universal clamour within the ACP membership for new and flexible WTO rules on S&DT. Specific proposals have been tabled demanding longer phase out periods to dismantle trade barriers; reduced obligations to liberalize trade regimes and the carving out of exemptions on product and sector coverage. From the perspective of the most ACP countries, the award of more generous S&DT provisions would dampen the costs of reciprocity.

The present discussion in Geneva focuses on seeking clarification on the rules governing the notification of Regional Trade Agreements (RTAs) under GATT Article XXIV. One critical concern of the Caribbean relates to the computation of substantive trade. In practice this has been interpreted to stand at 90% of all trade with no sector exemption. In order to offer the region the opportunity of protecting sensitive sectors, Caribbean has argued for these rules to be made more flexible. While this discussion is the preserve of the Council on RTAs, the substance of the discussions revolves around the provision of S&TD.

Coherence Among Various Trade Negotiations

The start of talks on EPAs means that the Caribbean will be negotiating simultaneously in three theatres – WTO, FTAA and EPAs. From a regional perspective, one common thread in all three negotiation theatres will be staunch pursuit of strong S&DT provisions. Para. 44 of the Doha Ministerial Declaration after reaffirming the centrality of S&DT provisions in WTO Agreements, calls for a review of such provisions *with a view to strengthening them and making them more precise, effective and operational*.

In spite of the well-documented lack of progress on this issue in Geneva, the Caribbean has no other option but to seek the issue on the front burner with the WTO. Our European partners have not been particularly helpful in supporting the position of the ACP on this issue of vital importance. In the absence of any movement by Brussels on the treatment of S&DT, ACP negotiators should perhaps consider coupling the pace of negotiations with

the EU position on this issue. If this strategy were pursued, the results of the Cancun WTO Ministerial could serve as a benchmark for the ACP-EU negotiations.

Another point of confluence among all three negotiations will be the imperative of injecting greater flexibility into Article XXIV rules governing the FTAs. Article XXIV was initially crafted to regulate FTAs solely among industrialized countries. While the UR reformulated Article XXIV, it remains a legal quagmire. Resultantly, North-South FTAs are exposed to challenges by other WTO members. In addition, the Caribbean has some fundamental concerns on issues such as product coverage, length of transitional phase-in periods.

Coherence also extends to the inter-relationship between the EPA and FTAA processes. Trade lawyers warn that the MFN provisions within Cotonou make it mandatory for the EU to be automatically granted equivalent treatment as those granted by the Caribbean to any industrialized country. The EC mandate is also unambiguous when it states that:

“... ACP countries shall grant to the Community at any time treatment no less favourable than MFN treatment. This does not apply with respect to concessions made between ACP countries or by ACP countries to other developing countries in the framework of regional agreements or other trade provisions compatible with WTO requirements.”

If the weight of legal opinion is correct, Caribbean negotiations on EPAs have a distinct element of automatism. FTAA negotiations are scheduled to be concluded by latest December 2004 with EPAs following three years later. In this regard, the FTAA negotiations assume even greater importance.

Addressing Supply Side Constraints

Given the level of development of Caribbean countries, trade preferences form a necessary but not sufficient condition for them to trade themselves onto the path of sustainable development. Preferences are redundant in the absence of a steady supply of exportable goods and services. Most ACP-EU trade pacts have recognized this link. Yet, the history of efforts aimed at addressing ACP supply side constraints is a litany of failure. A recent survey of the sectoral distribution of EDF programming showed the following results: Structural Adjustment (30.7%); Transport (21.4%); Governance (7.9%); Rural Development (7.0%) and Water (6.7%). Interestingly, in spite of the new mantra emanating from DG Trade to mainstream trade into NIPs, this programme line received a meagre 0.1% of all EDF resources.

The EC designed and implemented programmes have tended to target poverty reduction as the major aim. In pursuit of this laudable objective, EDF financed programmes have ignored the imperatives of improving the stock of

human capital, addressing inadequate physical infrastructure, low level of technology and poor regulatory framework. Worse, the EC appears wary of committing extra resources beyond EDF to tackle supply side constraints. The problems with EDF programmes extend beyond programme design. One of the major concerns expressed by all ACP partners is the slow disbursement of funds. The Commission itself has given a commitment to reduce the average lag between project approval and disbursement of funds to 3.2 years in four years' times.

Programmes aimed at tackling supply-side capacity constraints form part of the strategic objectives during EPA negotiations. An associated element of this objective is seeking EU contribution to underwrite the costs of adjustment incurred in adopting a more liberalized trade regime. These goals are key to giving weight to the Caribbean hope that EPAs are FTAs combined with a strong developmental component.

Concerns on Phase I

The ACP has now, finally, adopted its Negotiation Guidelines. As most observers are aware, the document calls for a two-phased process of negotiation with Phase II possibly starting in September 2003. The Caribbean favoured a lengthy Phase I covering areas of common interests to all ACP countries. In contrast to the region, the EU is keen on using this period to focus merely on issues of principles and objectives and negotiation structures and timetables.

The Caribbean argued that the following non-exhaustive but indicative list of issues should fall under the ambit of Phase I negotiations - rules of origin, S&DT, competition policies, anti-dumping and countervailing measures, standards, investment, services, commodity protocols, trade facilitation, SPS, financing the costs of adjustment, programmes aimed at addressing supply side constraints, dispute settlement measures, WTO-compatibility, intellectual property measures and trade and environment.

The Caribbean stance on having a substantive Phase I process has been accompanied by a wave of misunderstandings. For example, some argue that the significance of Phase II is devalued by having the same issues discussed under the two phases. Yet, it is difficult to imagine that the EC will not table a uniform set of rules of origin for all of the ACP parties wishing to negotiate an EPA. Whereas Phase I focuses on crosscutting issues of interests to all ACP members, such as those enumerated in Para. 12(a) of the ACP negotiation Mandate, Phase II is specific to the regions or countries negotiating an EPA. Similarly, building on the success attained by developing countries at the Doha Ministerial, why should not ACP countries pursue their common interest in realizing flexible interpretations of both S&DT and Article XXIV provisions within the WTO?

The imperative of a substantive Phase I is grounded not merely on the need to buttress bargaining leverage or overcome capacity constraints. EPA negotiations are scheduled to be conducted within an environment of potentially seismic trade policy developments. For example, the introduction of a new EU GSP in 2004, CAP reform in 2006, the first wave of countries acceding to the EU in 2004, Cancun WTO Ministerial in 2003, the outcome of the Doha Round in 2005 and the conclusion of the FTAA in 2004. This cluster of developments injects an understandable element of uncertainty for Caribbean countries. Prudence dictates that these elements are fully taken into account before tabling commitments under an EPA.

Finally, the region will shortly be embroiled in three simultaneous sets of trade negotiations – EPAs, WTO and FTAA. Perhaps the region has succumbed to a bout of negotiation fatigue, exacerbated by limited negotiation capacity. It should be noted that resource constrained countries have been negotiating trade rounds almost continuously since the Uruguay Round. The conclusion of that landmark trade round spawned the current volley of FTAs. CARICOM has since 1994 concluded FTAs with Colombia, Venezuela, Cuba and the Dominican Republic in addition to negotiating Lome IV, Cotonou and the FTAA.

Conclusion

In summary, EPA negotiations pose a cluster of challenges that the Caribbean cannot sway from. These challenges include the cost of reciprocity, the configuration of a regional EPA, the quest for improving market access conditions from both traditional and new exportables, the need to instil a strong developmental component in EPAs by tackling supply side constraints and obtaining EU funding to underwrite the costs of adjustment and the search for coherence among all FTAA, EPA and WTO negotiations.

EPA will no doubt prove to be a stern test of the region's capacity to defend its fundamental economic interests. At the same time, the Caribbean has every incentive to continue its proactive stance. Here this means tabling specific proposals on rules of origin, law on cumulation S&DT provisions, for example. The need for coherence among the various negotiation spheres compels the region to adopt a joined-up stance with respect to both the substantive issues under discussions and tactical approaches in pursuit of attaining stated objectives.