Navigating New Waters

A Reader on ACP–EU Trade Relations – Volume 1

Edited by Sanoussi Bilal and Roman Grynberg



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VOLUME 1

Edited by

Sanoussi Bilal

Roman Grynberg



COMMONWEALTH SECRETARIAT

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Foreword

After more than four decades of co-operation, the European Union (EU) and the African, Caribbean and Pacific (ACP) countries are at a turning point in their relationship, as they proceed in redefining their trading relations. Moving away from the non-reciprocal preferences granted by the EU to ACP imports to its market, which prevailed since 1975 under the Lomé Conventions and now the Cotonou Agreement, the two parties have agreed to negotiate free trade agreements. These economic partnership agreements (EPAs), to be in place by 2008, should have broad impacts on the ACP countries, reaching beyond traditional market opening.

In a joint effort by the Commonwealth Secretariat and the European Centre for Development Policy Management (ECDPM), this reader aims to provide a broad yet in-depth overview of the issues facing ACP countries, by highlighting key analyses that they have either conducted, stimulated or disseminated, or which have been carried out independently. Offering insights for negotiators and observers alike, the reader presents a comprehensive treatment of specific issues such as market access, services and investment, as well as addressing key cross-cutting themes such as the development dimension, compatibility with the rules prevailing at the World Trade Organization, capacity building, and the negotiating process itself. Perspectives from the regions are also provided, as well as background material to place the debate in its wider historical context. Bringing together a collection of pieces from a host of organizations and independent experts allows this reader to offer a roadmap on the gamut of relevant issues for the negotiations, highlighting key material in each subject area with additional references for further reading (generally available on www.acp-eu-trade.org).

Lingston Cumberbatch
Chairman of ECDPM
Director of the ACP EPA Project Management Unit (PMU)

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Acronyms

ACP	African Caribbean and Pacific countries
ACS	Association of Caribbean States
AFTA	Asia Free Trade Area
AGAO	African Growth and Opportunity Act
AIDCO	EuropeAID Cooperation Office of the European Commission
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South-East Asian nations
ATC	Agreement on Textiles and Clothing
ATPSM	Agricultural Trade Policy Simulation Model
AU	African Union
BEAC	Banque des Etats d'Afrique Centrale
BIT	bilateral investment treaties
BLNS	Botswana, Lesotho, Namibia and Swaziland
BoP	balance of payments
BSE	bovine spongiform encephalopathy
CACM	Central American Common Market
CAIC	Caribbean Association of Industry and Commerce
CAP	Common Agricultural Policy
CAREC	Caribbean Epidemiological Centre
CARICOM	Caribbean Community and Common Market
CARIFORUM	Caribbean Forum
CARIFTA	Caribbean free trade area
CAST	Caribbean Action for Sustainable Tourism
CBERA	Caribbean Basin Economic Recovery Act
CBI	Caribbean Basin Initiative
CCJ	Caribbean Court of Justice
CDB	Caribbean Development Bank
CDE	Centre for the Development of Enterprise
CEE	Central and Eastern Europe
CEEC	Central and Eastern European countries
CEMAC	Communauté Economique et Monétaire d'Afrique Centrale
CET	common external tariff
CFP	Common Fisheries Policy
CFSP	Common Foreign and Security Policy
CHA	Caribbean Hotel Association
CHARMS	Caribbean Hotel Association Reservation Management System
CIDA	Canadian International Development Agency
CIF	cost–insurance–freight
COMESA	Common Market for Eastern and Southern Africa
Comtrade	Commodity Trade Statistics Database (United Nations)
COTED	Council for Trade and Economic Development
CPA	Cotonou Partnership Agreement

CPC	United Nations Central Product Classification Code
CRS	computer reservation system
CRTA	Committee on Regional Trade Agreements (WTO)
CSME	CARICOM Single Market and Economy
CTI	Confederation of Tanzanian Industry
CTA	Technical Centre for Agriculture and Rural Cooperation ACP-EU
CTO	Caribbean Tourism Organisation
DCs	developing countries
DDA	Doha Development Round/Agenda
DFID	Department for International Development (UK)
DRC	Democratic Republic of Congo
DWP	Doha Work Programme
EAC	East African Community
EBA	Everything-But-Arms initiative
EC	European Commission
ECA	European Court of Auditors
ECCAS (CEEAC)	Economic Community of Central African States (Communauté Economique des Etats d'Afrique Centrale)
ECO	Economic Cooperation Organization
ECOWAP	Economic Community of West African States Agricultural Policy
ECOWAS	Economic Community of West African States
EDF	European Development Fund
EDFIs	European Development Financing Institutions
EEA	European Economic Area
EEC	European Economic Community
EEZ	Exclusive Economic Zone
EFP	European Financing Partners
EFTA	European Free Trade Association
EIB	European Investment Bank
EPA	Economic Partnership Agreement
ESA	Eastern and Southern Africa
ESRF	Economic and Social Research Foundation
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FCFA	Franc de la Communauté Financière Africaine
FDI	foreign direct investment
FOB	Freight-on-Board
FPA	Fisheries Partnership Agreement
FTA	free trade agreement
FTAA	Free Trade Area of the Americas
FUG	ACP Follow-Up Group
FVO	Food and Veterinary Office
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDS	Global Distribution System
GRT	Gross Registered Tonnage
GSP	Generalised System of Preferences

GSTP	Global System of Trade Preferences
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
HACCP	Hazard Analysis Critical Control Point
HS	Harmonised System
IADB	Inter-American Development Bank
ICSID	International Centre for the Settlement of Investment Disputes
IDA	International Development Association
IF	Investment Facility
IFC	International Finance Corporation
SME	Small and Medium Enterprise
IFTO	International Federation of Tour Operators
IGAD	Inter-Governmental Authority on Development
IICA	Inter-American Institute for Cooperation on Agriculture
IOC	Indian Ocean Commission
IPPC	International Plant Protection Convention
ISO	International Organisation for Standardisation
IT/ICT	Information Technology/Information and Communication Technology
IUU	Illegal, Unregulated, Unreported (fishing)
JCCI	Johannesburg Chamber of Commerce and Industry
JEC	Joint Economic Council (Mauritius)
JTAT	Jamaica Trade and Adjustment Team
LDC	Least Developed Country
LVC	local value content
MDGs	Millennium development goals
MERCOSUR	Mercado Commun del Sur/Southern Common Market Agreement
MFN	most favoured nation
MIF	Multilateral Investment Fund of the Inter-American Development Bank
MRA	Mutual Recognition Agreement
MRLs	Maximum Residual Levels
NAFCOC	National African Federated Chamber of Commerce and Industry
NAFTA	North American Free Trade Agreement
NDTPF	National Development and Trade Policy Forum
NEDLAC	National Economic Development and Labour Council
NEPAD	New Partnership for Africa's Development
NIP	National Indicative Programme
NPC	net production cost
NTBs	non-tariff barriers *or* non-trade barriers
OECD	Organisation for Economic Cooperation and Development
OECS	Organisation of Eastern Caribbean States
OED	Operations Evaluations Department
OIE	International Office of Epizooties
OIRSA	Regional International Organisation for Plant protection and Animal
ORCs	Other regulations of commerce
ORRCs	Other restrictive regulations of commerce
PICTA	Pacific Island Countries Trade Agreement
PMU	Programme Management Unit
PRSP	Poverty Reduction Strategy Paper

PTA	Preferential Trade Area for Eastern and Southern African States
PTY	Proprietary
PUCMM	Pontificia Universidad Católica Madre y Maestra
QTC	The Quality Tourism for the Caribbean programme
RFMOs	Regional Fisheries Management organisations
RIAs	Regional integration agreements
RIBs	Regional Integration Budget Support Facility
RIOs	Regional Integration Organisations
RIP	Regional Indicative Programme
RNF	Regional Negotiating Forum
ROO	Rules of Origin
RPTF	Regional Preparatory Task Force
RTAs	Regional trade agreements
SACOB	South African Chamber of Business
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAPTA	South Asian Association for Regional Cooperation (SAARC) Preferential Trading Arrangement
SAT	Substantially all trade
SDT	Special and Differential Treatment
SEM	Single European Market
SME	Small and Medium-sized Enterprise
SPS	Sanitary and Phytosanitary Standards
STDF	Standards and Trade Development Facility
TBT	technical barriers to trade
TCB	trade capacity building
TRQs	Tariff rate quotas
TRTA	trade-related technical assistance
TSA	Tourism Satellite Account
UDEAC	Union Douanière et Economique de l'Afrique Centrale
UEMOA	Union Economique et Monétaire Ouest Africaine (West African Economic and Monetary Union)
UHT	Ultra Heat Treatment
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCLOS	United Nations Convention on the Law of the Sea
UNCTAD	United Nations Conference on Trade and Development
UNCTNC	United Nations Centre for Transnational Corporations
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
UNIDO	United Nations Industrial Development Organization
USA	United States of America
USAID	United States Agency for International Development
USVI	United States Virgin Islands
UWI	University of the West Indies
WAEMU/UEMOA	West African Economic and Monetary Union
WHO	World Health Organization

WPDR	Working Party on Domestic Regulation (at World Trade Organisation)
WTO	World Trade Organization
WTO-OMT	World Tourism Organisation
WTTC	World Travel and Tourism Council

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I

Introduction

1

EPAs Make Sense Only if They Foster Development: A Broad Overview

Sanoussi Bilal and Roman Grynberg

EPAs: Best or worst case scenario?

Imagine two regions: one rich, the other poor. The rich one, which likes to consider itself a free trader, had traditionally kept its market open to imports from the less prosperous region. Yet, the poor region has over several decades generally failed to develop capacity to export products beyond a few primary commodities.

Conscious of the moral imperative to strive for a more equitable world, and hence to foster the development of the poorer region, the rich region decides to make a generous offer. It proposes to negotiate a joint partnership with the poor region to promote its economic development. The principles are simple. Let us stimulate private sector investment by creating a large market among the poor countries. Let this market be open to foreign investment and exports from the rich, so as to benefit the local economy (consumers and industry) in the poor region. By enshrining their domestic trade (-related) policy and regional integration efforts in a formal agreement with the rich region, governments in the poor region would increase the credibility of their reform process. This pro-development approach would be reinforced by removing not only tariffs in goods, but also on trade in services, as well as other technical barriers to trade (TBTs) and behind-the-border restrictive measures. Last, but not least, the institutional and productive-capacity development, domestic policy reforms and adjustment measures needed to accompany the economic liberalisation would be supported by appropriate development assistance from the rich region.

Consider now two other similar blocks, where this time the prosperous region, having granted for decades almost free access to its market to products from the poor region, realises that charity does not pay off: it is costly for the rich while it fails to boost the economies of the poor. It therefore puts the following deal on the table: either the poor countries lose their preferential market access to the rich region, or they open their own market to capital, goods and services from the rich, under the conditions dictated by the rich regions. Besides, rich entrepreneurs having little to no interest in tiny underdeveloped market in a poor country, the poor countries are summoned to come together and adopt common external and internal economic policies so as to create an effective, large, integrated internal market. To sell their iniquitous programme to the poor, the rich region flexes its muscles while wrapping its arguments in the politically correct language of poverty alleviation and development. Promising development aid that it fails to deliver at any significant level, the rich region revels in a paternalistic approach, claiming to promote the interests that the poor region has been unable to effectively defend.

These two scenarios, of the good North–South partnership and the shrewd cold-hearted free trade agreement, are perhaps just two sides of the same coin. Call the rich region the European Union (EU), and the poor one the group (or any sub-regional grouping) of the African, Caribbean and Pacific (ACP) countries.

The two regions have, since the creation of the European Economic Community in 1957 and the decolonisation process, established a privileged relationship. This has been enshrined in the so-called Yaoundé agreements (1963–1969; and 1969–1975), followed by the four successive Lomé Conventions (1975–2000), under which the EU has granted, on a non-reciprocal basis, a preferential (almost free) market access to ACP imports, accompanied by a substantial development (aid) component. With the signing, in 2000, of the Cotonou Agreement –

the successor to Lomé IV bis Convention – the ACP and the EU agreed to enter negotiations on economic partnership agreements (EPAs), which are envisaged as deep free trade agreements (FTAs) between the EU and ACP regions. The negotiations, which started in September 2002, should lead to the entry into force, by 1 January, 2008, of EPAs between the EU and six ACP regions (Central Africa, East and Southern Africa, Southern Africa, West Africa, the Caribbean and the Pacific).

Depending on whether or not one considers this initiative as conducive to the pro-poor sustainable development of ACP economies, one will characterise EPAs as an example of the best-case scenario, or the worst-case scenario.

The European Commission, and in particular its Directorate General (DG) for Trade, heartedly subscribes to the vision of the EPAs as the best-case scenario. At the other end of the spectrum, some actors have denounced the newly envisaged EPAs as a unilateral initiative by the EU to impose on the ACP a new trade regime ultimately detrimental to their development interests.

In effect, EPAs will have a beneficial effect on ACP countries only if the development dimension is properly integrated into an EPA. Similarly, the impact of EPAs on the regional integration process of ACP countries will depend on the way the EPA process is formulated and implemented. In any case, EPAs will have far-reaching consequences for the regional integration of the ACP countries. They will also set a new paradigm for the relationship between the EU and its former colonies, which will lead to a substantial revision of the framework for development and political relations currently embodied in the Cotonou Agreement.

The purpose of this chapter is to review the principles and process of EPA negotiations, and to discuss the coherence between the EPA process, its development dimension and the regional integration agenda of ACP regions.

The Cotonou Agreement, EPAs and EU perspective

The EPAs, following the framework outlined in the Cotonou Agreement, will be trade agreements between the EU and the ACP countries ('in a position to do so' – Art. 37.5) based on the principle of reciprocity, progressively removing barriers to trade between them in a way compatible with World Trade Organization (WTO) rules. Under the current multilateral trading regime, this implies that EPAs will be free trade agreements in the sense of GATT Article XXIV on regional trade agreements.

The economic and trade co-operation provisions of the Cotonou Agreement explicitly provide for the coverage of standard market access issues for goods, commodities and services (with specific reference to maritime transport, information and communication technologies and the information society, as well as support to the tourism sector). The Cotonou Agreement also provides for increased co-operation in important trade-related areas, such as competition policy, the protection of intellectual property rights, standardisation and certification, sanitary and phytosanitary measures (SPS), trade and environmental considerations, trade and labour standards, consumer policy and the protection of consumer health, and envisages possible agreements on fisheries and food security.

These Economic Partnership Agreements are thus officially envisaged by all parties as development-oriented free trade agreements (FTAs) between (regional) groups of ACP countries and the EU. Besides trade in goods and agricultural products, they will also cover services, possibly up to an extent that goes beyond the provisions currently negotiated at the multilateral level through the General Agreement on Trade in Services (GATS). For some ACP countries, this is of key importance because services constitute an increasingly significant sector of their economies, and present a possible engine for further economic growth in the future. Moreover, a whole range of trade facilitation and trade related matters would be covered under EPAs. Among them, the European Commission would like EPAs to cover issues such as competition policy, investment, sanitary and phytosanitary measures (SPS), standards and certification, protection of intellectual property rights, anti-dumping and anti-subsidy measures, customs procedures, rules of origin, public procurement, trade and environment, trade and labour standards and health and safety regulations

(Articles 45–54). ACP countries, however, have expressed mixed reactions to the heavy agenda on trade-related issues, which they generally would like to see narrowed down to some key issues, subject to their own regional integration agenda.

For the European Commission (EC), and in particular the Trade Directorate General (DG Trade), EPAs will foster development mainly through trade liberalisation and the creation of the right policy framework to attract investment. By creating free trade areas (FTAs) with the EU, the ACP regions will benefit from the standard gains from trade: increased market access to the EU for ACP exports, reduced prices of EU imports for ACP consumers, and associated competitive effects should foster economic growth and hence development. In addition, by building on the ACP regional integration processes, EPAs should contribute to the establishment of effective regional markets in the ACP, thus attracting and stimulating (both domestic and foreign) investment, a necessary condition for sustainable development.

In the views of the EC, these positive effects will be reinforced by several elements. First, EPAs will not only address tariff barriers, but also non-tariff and technical barriers to trade, as well as a number of trade-related 'behind the border' measures (such as trade facilitation, competition, investment, etc.). This broad coverage should provide effective greater market access and market integration, thus increasing the benefits from trade.

Second, EPAs will not only cover trade in goods and agricultural products, but also in services, possibly up to an extent that goes beyond the provisions currently negotiated at the multilateral level through the General Agreement on Trade in Services (GATS). For some ACP countries, this is of key importance because services constitute an increasingly significant sector of their economies, and present a possible engine for further economic growth in the future.

Third, with their comprehensive coverage, EPAs should contribute to lock in policy reforms in the ACP, increasing the relevance and credibility of the regional integration process of ACP regions, and facilitating their integration in the world economy.

Last, but not least, trade negotiations for the establishment of EPAs take place in the context of the Cotonou Partnership Agreement, which comprises two other pillars, namely political relations and – of key relevance here – development. EPA negotiations should thus be accompanied by discussions on the development assistance available for the ACP (currently under the European Development Fund – EDF), as well as possible complementary support by other donors. To facilitate this process, Regional Preparatory Task Forces (RPTFs) have been set up, outside but closely linked to the formal EPA negotiations setting. Comprising development officials and experts from both the EC and the ACP region concerned, their aim is to 'cement' the strategic link between the EPA negotiations and development cooperation. In particular, they should contribute with (innovative) ideas for cooperation activities, help in the identification of sources of assistance required for EPA-related capacity building and facilitate the efficient delivery of such support.

From Lomé to Cotonou: Shift of paradigm

The decision to negotiate economic partnership agreements, based on the principle of reciprocal market opening, with ACP groupings and not the ACP group as a whole, marks a clear change of paradigm in the ACP–EU partnership, which tends to mark the end of the specificity of the group of ACP countries in their relations with the EU.

Relations under Lomé

European co-operation with the ACP countries dates back to the Treaty of Rome that established the European Economic Community (EEC) in 1957. In the Treaty, the signatories expressed solidarity with the colonies and overseas countries and territories and committed themselves to contribute to their prosperity. The first formal association of ACP and EEC countries took shape through the so-called Yaoundé I (1963–69) and Yaoundé II (1969–75) agreements. At the time, the lion's share of the resources went to French-speaking Africa, mainly aiming to build infrastructure in the wake of decolonisation.

EEC membership by the United Kingdom in 1973 led to the signing of the wider Lomé Conven-

tion between 46 ACP countries and the then nine EEC member states (1975–80) and the effective creation of the ACP group. The first Lomé Convention was very much a child of its time. It reflected the relative geopolitical power of ACP countries in the context of the Cold War, the oil crisis and the prevailing ideological debate on a 'new international economic order'. Four successive Lomé Conventions (1975, 1979, 1984 and 1989 – over ten years) represented the world's largest financial and political framework for North–South co-operation.

Initially, the Lomé Convention was considered to be a highly innovative model of international co-operation. The aid and trade components of Lomé co-operation provided predictable aid flows over five year periods as well as non-reciprocal trade benefits. As for aid, equal partnership was the cornerstone of the first conventions. It gave ACP countries the responsibility for their own development by entrusting them with a lead role in managing Lomé resources, with the EU[1] playing a supportive role only. In its trade provisions, Lomé I introduced the so-called Stabex scheme to help stabilise export receipts on a wide number of agricultural products such as cocoa, coffee, groundnuts, and tea. Lomé II created a similar mechanism (Sysmin) for countries that were heavily dependent on mineral resources and suffered export losses because of declining world prices. In addition, the EU also agreed on separate trading protocols on sugar, beef and veal, bananas, and rum. The banana protocol, for instance, gave duty-free entry to the EU market for a specific quota of bananas and has been a lifeline for many small Caribbean states that could not compete in the world market. Under the sugar protocol, the EU still buys a fixed quantity of sugar each year from ACP producers at guaranteed prices, higher than world prices.

Despite the continuity of the four Lomé Conventions, which were revised every five years, ACP–EU relations changed over the course of time, especially after 1990. During that decade, European calls for changes in the relationship in all of its three main pillars – political dialogue, co-operation and trade – gradually built up until they cumulated in proposals that set the stage for replacing the Lomé Convention by the Cotonou Agreement.

In the political sphere, the initial principles of state sovereignty and equal partnership came under more and more pressure as the EU pushed for human rights, democracy and the rule of law to become increasingly part of the dialogue. There were several reasons why this change came about. Since the end of the Cold War, the ACP group diminished in terms of geo-political, security and economic importance to the EU. Also, other international arrangements became more of a priority – such as the eastward enlargement of the Union itself.

Besides the changing political nature of the agreement, the international cooperation pillar also came under increased scrutiny. On paper, the Lomé Convention may have been the finest and most complete framework for North–South co-operation. In practice, however, it evolved into a very complex tool, with too many objectives, instruments and procedures. The result was often reflected in long delays, bureaucratisation, reduced efficiency, and questionable development impact. Though through Lomé the EU had turned into the world's most generous provider of development assistance, its influence and impact as a global player were felt to be far below its potential.

In addition, the Lomé trade regime was increasingly challenged for reasons of both effectiveness and political acceptability. Despite preferential access to EU markets in as much as 99% of all products, ACP export performance had deteriorated over time (its share of the EU market declined from 7% in 1975 to 4.3% in 1980 and 3.1% in 2002). As can be seen in Figures 1, 2 and 3, in all three main ACP regions, export performance was below the world average during the past two decades. In many ACP countries, the structure of domestic economies along with domestic policies constrained effective usage of European trade preferences. Moreover, the most targeted of preferences, those based on tariff quotas for agricultural products at prices based on internal EU prices by their nature retarded economic diversification. As a consequence, diversification away from traditional export products remained very limited: 50% of total ACP exports to the EU are still concentrated in only eight products. Strikingly, non-ACP developing nations that had not enjoyed preferential access have been outperforming the ACP group in exports to the EU.

Figure 1. Evolution of ACP merchandise exports by region since 1980 (1980 = 100)

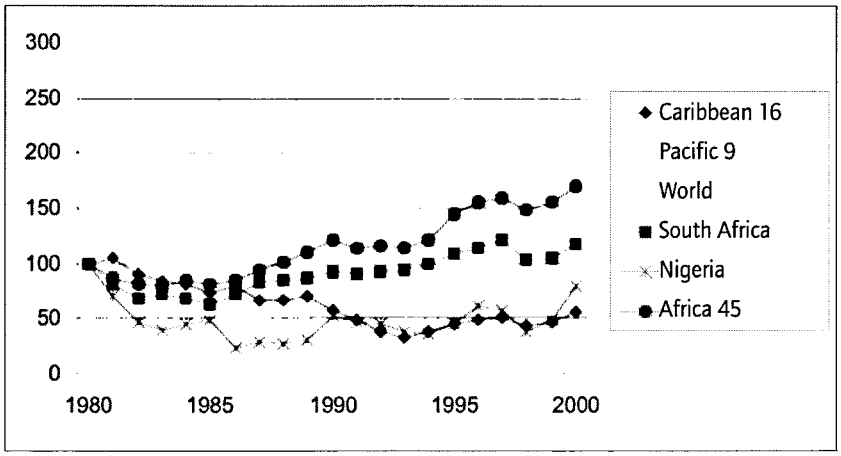


Figure 2. Evolution of merchandise exports: 1950-2000 (1950 = 100)

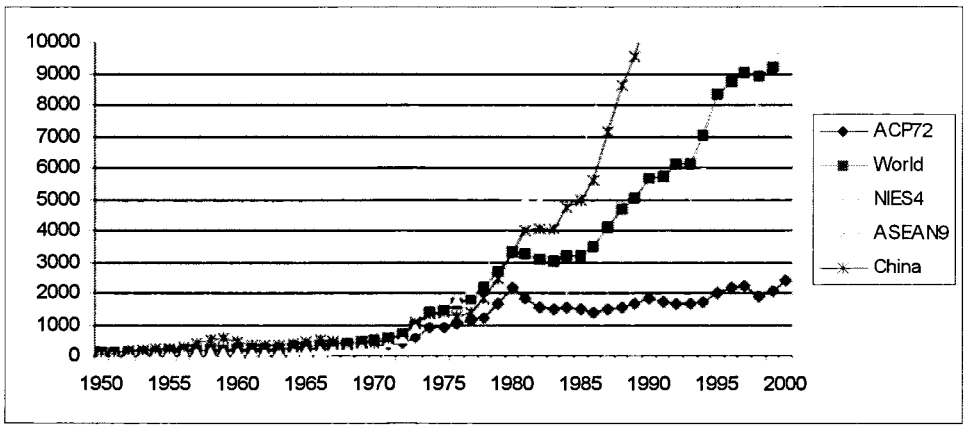
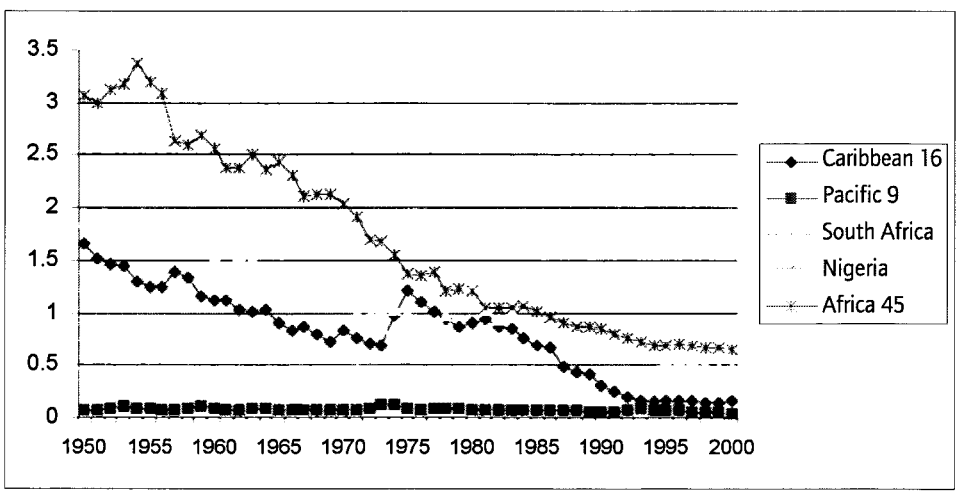


Figure 3. Evolution of share of ACP exports in world total by region: 1950-2000



Source: UNCTAD (2002), *Participation of the African, Caribbean and Pacific Group of States in International Trade*, UNCTAD/DITC/TNCD/Misc.27, www.unctad.org/en/docs/poditctncdm27.en.pdf

Another important factor concerned the increasing tension between ACP trade preferences and WTO rules. The problem with the Lomé trade arrangements was not that it offered non-reciprocal trade preferences, but that it discriminated between ACP and non-ACP countries of similar levels of development. Following mounting pressures at the GATT/WTO, the EU finally obtained a waiver from other WTO members for the second period of Lomé IV (1995–2000), thus temporarily exempting the ACP–EU trade regime from challenges by third countries. Yet, as one of the main proponents of the multilateral trading system, the EU argued that future trade arrangements with the ACP would need to comply fully with WTO rules. When the EU sought once again a renewal of the Cotonou waiver at the Doha Ministerial conference in 2001 it was forced to make substantial trade concessions to non-ACP developing countries.

New elements in the Cotonou Agreement

With such a range of pressures on the Lomé partnership, the European Commission took the initiative in 1996 to launch a broad-based consultation process on the future of ACP–EU co-operation. This process led to the so-called 'Green paper' (1996) and set the scene for the negotiations of a successor agreement between 1998 and 2000.

From the outset of the negotiating process, it became clear that in these post-Lomé negotiations would not be business as usual. From an EU perspective, the imperatives were: to apply greater aid selectivity and differentiation in the treatment of ACP countries; to link aid and performance; to make the trade regime 'compatible' with the requirements of the WTO; to ensure a closer involvement of civil society, the private sector and the economic and social actors; as well as to rationalise Lomé co-operation instruments. During the negotiations, the ACP took mostly defensive positions, aiming to preserve traditional Lomé cornerstones such as sovereignty, autonomy in the management of EU assistance, and non-reciprocal trade preferences.

Yet, when the new Cotonou Partnership Agreement (CPA) was signed in June 2000, it became clear that the new agreement contained elements that strongly departed from the previous Lomé Conventions. The key changes include:

- a reinforcement of the partnership's political dimensions;
- the extension of the partnership to new (non-state) actors;
- more rationalised and performance-based aid management; and
- the transformation towards new WTO-compatible trade relations.

Stronger political foundation

The first major innovation in the new agreement is the stronger political foundation given to the ACP–EU partnership (Title II, Part 1). The essential elements underpinning ACP–EU co-operation already existed under the Lomé IV bis Convention. They include respect for *human rights, democratic principles and the rule of law*. A violation of any of the essential elements may provide grounds to suspend EU assistance and trade co-operation with the ACP country concerned (Article 96). Yet, under the Cotonou Agreement, a broad range of political issues that fall outside the range of traditional development co-operation (e.g. peace and security, the arms trade, migration) are also included. It is the intention of both parties that the joint ACP–EU institutions, such as the ACP–EU Councils of Ministers, the ACP–EU Ambassadorial Committee and the ACP–EU Joint Parliamentary Assembly, will play a more effective role in addressing these issues.

The EU had wanted good governance to be included as an 'essential element', whose violation could lead to a suspension of EU aid. After lengthy discussions, good governance was accepted as a 'fundamental element', meaning that in itself it would not constitute a ground for suspension. However, both sides did agree that serious cases of corruption, including acts of bribery, could trigger a consultation process, possibly leading to a suspension of aid (as a measure of last resort).

Extending the partnership to new actors

A second major new feature relates to the participation of non-state actors and local authorities. A new

chapter on the actors of partnership (Chapter 2 in Title I, Part 1) recognises their complementary role to central governments and defines basic principles for their participation.

ACP governments will continue to be responsible for determining the development strategy for ACP countries. Yet non-state actors (civil society, private sector, trade unions, etc.) and local authorities will be involved in consultations and planning of national development strategies, provided with access to financial resources, and involved in the implementation of programmes. They will also receive capacity-building support.

Among the new actors, most attention is given to the private sector. Its role as engine for development is explicitly recognised. A comprehensive programme of action to support the private sector at different levels is outlined. For the first time the private sector will have access to funding via the European Investment Bank (EIB) without requiring a state guarantee. A new Investment Facility aims to stimulate regional and international investment, while strengthening the capacity of local financial institutions

Programming of EU assistance

A third innovative element is related to performance-based aid management, the simplification of instruments and rolling programming (Part 4).

The CPA marks the end of the 'aid entitlements' (i.e. fixed allocations regardless of performance). Instead, the EU can use the resources for the ACP in a more selective and flexible way. Aid allocations will be based on an assessment of each country's needs and performance with the possibility to regularly adjust financial resources in light of this assessment, through a system of rolling programming. In practice, it means that more money can be channelled to 'good performers' and that the share of 'bad performers' can be reduced.

All this means that programming of aid resources becomes a strategic management tool, aimed at ensuring that the EU support to a given country or region is deployed in a much more effective and coherent manner. However what remains uncertain is the extent to which development assistance will as a result be channelled to those more-developed countries in the ACP rather than towards the LDCs which are in greatest need.

Trade under Cotonou

Though the changes affecting ACP–EU political dialogue, participation of new actors, and aid management are all important deviations from Lomé, the most radical innovation concerns the area of trade. Whereas for the last 25 years, the Lomé Convention granted non-reciprocal market access to the ACP, the CPA foresees the establishment of several reciprocal trade and economic co-operation agreements between the EU and different groups of ACP countries.

Trade provisions in the Cotonou Agreement

Part 3 of the Cotonou Agreement, Title II – covering Economic and Trade Cooperation – sets the path for replacing the current non-reciprocal preferential market access for the ACP group with new, WTO-compatible trading arrangements. These arrangements are scheduled to enter into force by 2008 at the latest. During the transitional period up to 2008, the time in which negotiations for the new arrangements are to take place, Lomé trade preferences have been temporarily extended.[2]

The option for new trade arrangements that is described most in detail in the CPA is that of Economic Partnership Agreements (EPAs). The concept of EPAs comes down to WTO-compatible and reciprocal free trade agreements (FTAs) between the EU and (preferably) sets of ACP regional groupings. EPAs would aim to go beyond 'traditional' free trade agreements, which only cover trade in merchandise goods. Instead, EPAs would include trade in agriculture and fishery products, trade in services, as well as rules on investment. In addition, co-operation is foreseen in a number of trade-related (regulatory) areas such as competition, intellectual property rights, standardisation and certification, sanitary and phytosanitary measures (SPS), trade and the environment, trade and labour standards, consumer policy, and food security.

However, EPAs are not the only possibility for new trading arrangements with the EU. ACP countries belonging to the group of least-developed

countries (LDCs) can opt for the 'Everything But Arms' (EBA) initiative, which provides duty- and quota-free access to all LDCs. For non-LDC ACP countries that want to opt out of EPA negotiations with the EU, alternative arrangements are to be examined in 2004 (Article 37.6).

Five principles as a framework

Both the general scope and the content of EPAs are well-described in the Cotonou Agreement. EPAs are not foreseen to be just ordinary FTAs. Rather, they are to be *FTAs plus*, having a clear development dimension. In that respect, **sustainable development and poverty reduction** can be seen as the overarching principles that should guide the formation of EPAs (Article 34). The remaining four principles are to serve as a framework for the current negotiations: regionalism, reciprocity, differentiation and WTO-compatibility.

Reciprocity. The most important element of an EPA is the establishment of a (bi-regional) FTA, which will progressively abolish substantially all trade restrictions between the EU and the ACP countries concerned (Article 37.7). This is a radically new element in ACP–EU trade relations. For the first time, ACP countries will have to open up, on a reciprocal basis, their own markets to EU products in order to retain their preferential access to the EU market. In addition, ACP regions that negotiate EPAs will have to enhance their own integration in order to jointly negotiate an EPA. Thus except for trade liberalisation *vis-à-vis* the EU, ACP countries would need to open their markets towards their regional partners. The rationale for reciprocity rests on the principle that liberalisation of ACP (regional) markets will create larger markets and increase competition within ACP economies, stimulating (EU) investment and the necessary economic adjustments processes, leading to growth and development.

Regionalism. As mentioned, the CPA clearly envisages negotiations with ACP regional groupings that will be in a position to negotiate EPAs. Though the EU has not ruled out the possibility of concluding agreements with single countries, this is only likely to happen in exceptional cases, and when such an agreement does not fracture the regional integration process of the country concerned. The principle of basing the future trade co-operation on regional integration initiatives stems from the conviction that regional integration is a key stepping stone towards further integration into the world economy, as well as a main instrument to stimulate investment and to lock in the necessary trade and economic reforms (Article 35.2).

Differentiation. Considerable weight in the CPA is given to differentiation and special treatment, which affirms the North–South character of the relationship. The agreement states that EPAs will take into account the different levels of development of the contracting parties (Article 35.3). Hence, EPAs should provide sufficient scope for flexibility, special and differential treatment, and asymmetry. In practice, this could mean that certain ACP countries will be allowed longer transitional periods before their markets are fully liberalised or that certain sectors are entirely excluded from liberalisation. In particular LDCs, small and vulnerable economies, landlocked countries and small islands, for which special provisions have been included in the CPA (Part 5), should be able to benefit from differential treatment in EPAs.

WTO compatibility. Underlined by various articles in the CPA, EPAs should be compatible with WTO rules. WTO compatibility is pursued to prevent the new arrangements from being challenged by other WTO members. Yet, there exists considerable scope for tension between this principle and the aforementioned principles of regionalism and differentiation. As some of the relevant multilateral rules concerning FTAs and special and differential treatment are currently being renegotiated in the Doha Round, it remains uncertain how much flexibility is available for the EPAs that are currently being concluded.[3]

Alternatives to EPAs[4]

The Cotonou Agreement does not contain provisions that bind the EU or the ACP countries to conclude EPAs. On the contrary, it is stated that in 2004, the Commission will review the state of affairs and propose alternatives for those countries that 'decide that they are not in a position to enter

into economic partnership agreements' (Article 37.6). Though the scope and content of these alternatives are currently uncertain, the most commonly referred to alternative to EPAs is the EU Generalised System of Preferences (GSP), in one form or another. The current EU trade system entails FTAs, the Cotonou Agreement, the GSP, and its specific 'Everything But Arms' (EBA) provisions for least-developed countries (LDCs), and MFN (most-favoured nation) duties. With the end of the Cotonou regime of preferences, the existing available options of preference for the ACP are therefore an FTA/EPA or the GSP/EBA.

GSP (+)

Taking into account the difficulties entailed in seeking a reform of GATT article XXIV and the possible opposition of certain WTO members, many EU officials, consider the EU GSP the only real alternative to EPAs. The reflections on this option tend, however, to focus on the weaknesses of the current GSP, its recent evolutions and the possibility of reforming it further to make it more suitable to (non-LDC) ACP countries' needs.

The EU considers the GSP to be an inferior alternative to an EPA, a clear 'second best', since it is unilateral in nature covering only market access without any developmental dimension. Additional common critiques to the existing GSP include:

1. The GSP market access conditions (tariff preferences, thresholds triggering the imposition of safeguard measures, rules of origin) are less advantageous than those in the Cotonou framework. Moving from the Cotonou *acquis* to the GSP would contradict the Cotonou Agreement provision that in the context of the new trading arrangements no ACP country shall be worse off and 'on the Community side trade liberalisation shall aim at improving current market access for the ACP countries'.[5]
2. Since it is not a contractual arrangement the GSP lacks predictability and therefore does not provide any incentive for investors.
3. The graduation system included in the EU GSP reduces the appeal of this scheme as a long term basis for the ACP–EU economic partnership.
4. All developing countries are entitled to the GSP preferences, and this further reduces the market access attractiveness of the GSP for the ACP.
5. Given that GSP schemes obey to the WTO Enabling Clause principles, they cannot differentiate among non-LDC developing countries, and therefore do not offer the flexibility requested by ACP countries to take into account the particular needs of small island and landlocked ACP states.

The recent legal history of the EU GSP has partly confirmed this last point, demonstrating that a preferential scheme can be challenged successfully at the WTO by those developing countries that are not beneficiaries of trade preferences offered by a developed country. The Government of India challenged in 2002 the special 'extra' preferences provided under the EU GSP to a select group of developing states on the grounds that the EU was supporting them in the fight against narcotics trade. Final judgement on the Indian complaint was reached in 2004 by the WTO Appellate Body, who found that the EU GSP was illegal, though it also stated that differentiation between countries within GSP schemes is acceptable provided it is related to objective and internationally accepted differences in developing-country circumstances. This development has led to the adoption by the EU in April 2005 of a new GSP system comprising a larger range of products receiving preferences, a revised graduation mechanism, and an additional special trade regime, named GSP+. This attempts to make use of the Appellate Body's ruling that a certain degree of differentiation among developing countries is acceptable, and GSP+ offers better market access than the standard GSP to those countries that satisfy two criteria: 'vulnerability' (determined by indicators of smallness and lack of economic diversification); and commitment to human and labour rights as well as environment and governance principles (ratification and implementation of several UN/ILO Conventions).

The critiques outlined above on the scarce attractiveness of the EU GSP as an alternative to EPAs for ACP countries are still valid, but the recent ruling by the WTO Appellate Body, the subsequent

reform of the European preferential scheme, and the further review by the EU scheduled for 2008 create a fluid situation that could favour the adaptation of the GSP to make it a concrete, attractive and legal alternative to an EPA.

The fact that the EU GSP is a unilateral scheme and therefore not contractual has been the object of debate for long and already the former WTO Director General Ruggiero suggested that the EU could autonomously make the GSP contractual, by binding its concessions in the WTO. More recently, in the context of the reform of the ACP–EU relations, the debate has included the possibility of creating an 'enhanced GSP' with Cotonou-equivalent preferences to make it also attractive for the ACP countries. Extending the GSP+ to incorporate all ACP exports and improve its market access preferences to the Cotonou level where they are inferior would constitute a WTO-compatible alternative to an EPA with a definite appeal for non-LDC ACP countries as well.

Stevens and Kennan (see Chapter 9) suggest that only about one-tenth of ACP exports are not already covered by the GSP+ and that their inclusion in it would not constitute a significant erosion of ACP preferences, either because competitors are not eligible for the GSP+ or they already benefit from duty-free access under separate trade arrangements with the EU. Therefore, the only cases of substantially 'less preferential' treatment than in the Cotonou framework under the 'enhanced GSP' scenario would relate to the products that benefit from the commodity protocols: sugar, bananas and rum. Within the ACP, however, serious difficulties with these products will be faced regardless of the future ACP–EU regime, so one could question to what extent such erosion should be considered a negative aspect of the 'enhanced GSP'.

The Everything But Arms (EBA) initiative

Those ACP countries that belong to the group of LDCs can opt out of EPAs in favour of the EBA initiative. This preferential scheme has been operational since March 2001 and benefits all 49 LDCs around the world.[6] EBA has provided full duty-free and quota-free access for all LDC exports – except arms – and does not include any reciprocal conditions to be met by LDCs.[7]

Since out of 76 ACP countries, 39 are LDCs, more than half of the ACP group would qualify for EBA access should they not want to negotiate EPAs. Yet, the trade-off is not simple. The EBA initiative provides duty and quota-free access for all LDC products and hence seems by definition as good as any future EPA might be. Why under these conditions would ACP LDCs need to open up their market on a reciprocal basis to EU products? EBAs do not address technical barriers to trade and other trade-related issues (unlike the foreseen EPAs), and operates under stricter rules of origin than currently prevailing under Cotonou (and future EPAs). Besides, EBA access does not yield the same export revenues in those products currently covered by the Commodity Protocols (banana, beef and sugar). The prices received under the sugar and beef protocols from which some ACP countries benefit are the same as the prices received by domestic (subsidised) EU producers and hence much more favourable than world market prices. Thus, when an LDC ACP country currently profits from those protocols, it needs to weigh these benefits against the 'flat' access offered through EBA. The question remains as to the future of the Protocols, as well as their incorporation or not into EPAs.

In addition, as with GSP, EBA is a unilateral initiative which arguably could be reversed by the EU at some point in the future, although this scenario does not seem likely. Further uncertainty is added by the fact that EBA is confined to LDCs only: a country graduating from this status will lose EBA preferences and be left with more unfavourable GSP status. Another less favourable provision of EBA is its safeguard clause that allows the EU to withdraw preferences whenever LDC exports rise above 'usual' levels. The exact interpretation, and thereby its adverse effects to LDCs' exports, is unclear and thus enhances uncertainty.

It remains therefore for each ACP LDC to assess whether the current EBA regime is a superior alternative to the proposed EPAs.

However, the regional dimension of EPA introduces a new bias in the determination of ACP LDCs. Indeed, even if the advantages of EBA were

to outweigh those of an EPA, an ACP LDC would endanger the regional integration process, or exclude itself from its regional partners, by opting out from an EPA. This is the case since all LDC ACP countries are involved in some sort of regional arrangements with non-LDC ACP countries: opting for EBA could fracture these arrangements and possibly isolate the LDCs from their regional partners. Although participation in EPAs by LDCs is strongly advocated, the EU has provided little evidence that reciprocity will provide sufficient benefits to LDCs to justify the considerable short term adjustment cost.

EPAs: A regional focus

A common characteristic of all six regional EPA negotiations is that they have, in their initial stage, focused on the regional integration process of each EPA region. Indeed, the European Commission has undertaken to review, with its ACP regional partners, the state of regional integration in all six ACP regions and their future agenda. Arguably, this approach comes from the need for EPAs to build upon and reinforce the regional integration process of ACP regions. But it can also be traced back in a broader favourable approach towards regionalism adopted by the European Union.[8]

The regional dimension of EPAs

The ACP countries enjoy a special privileged relationship with the EU in the context of the EU partnership agreement with the ACP countries (under successive Lomé Conventions and since 2000 the Cotonou Agreement). This partnership is due to be enhanced with the current negotiations of EPAs, leading to enhanced economic integration among the EU and the ACP regional groupings.

A basic principle of EPAs contained in the Cotonou Agreement is that they should build on and reinforce the regional integration process of the ACP. Article 37.5, mentioned above, states that the negotiations of EPAs shall 'tak[e] into account regional integration processes within the ACP'. The regional integration process is a recurrent theme in the Cotonou Agreement and appears in numerous articles.[9] According to the European Commission, by building on larger well-integrated regional markets, regional EPAs should contribute to foster the integration of the ACP in the world economy, provide for economies of scale, stimulate investment and contribute to lock in the necessary trade reforms.

It is on this ground that the EC considered negotiating with existing ACP regional groupings. This conception was presented in its 1996 Green Paper, which developed the notion of the then Regional Economic Partnership Agreements (REPAs), the equivalent of today's EPAs. The emphasis on regions is based on the Commission's view that regional integration is a stepping stone toward further trade liberalisation and thus integration into the world economy.

The principle advocated by the European Commission is that economic integration at the regional level with the EU should reinforce the respective integration process of regional groupings. It should enhance the benefits from regional integration among developing countries, in the form of enhanced trade and investment flows for instance, from Europe and within the developing regions. This will provide stronger incentives to the members of regional groupings to commit to the objectives of the region (and not opt out from a grouping that is tied to the EU). This regional partnership with the EU should therefore help to increase the credibility of regional integration processes, in particular in Africa.

In this respect, the EU is also perceived as an 'external guarantor' to avoid economic and integration policy reversal and create a lock-in effect through cooperation with the EU and possible bi-regional agreement.

The EPAs will also benefit from deeper integration within the regions, so that better integrated regions can conclude more comprehensive agreements with the EU, which, in the views of the European Commission, can only be beneficial to them. The more the better! Stronger regional groupings will in turn be able to provide stronger support to the African Union (AU) process. Moreover, the different regional EPAs should be based on a similar framework. So, while the European Commission envisages differentiated specific provisions for each EPA, their general structure should be common.

Ultimately, as explicitly indicated in the Commission negotiating mandate from the EU member states, EPAs could over time be merged among regions in Africa to become larger entities. Hence, a common EPA for all African ACP countries could be envisaged in the long run. This would then be compatible, and perhaps in fact reinforce, the integration process of the African Union (AU). Or so goes the global vision of the European Commission.

In a document produced prior to the opening of the EPA negotiations, the Commission also stressed that negotiations on EPAs with ACP groupings should rely on and further enhance 'functioning' and 'effective' regional integration processes among ACP countries.[10] In view of the poor record of some ACP regional groupings, the Commission was obviously concerned to enter into negotiations on EPAs with groupings whose existence is more than purely formal, and which pursue or have achieved substantial economic integration in practice. However, the determination of criteria to distinguish between an 'effective' and an 'ineffective' regional integration initiative is likely to prove controversial. In fact, one may wonder whether some of the regions self-determined for an EPA, such as CEMAC, the PACP, or the ill-defined SADC–EPA configuration (which excludes key members of SADC) do constitute effective regional groupings with functioning regional integration mechanisms.

The European Commission can also be quite prescriptive in what it considers key elements for effective integration. For instance, the European Commission outlined a 'toolbox' for EPAs which highlights key elements for successful regional integration, to be considered by the ACP, but which also reflects the broader thrust of the European Commission on what credible regional integration processes should entail. It identifies five components.[11] The first two relate to trade in goods (boiling down to the creation of a customs union) and trade in services (with the liberalisation of the four modes of supplies and the development of a simplified and harmonised regulatory system). A third category covers trade (related) rules that affect effective regional integration. These include SPS and technical regulations that need to be harmonised at regional level through the setting up of regional bodies. A regional authority must be created to enforce competition and subsidy rules. Similarly, regional policies must be established on intellectual property rights, investment, public procurement, environmental, labour and consumer rules. To ensure appropriate and credible implementation of regional policies, enforcement mechanisms must also be put in place (e.g. regional appeal courts, regional binding arbitration, etc.). Finally, regional groupings may consider fiscal and macro-economic harmonisation, creation of monetary union, and the development of appropriate regional bodies 'to be the motor of integration'.

Overlapping membership or the 'spaghetti bowl' nightmare

Many ACP countries belong to more than one regional grouping, some of which have overlapping membership and in some cases conflicting objectives and obligations. This is the case for instance in East and Southern Africa with COMESA/SADC/EAC whose integration processes and agenda are still not consistent.

For instance, most SADC members belong to at least one other regional grouping. This is perfectly consistent with the principles of a free trade agreement, where each member remains in charge of its own trade policy towards non-members. A country can thus belong to several different free trade agreements, as is often the case. However, in the case of customs unions, where members adopt a common external tariff/policy, a lack of coherence leads to conflicting obligations. SADC includes a subgroup of countries, South Africa and the BLNS (Botswana, Lesotho, Namibia and Swaziland) countries, which have formed the Southern African Customs Union (SACU). A possible SADC customs union (proposed by 2010) will thus require the alignment of a SACU and SADC common external tariff. To complicate matters further, several SADC members also belong to the Common Market of Eastern and Southern Africa (COMESA), which is set to become a customs union in the very near future.[12] In addition Tanzania, besides its SADC membership, is also part of the East African Co-operation (EAC), which became a customs union in

2004, but not of COMESA, unlike its two other union partners, Kenya and Uganda. This leads to unavoidable conflicting economic integration commitments and objectives.

South Africa, which was only a qualified member[13] of the ACP, already concluded a free trade agreement with the EU in 2000 (the TDCA) and will not therefore be part of the EPA negotiations. SADC membership often overlaps with other regional arrangements, which have different (and sometimes conflicting) integration and trade programmes, and whose members are also expected to negotiate EPAs with the EU. Currently, Angola, Botswana, Lesotho, Namibia, Mozambique, Swaziland and Tanzania have chosen to negotiate EPAs under the SADC banner, the SADC–EPA group. South Africa will participate as an observer. Other SADC Members will negotiate EPAs under the banner of other regional arrangements, notably the East and Southern Africa (ESA) EPA configuration, which regroups COMESA countries. Tanzania is a case in point, as its two other EAC partners, which unlike Tanzania are members of COMESA, have joined the ESA–EPA, while Tanzania negotiates an EPA under the SADC (minus) configuration.

Unless the SADC–EPA and COMESA–EPA end up being identical agreements, which can be merged into one broad SADC–ESA EPA, the regional integration processes in the region could be seriously compromised. Similarly, BLNS countries are *de facto* part of the TDCA, since they belong to SACU, a customs union with South Africa. How can then BLNS countries negotiate a separate EPA with Angola, Mozambique and Tanzania under the SADC banner? Again, this is doomed to split the region or lead to conflicting obligations.

EPA negotiations force countries to choose one region over another, in the case of multiple memberships. While this may arguably be a desirable outcome, the danger is that considerations about the relationship with the EU take precedence over regional concerns. That is, external considerations driven by the EU may prevail over domestic (national and regional) concerns. The issue is whether the regional integration process can be driven, or supported, by foreign forces (in this case the EU), or whether the process, to be sustainable, should not be endogenous. This is a question that ultimately can only be resolved by the ACP countries themselves.

Asymmetry of integration, development or interest within a region

Alternatively, EPA negotiations with the Caribbean have been undertaken with CARIFORUM, that includes CARICOM (which moves towards an effective customs union and the completion of its single market) and the Dominican Republic, in a free trade area. The EPA agenda, which has ambitions according to the EC to address 'behind-the-border' policy matters, suggests deep integration, more in line with the CARICOM agenda of integration than the shallower CARIFORM FTA. By pushing for a more substantive regional integration agenda to fit the EPA process, the European Commission creates tensions in the CARIFORUM region, which might undermine, rather than promote, regionalism in the Caribbean.

The level of integration of a region plays, therefore, a key role in the pursuit of an EPA. Varying degrees of integration within a region may create tensions among regional partners, which may ultimately undermine the claimed objective of EPAs to build upon and strengthen regional integration. Such fears have been raised in the context of West Africa, with UEMOA experiencing a deeper form of integration than the encompassing ECOWAS. The current process of convergence between the UEMOA and ECOWAS regional integration processes would appear to remedy such possible tensions. Yet, a failure to comply in time the implementation of an ECOWAS common external tariff could endanger the EPA negotiations process, and result in a split region. This led some West African officials to complain that the European Commission, by pushing for a comprehensive EPA agenda, was forcing the speed of integration of the region in an excessive way.

Another potential source of tension within a region due to EPA is the presence of least-developed countries (LDCs), whose interests are likely to differ substantially from those of other developing ACP countries. Reciprocity is the cornerstone of the

Commission's approach to the negotiations of EPAs. However, this raises questions about its consistency with the implications of the 'Everything but Arms' (EBA) initiative, where the EU grants non-reciprocal market access to all LDCs. At issue are the ACP LDCs non-reciprocal trade preferences with the EU under an EBA, which they would have to forfeit by entering into an EPA. This of course raises the question of whether ACP LDCs (40 out of the 77 ACP countries) have any serious incentive to join an EPA. The Commission's informal argument appears to be that EPAs will encompass much more than standard market access measures, and will include trade-related measures as well. Yet, the superiority of an EPA over EBA, in terms of the benefits for ACP countries, has yet to be formally demonstrated.

More crucial for regional integration, is what would happen should an ACP LDC decide not to sign an EPA and retain instead its EBA non-reciprocal market access to the EU? Clearly, this would seriously undermine the regional integration process. Indeed, either the LDC is excluded from the region and the regional EPA is signed, or the LDC remains a member of the regional grouping and EPAs are concluded with the other individual members of the region. In the latter case, EPAs will force the region to maintain border controls, so as to determine the origin of the products traded with the EU, not to mention the possible consequences on trade-related issues that would not cover the whole region.

Note that the same problem would arise should any member of a regional grouping (LDC or not) decide to opt out alone from an EPA. In such an event, an EPA could lead to the disintegration (rather than integration) of a region. For the sake of illustration, what would happen to ECOWAS were Nigeria unwilling to sign a common regional EPA with the EU? Would the integration process of ECOWAS, due to become a customs union, be reinforced? This is a hypothetical example that could be repeated with most countries in the various African regions. The point is that unless all countries of a region can agree on a common EPA, the partnership with the EU may seriously disrupt the regional integration process. How, in these conditions, would the regional economic communities (RECs) be able to be the building blocks to the African Union integration process?

In the Pacific regional integration is perhaps the most shallow and immature of any ACP region. While the Melanesian states have pursued very haphazard trade integration dating back to the mid-1990s, it is only in the last few years that all Pacific ACP states signed their first trade integration agreement, the Pacific Islands Countries Trade Agreement (PICTA). Ratification and implementation of PICTA has been extremely slow. The EU's need to complete negotiations in this most remote and vulnerable of regions may compound existing sub-regional tensions between the Melanesian states group and the Pacfic ACP group as whole.

Each ACP regional grouping is also put in the difficult position of having to speak with one voice during the negotiations with the EU. While this is to be expected from a customs union with a common external policy, it is unusual for a free trade area where member countries retain full sovereignty in the determination of the external trade policy. A common position by an FTA requires therefore a strong, well-developed co-ordination process among the member countries. In any case, any regional agreement involving an FTA as one of the partners will have to be notified individually to the WTO by each member of the FTA.

Political will may be insufficient. Conflicting interests may generate tensions within the region. Even in the presence of explicit commitment to negotiate as a group, weak institutional capacity may prevent many groupings from effectively defending the interests of their members during the negotiations with the EU.

Other criticisms of the EC's EPAs

The European Commission's approach to EPAs has raised many criticisms. From an economic point of view, it has been noted that the European Commission tends to ignore the potentially negative effects of regional integration agreements, in particular among developing countries, and of EPAs based on reciprocal regional free trade agreements. ACP regional groupings, particularly in Africa, are characterised by large differences in the size of their

economies and levels of development, as well as in the structure of their tariff rates. As a result, preferential trade liberalisation is likely to generate significant trade diversion and transfers of resources, through the loss of revenues from import duties, in favour of the dominant country in the regional grouping which is often more industrialised and imposes higher tariffs on industrial goods. Regional integration among poor countries with different sizes and levels of development could lead to income divergences among the partners.

For the ACP countries, preferential liberalisation of imports from the EU could lead to severe loss of fiscal revenues resulting from the abolition of customs duties and may require significant adjustments to domestic production because of competition from EU products. These elements could destabilise the ACP regional integration process that the EU seeks to reinforce.

Negotiating EPAs may not only result in trade diversion, but also divert the attention of ACP countries away from other regions and multilateral considerations. The danger of 'EPA-centrism' is reinforced by the limited negotiating capacity of ACP countries and regions. This is likely to be overstretched during the EPA negotiations, and may not allow ACP countries to devote enough effort to the WTO negotiations.[14]

Many observers note that the Commission's approach may also lead to a split in the ACP group. The EBA initiative has already divided the group into two distinct categories, the LDCs (which benefit from the EBA) and non-LDCs. The clear and present danger is therefore that the ACP group will lose its coherence and may end up divided into regional entities. The negotiation of separate EPAs with each regional ACP grouping will most certainly further divide the ACP group. By negotiating with a subset of ACP countries, the EU could reinforce its bargaining position *vis-à-vis* the ACP countries. For the EU it is indeed easier to negotiate with a smaller partner or group of partners.

The EPA negotiations process: Key features

EPA negotiations: A two-phase process

The EPA negotiations were officially launched on 27 September, 2002. These new trade agreements, which should enter into force by January, 2008, should build upon ACP regional integration initiatives and aim to facilitate the gradual integration of the ACP countries into the world economy. If concluded, the EPAs will have a profound impact on the ACP economies and fundamentally change the relationship between the world's largest single market and some of the poorest and most vulnerable regions in the world.

The EPA negotiations have been structured around two phases, which somewhat overlap. The first phase of the negotiations, which started on 27 September, 2002, has taken place between the European Commission (EC) and the ACP group as a whole. The objectives were to define the format, structure and principles for the negotiations.

The second phase of regional negotiations started in October 2003, between the EU and the six self-determined ACP negotiating groupings:

- CEMAC-plus (i.e. the Communauté Economique et Monétaire de l'Afrique Centrale, plus Sao Tomé and since December 2005 the Democratic Republic of Conga), since 3 October 2003.
- ECOWAS-plus (Economic Community of West African States, plus Mauritania), since 6 October, 2003.
- ESA (Eastern and Southern Africa) since 7 February, 2004.
- CARIFORUM (Caribbean Forum of ACP states) since 16 April, 2004.
- SADC-minus: (Southern African Development Community countries not already part of another EPA grouping, i.e. the BLNS countries plus Angola, Mozambique and Tanzania), since 8 July 2000.
- PACP states (Pacific ACP states) since 10 September, 2004.

The joint declaration[15] and report[16] on the progress of the all-ACP level discussions adopted at the ACP–EU Ministerial Negotiating meeting on 2 October 2003 were the result of compromise solutions worked out at the highest political levels. This started with the ACP Council of Ministers agreeing

on the follow-up mechanisms for linkages between the all-ACP Phase I and the regional Phase II of the negotiations, and followed with the ACP Ministerial Chairman and then EU Trade Commissioner Pascal Lamy agreeing on the form, wording and status of the document and further mechanisms that would relate the progress in Phase I to negotiations in Phase II. The ACP had sought to have a legally binding agreement on the issues agreed in Phase I to provide guidelines for Phase II regional negotiations. The European Commission had maintained all along that the objective of all-ACP level discussions was clarification of issues and that the Cotonou Agreement served as a sufficient legal basis for negotiations. By way of compromise, it was finally agreed that the joint report would 'serve as a point of reference, and provide guidance, for the negotiations to be conducted at regional level'.

On the substance of what had been agreed to date, the joint declaration stressed the 'satisfactory' results of Phase I 'with regard to the high degree of convergence reached'. A detailed examination of the report, however, reveals that convergence was reached mainly in reaffirming existing principles and objectives, and not in areas of substance in addition to the existing commitments of the Cotonou Agreement. Even where there is convergence, differences in interpretation often remain. For instance, the ACP and the EU agree that access to the EU market should be maintained and improved under EPAs. However, in the context of increasing trade liberalisation and diminishing preferential treatment, improved market access can only stem from more favourable rules of origin and comprehensive treatment of non-tariff barriers. The EU's commitment to tackling issues of this nature remains unclear.

In the end, both sides agreed that the discussions on remaining divergences on issues of all-ACP interest could continue at that level in parallel with regional level negotiations. Three follow-up mechanisms were agreed:

The Joint ACP–EC Ministerial Trade Committee (JMTC) will be responsible for ensuring mutual understanding on horizontal issues of all-ACP interest in discussions at that level and should make recommendations to ensure coherence of the negotiations. ACP ministers and DG Trade will meet as appropriate to take stock of the discussions.

An ACP follow-up mechanism for the regional Phase II of the negotiations. The mandate of this body is to ensure circulation of information among the regions and coherence in the various negotiating processes and to give non-binding advice on issues or approaches in the negotiations should there be a need for this. It will comprise the chief technical negotiator for each region; a representative from each of the six ACP regions; a representative of the regional organisations; the Secretary-General of the ACP group; the *Troika* of the Committee of Ambassadors; and a representative of the High-Level Group of Experts. At the political level, the ACP Council of Ministers, with due regard to the Committee of Ambassadors' report and possible recommendations from the Ministerial Trade Committee, will review the state of advancement of the negotiations to ensure coherence between the various processes.

An all-ACP–EC Technical Monitoring Committee. The main purpose of this mechanism will be to ensure a free flow of information and to promote dialogue between the different ACP regional groupings, on the one hand, and between them and the European Commission (EC), on the other. The committee will be composed of representatives of the ACP follow-up mechanism and EC officials.

On the whole, the first phase of the all-ACP negotiations can be seen as a failure for the ACP and somewhat of a victory for the EU. Indeed, the ACP group claimed to keep its cohesion, and defend common interests throughout these negotiations. Yet, they reached no substantive agreement with the EU after one year of 'negotiations', that were in fact closer to discussions of clarification. The ambitions of a grand ACP unity was further dented by the eagerness of some regions (notably Central and West Africa) to start negotiations with the EU at the regional level, as soon as possible. It is worth noting that they (like other ACP regions) were encouraged to do so by the European Commission. The then-Trade Commissioner Pascal Lamy had even publicly invited ACP regional organisations to start informal discussion on EPAs during the course

of this first all-ACP phase of negotiations, thereby undermining attempts to form a common ACP front.

Recent developments in the EPA negotiations process

After the official launching of all six regional negotiations in 2003–04, initial negotiations and discussions have slowly started on the determination of the policies, instruments and capacity building support necessary for EPAs. In particular, the Phase II regional negotiations have centred on the regional integration process (stocktaking exercise: level of integration, objectives, support) in each of the six EPA groupings, the general framework of an EPA, and discussions on issues such as technical barriers to trade and SPS measures. In parallel, support measures have been discussed in Regional Preparatory Task Forces (RPTFs), whose objectives are to bring together trade and development ACP regional and European Commission officials, together with other donors when appropriate, to identify existing mechanisms/funds and complementary strategy to support/finance accompanying measures for EPAs.

2006 is a decisive year in the effort to reshape ACP–EU trade relations. **All EPA negotiating regions have started the substantive negotiations (Phase III),** which focus on the specific structure and scope of each EPA, the approach to trade liberalisation, as well as the drafting of legal provisions. In addition, **'a formal and comprehensive review' of EPA negotiations** is being carried out in the second half of 2006 for all EPA negotiating regions, as foreseen by Article 37(4) of the Cotonou Agreement.[17] A monitoring mechanism of EPAs has also been discussed and initially set up by the European Commission with the ACP at a technical level, but several proposals have been suggested to initiate a more ambitious process. While many ACP stakeholders have expressed concerns about EPAs, in particular related to their development dimension, the European Council pledged to 'closely monitor EPAs so that they help achieve development objectives'.[18]

On the development assistance side, 2006 is also a decisive year, with the allocation and programming of the 10th European Development Fund (EDF), which will play a central role in supporting the initial implementation of EPAs (that is from 2008 to 2013).

With severe capacity constraints,[19] what concrete proposals for an EPA will the ACP be able put on the negotiating table? Will they be based on well-defined national development objectives, a real assessment of the potential impact of EPAs on these, and a sophisticated negotiating strategy to address them? Will they be able to identify the specific costs associated with EPA-related adjustments and domestic reforms and include specific proposals on the way the EU can support the ACP through EPA or WTO trade policies and rules, as well as through financial support via other instruments to enhance production, supply, and trading capacity and offset adjustment costs? Or do national and regional-level capacity constraints and the apparent end-of-2007 deadline to conclude EPAs mean that the ACP members with the main constraints to identify and development needs to defend (and who are also the neediest in terms of development) are not and will continue to not be able to be fully involved in the preparations for negotiations, thus preventing the ACP from putting forward proposals which can ensure the true development potential of EPAs is realised?

All eyes will be on the European Commission's (EC) response to the ACP's proposals. At the highest levels, the EC has been reaffirming the central development objective of EPAs, stating its willingness to be flexible in allowing the ACP to define trade provisions and support needs and promising to ensure coherence in EU and WTO policies and rules to work in the interest of ACP countries.[20] The specific reaction of the EC to the ACP proposals will be measured in relation to these statements. Will the Directorate General for Trade of the European Commission ensure that its response is based on sound development assessments and make concessions or change the rules in EPAs or the WTO if necessary? Will they ensure that other parts of the EC and EU member states move with the same urgency as trade negotiators *vis-à-vis* the end-of-2007 deadline to ensure the necessary changes in policies and the effective and timely delivery of

support to increase production/competitiveness? Regardless of whether the issues are dealt with within or outside of the formal EPA negotiations, they will determine the development success of EPAs.

EU member states are increasing pressure on the EC to ensure that the development objectives of EPAs can be realised. In March, the UK government issued a statement calling for EPAs to be designed to deliver long-term development, economic growth, and poverty reduction in ACP countries and challenging the EC's negotiating positions in several areas.[21] The statement draws heavily on the UK Commission for Africa Report's recommendations on trade and EPAs.[22] It calls on the EU to, among other things, ensure that the ACP group makes its own decisions on the timing, pace, sequencing, and product coverage of market opening. There are indications that other EU member states are working on similar positions and that there may be a like-minded group of EU member states that will work to increase the development scrutiny of the EPA negotiations.

The 2006 Review of EPA and the elaboration of an effective monitoring mechanism of EPAs could play a key role in shaping EPAs and their implementation, with a view to effectively fostering development in ACP regions. But these processes cannot be seen in isolation from the current negotiations, the discussion on accompanying measures, and the determination of support measures, including within the context of the EDF programmatic exercise. In all cases, time is quickly running out and key decisions will have to be made in the coming months.

ACP concerns and mounting frustration

From an ACP perspective, to be of benefit EPAs must be 'economically meaningful, politically sustainable and socially acceptable'. While most of the ACP would agree with the EU on the development opportunities entailed in an EPA, they tend to consider trade liberalisation and regional integration as necessary, yet far from sufficient, conditions to foster development and alleviate poverty. In other words, creating large open regional markets and increasing export opportunities for the ACP are only factors of potential development, which require additional conditions to be beneficial. It is here at the interface between trade and development that the EPAs have yet to emerge as coherent development instruments.

In particular, ACP economies need to have the capacity both to benefit from increased market access (notably in the EU) and to face greater competition domestically. Trade liberalisation should thus be accompanied by development support to address supply-side constraints, as well as related institutional and structural weaknesses. This support should be determined by and synchronised with the EPA negotiation and implementation processes. That is, the nature and size of support should be commensurate to the adjustment process required, in line with the ACP development objectives and regional priorities. Proper sequencing of liberalisation commitments and implementation with development support is also of prime importance. The trade-related assistance should be sensitive and efficiently delivered, so as to coincide with the needs of and challenges faced by the ACP. This could entail for certain regions and countries, that specific components of such trade-related assistance might need to come before the implementation of trade liberalisation (for example strengthening of tax collection/administration systems where revenue shortfalls due to tariff reduction are expected to be particularly serious).

In addressing these issues, all ACP regions have noted an increasing dichotomy between the political rhetoric at the EU level, where the pro-development component of EPAs is repeatedly emphasised, and the pragmatic approach adopted by EC trade negotiators, who focus on a narrower definition of development based mainly on trade-related gains, thus avoiding, according to some ACP negotiators, substantive discussion on the broader development dimension of EPAs. Indeed, at the highest levels, the EC has been reaffirming the central development objective of EPAs, stating its willingness to be flexible in allowing the ACP to define trade provisions and support needs, and promising to ensure coherence in EU and WTO policies and rules to work in the interest of ACP countries.[23] However, ACP diplomats feel that EC trade negotiators refuse to explicitly take into consideration adjustment

costs and other support measures in the negotiations, leaving these key issues for the ACP to be dealt with in the context of the parallel RPTFs. These are not part of the trade negotiations setting, and therefore have no binding power on the negotiators. Hence, not only do the ACP regions regret the *de facto* sidelining of DG Development officials in the EPA negotiations; but the regional ACP negotiators apparently fail to see the political commitments made by Development Commissioner Louis Michel and even Trade Commissioner Peter Mandelson translated into the approach and content of the negotiations led by DG Trade officials.

The ACP have continuously stressed that high adjustment costs may seriously mitigate – and even negate – the benefits from market liberalisation through an EPA. These include fiscal reforms to face the loss of import revenues, adjustment measures for loss of competitiveness and restructuring of domestic industries, institutional development (to address issues such as compliance with food and safety standards, simplification and harmonisation of custom procedures, regulatory developments, etc.), support to develop the supply capacity necessary to benefit from increased market access, etc. In a forthcoming study to be published by the Commonwealth Secretariat, partial elements of the adjustment costs to EPAs have been preliminarily estimated to be at least € 9 billion for all the ACP.

While the ACP negotiators recognise the need to properly calibrate an estimate of the adjustment costs required for the preparation, negotiation and implementation of EPAs, they all note the inadequacy of the current development support mechanisms under the Cotonou Partnership Agreement to face the development challenges of EPAs. In particular, according to ACP negotiators:

1. EPAs should be tools for development

(a) EPAs should leave ACP 'no worse off': trade liberalisation is just a necessary, not sufficient condition to the effective development of the ACP.

(b) EPAs should effectively promote development.

2. which require significant adjustment costs

(c) EPAs will require significant adjustment costs, which if not properly addressed could impede the development of ACP economies;

(d) the EU has so far failed to grasp the magnitude of these adjustment costs and their potentially destabilising impact on the ACP; however,

(e) adjustment/development assistance and the EPA negotiations are intrinsically linked, and cannot be artificially disconnected;

3. with timely and effective mechanisms of support delivery

(f) the current mechanism to address EPAs adjustment costs (including through the RPTFs) do not guarantee the proper coverage of development support required in the context of EPAs, nor the timely deliver of the assistance needed; yet,

(g) appropriate level of support, timely disbursement of funding and effective delivery of assistance will affect not just the proper negotiation of EPAs, but especially the capacity to implement any agreement.

In addition, several ACP regions also contended that, in the preliminary discussions on regional integration in the context of the EPA negotiations, the EC strongly promoted its own approach to regional integration processes, based on the EU experience. However, ACP regions emphasised that instead of attempting to reproduce the EU experience, they should follow their own regional integration process, often based on flexibility, differentiation and variable geometry (as in the case of the Caribbean for instance). The emphasis in EPA negotiations should thus be, for each ACP region, on the synchronisation of self-determined regional priorities with the scope and process of EPA negotiations, rather than on incorporating in each regional integration process a standard EU agenda for EPAs, derived from the EU particular experience. Here again, ACP countries have complained about a perceived dichotomy between the flexible EU political discourse and the more rigid EC negotiators' approach.

The ACP group expressed publicly, for the first

time, its concerns with regard to progress in the Economic Partnership Agreement (EPA) negotiations during a hearing in the European Parliament's International Trade Committee in September 2005. The ACP had already adopted a key EPA declaration critical of the process ahead of the June ACP–EU Council, but this was in the context of negotiations and not officially in the public domain.[24]

The way forward

Concerns about the development dimension of EPAs, and more generally international trade agreements, are not new. In the context of EPAs, the UK government issued in March 2005 a statement calling for EPAs to be designed to deliver long-term development, economic growth and poverty reduction in ACP countries and challenging the EC's negotiating positions in several areas.[25] The statement, which draws heavily on the UK Commission for Africa Report's recommendations on trade and EPAs,[26] calls on the EU to, among other things, ensure that the ACP makes its own decisions on the timing, pace, sequencing, and product coverage of market opening. These are concerns regularly expressed by ACP countries, and recognised at the highest political level by the European Commission.

The main challenge is to effectively translate the legitimate concerns about the links between trade and development into the EPA negotiations and identify appropriate support mechanisms to guarantee that adjustment costs and development support are affectively and timely addressed. What remains in the negotiations as they are currently formulated is that the ACP countries will make bound commitments on market access and in return will obtain voluntary best endeavours on the complementary development assistance.

ACP countries and regions must undertake a thorough and systemic needs assessment, based on realistic perspectives. In particular, the case for development in EPAs has sometimes been undermined by unsubstantiated calls to address all development concerns of the ACP in the context of EPAs, from trade-related adjustment costs to systemic calls for infrastructure development support unrelated to trade matters. While all dimensions of the domestic structure and economy will have an impact on trade performance, not all institutional, structural and policy aspects of a country and/or region can be covered under trade-related negotiations and support. Hence the need for all the ACP countries and regions to undertake a systematic assessment of their specific trade-related needs that they would like to see covered in the context of the EPA negotiations.

Similarly, Europeans (institutions and member states) must recognise that EPAs will entail additional adjustment costs that should be properly addressed for the ACP to benefit from an EPA. Such adjustments should not come at the expense of other legitimate development concerns (infrastructure development, education, health, etc.), that may play a more vital role in ensuring sustainable development and poverty alleviation than a new trade regime. Hence, additional resources and/or mechanisms may be required to tackle trade-related assistance in the context of EPAs.

Effective, transparent and impartial review mechanisms have been suggested, to ensure that the development benefits promised by EPAs do materialise. Such mechanisms could of course facilitate the review of the negotiation process, with transparent updates and opportunities for concrete follow ups. But they could also be used to initiate a broader benchmarking exercise, which could serve to set objectively determined indicators to assess the development aims and content of EPAs. Benchmarks could be identified on real market access issues (including NTBs, TBT and other behind-the-border measures), on policy space (essential in the views of the ACP countries to keep sufficient flexibility in designing domestic policies) and development support. ACP regions could set their own indicators, which could be used as guidelines to identify their priorities and make their development objectives and needs more explicit. Such benchmarks could also prove to be a useful tool for the EC and EU member states in their dialogue with the ACP.[27]

In identifying complementary measures, EU member states have a key role to play, together with the European Commission. It is important to note that some of the rigidities of the EDF and other EC

co-operation instruments are in part due to the strict conditions imposed by EU member states on Community instruments and procedures. Moreover, the current directives for the EPA negotiations to the European Commission by the Council do not give a mandate to DG Trade to negotiate on development support. It is thus all the more important that EU member states work more closely with the Commission in order to address potential bottlenecks, stimulate co-ordination (among EU member states and with the EC), and identify possible complementarities, notably in the area of trade capacity-building and support measures.

To that end, it is worth connecting the issues of the linkages between trade and development within the Cotonou framework with the current debate on multilateral mechanisms for 'aid for trade',[28] since synergies might be identified between the two arena (in terms of experiences, new ideas, implementation mechanisms, etc.).

However, while considering the links between trade and development, it is important to keep in mind that development does not simply mean additional resources. Indeed, the development dimension of EPAs should be included in three main categories:

Trade(-related) rules The trade and trade-related provisions of the agreement regulating trade flows must account for the peculiar needs and weaknesses of ACP countries (for instance asymmetric liberalisation so that the coverage, scope and speed of tariff reduction for ACP countries are limited relative to those for the EU).

Accompanying measures and policies To facilitate the preparation, negotiation and implementation of trade(-related) measures, accompanying and adjustment measures and policies are necessary for ACP countries to fully benefit from and better cope with the challenges of trade liberalisation with the EU (for instance fiscal adjustment programmes and measures to address 'supply-side constraints').

Effective processes for support delivery Besides adequate trade rules and accompanying measures, it is essential that the development support mechanisms to finance and implement them lead to the effective delivery of assistance. Large portions of unused resources available under the European Development Fund (EDF) and the slow delivery of disbursements and projects implementation in some ACP countries suggest that specific provisions regulating development assistance should lead to more effective planning and timely delivery, as well as strengthened capacity and participation of ACP stakeholders.

Efforts to strengthen the linkages between trade and development should thus tackle these three dimensions.

EU member states should consider working more closely with the European Commission to ensure:

1. a greater coherence and complementarity between the trade-related content of EPAs, the necessary accompanying and adjustment measures, and the timely and effective delivery of support, possibly with binding commitments; to this end, the RPTF could be formally included in the EPA negotiations structure and its role strengthened;
2. that the EU effectively fulfils its promises on development as a key objective of EPAs, notably taking into consideration the most appropriate sequencing for development objectives;
3. the transparency and accountability of the EPA negotiations process, notably with regards to the integration of the development dimension; to this end, a new monitoring mechanism could be set in place, which would include ACP and EU member states representatives;
4. that ACP (development) concerns are properly addressed in the context of EPA negotiations, possibly through the use of explicit development benchmarks;
5. a positive engagement of the ACP private sector in the EPA negotiations, as it represents a potential driving force in the economic restructuring of ACP economies; and
6. the consistency between EPA and WTO negotiations in terms of principles, rules and support (e.g. 'aid for trade' initiatives), and in particular in addressing development concerns.

Endnotes

1. Widening and deepening of the European integration process led to the transformation of the European Economic Community (EEC) into the European Community (EC) and finally to the European Union (EU). For reasons of clarity, the term EU will be used henceforth.
2. In November 2001, the EU and the ACP obtained another WTO waiver for his transitional period.
3. A discussion of WTO compatibility and EPAs is provided in chapter 3.
4. For an extensive discussion, see Bilal, S. and F. Rampa (2006), *Alternative (to) EPAs: Possible scenarios for the future ACP trade relations with the EU*, ECDPM Policy Management Report 11, Maastricht: European Centre for development Policy Management, www.ecdpm.org/pmr11
5. Article 37.7 of the Cotonou Agreement
6. LDC 'status' is given by the United Nations and applies to developing countries that have *both* a low average income *and* low export performance.
7. An exception is still made for bananas, sugar and rice, which are exempted during transitional periods ranging up to 2006 (bananas) and 2009 (sugar and rice). During these transitional periods, trade barriers will already be brought down systematically.
8. See Bilal, San (2005), 'Can the EU Be a Model of Regional Integration? Risks and challenges for developing countries', paper presented at the CODESRIA – Globalisation Studies Network (GSN) Second International Conference on Globalisation: Overcoming Exclusion, Strengthening Inclusion, Dakar, Senegal, 29 August to 31 August, 2005, www.acp-eu-trade.org/library.
9. Article 1(4) states that 'Regional and sub-regional integration processes which foster the integration of the ACP countries into the world economy in terms of trade and private investment shall be encouraged and supported'. Article 2 mentions regionalisation as one of the fundamental principles, noting that 'Particular emphasis shall be placed on the regional dimension'. This can be found in many aspects of the Cotonou Agreement not directly related to the negotiation of EPAs. With respect to economic and trade cooperation, Article 35.2 stipulates that 'Economic and trade cooperation shall build on regional integration initiatives of ACP States, bearing in mind that regional integration is a key instrument for the integration of ACP countries into the world economy'.
10. European Commission (2001), 'Orientations on the Qualification of ACP Regions for the Negotiation of Economic Partnership Agreements', Brussels: European Commission. www.epawatch.net/general/text.php?itemID=24&menuID=5
11. European Commission (2004), 'EPA Negotiations: Toolbox', http://europa.eu.int/comm/trade/issues/bilateral/regions/acp/toolbox_en.htm
12. Initially, COMESA planned to establish a customs union by 2004, but implementation has been postponed.
13. That is, while South Africa is a signatory of the ACP-EU Partnership Agreement, it is not entitled to benefit from the European Development Fund and the EU unilateral regime of preferences available to other ACP countries. Instead, the EU and South Africa have concluded a free trade agreement which entails also development assistance component, the Trade, Development and Cooperation Agreement (TDCA).
14. Bilal, San (2004), 'The Coherence of Multi-Level Negotiations: Challenges for developing countries', UNU-CRIS e-Working Papers W-2004/11, November 2004, www.cris.unu.edu/pdf/WP%20BILAL%20SANOUSSI.pdf
15. www.acpsec.org/gb/press/jtdecla2oct.htm.
16. www.acpsec.org/gb/sed/acp0011803-e.htm.
17. 'The Parties will regularly review the progress of the preparations and negotiations and, will in 2006 carry out a formal and comprehensive review of the arrangements planned for all countries to ensure that no further time is needed for preparations or negotiations.' (CPA Art.37(4))
18. Council of the European Union, 'The EU and Africa: Towards a Strategic Partnership', text adopted by the European Council at its meeting on 15–16 December 2005, Brussels, 19 December 2005, 15961/05 (Presse 367), http://europa.eu.int/comm/development/body/tmp_docs/the_eu_and_africa_towards_a_strategic_partnership_european_council_15_16_12_2005.pdf
19. See Julian (2005) TNI Vol 4, No. 1, January 2005, www.acp-eu-trade.org/tni.html
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22. Our Common Interest-Report of the Commission for Africa http://213.225.140.43/english/report/thereport/cfafullreport.pdf
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24. www.epawatch.net/general/text.php?itemID=295&menuID=25. The ACP Committee of Ambassadors' Trade Committee Chairman, Namibian Ambassador Katjavivi, who led the delegation of ACP Ambassadors to the meeting, informed parliamentarians that there has been little progress in addressing fundamental issues of concern to the ACP in a number of key areas, related in particular to the development dimension and regional integration priorities in negotiations with the EC to date. The Ambassadors noted, however, that several EU Member States seem to understand ACP concerns about the need for more developmental support to address supply side needs and to provide sufficient transition periods for liberalisation.
25. Economic Partnership Agreements: Making EPAs Deliver for Development, UK Department of Trade and Industry and UK Department for International Development, 22 March 2005, www.dti.gov.uk/ewt/epas.pdf
26. Our Common Interest, Report of the Commission for Africa, 2005, http://213.225.140.43/english/report/thereport/cfafullreport.pdf
27. See for instance ICTSD and APRODEV (2005), The EPAs and Sustainable Development: Benchmarks for Pro Development – Monitoring of the Negotiations www.aprodev.net/main/files/A%20EPAs%20and%20Sustainable%20Development%20FINAL.pdf
28. The 'Aid for trade' debate relates to recent initiatives in the context of WTO Doha Development Round to extend special financial facilities to low-income countries to help them financing adjustment costs and strengthen supply/trade capacity while undertaking trade liberalisation.

II

Background

2

From Lomé to Cotonou: Business as Usual?

Olufemi Babarinde and Gerrit Faber

Introduction

The ACP–EU Partnership Agreement signed in Cotonou in 2000 – hereafter called the Cotonou Agreement – has a long history behind it.[1] Part IV of the Treaty that established the 1957 European Economic Community (EEC) contained provisions on the Association of Overseas Countries and Territories. These articles laid the basis for the 1975 Lomé Convention between the European Union (EU) and the African, Caribbean and Pacific (ACP) states. This convention was adapted and renewed until the fourth edition lapsed in February 2000. Trade preferences and aid constituted the main benefits that ACP states received from the EU. Its successor, the Cotonou Agreement, which has been agreed for an unprecedented 20-year period, has also retained trade and economic assistance among the centrepieces of the strategy for achieving its main objectives. A careful scrutiny of the composition of the two groups of partners, as well as of the scope and instruments of co-operation, might enable a conclusion that the Cotonou Agreement is essentially a continuation of past practice. Indeed, Forwood aptly argues that:

> *Despite modifications in the instruments and objectives, all the features of Lomé have fundamentally been rolled over into the new Convention. In the area of trade, where the most obvious change has taken place, the framework for trade will be determined at some point in the future, and the current arrangements will continue for at least another decade. Rather than radical overhaul, the story of Lomé is one of incremental change.*[2]

In contrast, however, Oyejide and Njinkeu, conclude that 'Although its trade elements are not yet in place, the Agreement already clearly indicates that these trade elements will represent a major departure from those associated with the Lomé Convention',[3] thus suggesting that Cotonou amounts to a break with the past.

We will argue in this chapter that there are a number of forces impacting on the longstanding ACP–EU relationship that are altering the nature of the relationship in a fundamental way. We will first analyse the forces that make these changes inevitable, then discuss the forces in the environment of ACP–EU co-operation. We will look at the effectiveness of the Lomé model, analyse the Cotonou Agreement, and then look at the implementation of the new agreement.

Forces of change

The forces that have impacted on the ACP–EU relationship can be classified as either exogenous or endogenous. Some of them have been present for a decade or longer. It is the accumulation of these forces that have made the profound changes to the scope, instruments, and implementation of ACP – EU co-operation almost inevitable.

Exogenous impetuses

International trade liberalisation. A compelling argument for not renewing the Lomé Convention was the recognition that any new ACP–EU arrangement had to be fully compatible with the rules of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO). The preferential trade regime of the Lomé accord, particularly the non-reciprocal duty-free entry of ACP products into the EU market, was a violation of the Most Favoured Nation (MFN) principle of the GATT/WTO that aspires to establish and advance non-discrimination among its member states. Given

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the exclusivity of most of its trade privileges, the conventions were vulnerable on legal grounds. In fact, by 1994, two Dispute Settlement Panels had ruled that the Lomé Banana Protocol was incompatible with Article XXIV of the GATT. In 1997 the WTO's Dispute Settlement Body (DSB) again ruled that the Banana protocol was illegal,[4] because it discriminated against the so-called 'dollar bananas' of Central America.[5] Although allowance is made in the GATT/WTO for North–South arrangements such as the ACP–EU pact to obtain a waiver from the WTO for restricted non-reciprocal trade preferences, such exemptions are not meant to be indefinite.[6] In response, and to remedy the problem by complying with Article XXIV (GATT/WTO), the EU proposed a series of free trade agreements (FTAs), also known as Economic Partnership Agreements (EPAs).[7]

The evolving position of the EU in the world economy. The external economic relations of the EU show a continuous change, in terms of both geography and policy interventions. A few important changes are highlighted in order to put the shift from Lomé to Cotonou into perspective. First, since 1990, trade between the EU and the rest of the world has been rising at a higher rate than trade among the EU member states (intra-trade), both in exports and in imports. In 2001, 62% of EU exports were destined for other member states. This was 65% in 1990. Second, the 'preferred' partners in Africa and the Middle East have become rather marginalised in EU trade relations, while North America and Asia have remained and gained importance respectively. Tables 2.1 and 2.2 show the destination and origins of EU trade.

The external economic policies of the EU interact with the foregoing changes. For a long time, the EU was in the comfortable position that it could protect parts of its own market from foreign competition – mainly from Japan and the rest of Asia – while it could open up other segments of its markets

Table 1. Extra exports of the EU (by destination, percentage of total extra exports)

	1980	1990	2000	2001
Europe, non-EU	29.8	28.6	30.5	30.9
CEE countries	7.1	6.2	13.2	14
Africa	19	11.9	6.9	7
ACP	8.5	4.4	2.8	2.7
Mediterranean	14.6	12.4	11.5	10.2
North America	15.9	23.9	26.9	26.6
Latin America	6.7	4.3	5.8	5.7
OPEC	19.6	9.5	5.9	6.6
DAE	3.8	7.9	8.6	8.3

Table 2. Extra imports of the EU (by origin, percentage of total extra imports)

1980	1990	2000	2001	
Europe, non-EU	21.5	25.2	27.1	29.2
CEE countries	4.5	5.4	9.9	11.3
Africa	16.5	11.6	8.1	8.4
ACP	8.1	4.7	2.7	3
Mediterranean	9.1	10	8.5	8.8
North America	21.4	23.1	21	20.8
Latin America	6.6	6.1	4.7	4.8
OPEC	30.4	10.5	8.5	7.6
DAE	5.1	8.2	10.5	9.5

Source for Tables 2.1 and 2.2: Eurostat, 'External and intra-European Union trade – *Statistical Yearbook*, 2002 Edition' (Office for Official Publications of the European Communities, Luxembourg, 2002).

in return for improved access to the markets of its most important trading partners, the other OECD countries. Its 'preferred' partners in the Mediterranean and the ACP group were not putting competitive pressure on EU producers. The EU was a zealous defender of non-reciprocal preferences. The present shift to reciprocity should be considered in the light of the changing position of the EU in the world economy, in which the strategy of non-reciprocal preferences no longer produces the desired results. The EU needs good access to fast-growing markets if it is to remain an economic world power. The EU uses both regional and multilateral approaches to take care of its trading interests. Emerging markets are becoming strong negotiating partners in the WTO and are integrating at the regional level. This regional integration in Asia and Latin America entails the risk that the EU faces a deteriorated competitive position in these markets as a result of discriminatory regional trade arrangements.[8] In this situation, reciprocal trade arrangements with these regional blocs will guarantee market access to these emerging markets.

The WTO is the second channel to gain access to third markets. The non-reciprocal preferences under the traditional Mediterranean agreements and the Lomé Convention jeopardised the negotiating position of the EU in the WTO. In order to maintain these preferences against the pressures as mentioned above, the EU would have had to invest large amounts of concessions in other areas. Given the objectives of the EU in these negotiations, the EU has to use its concessions in a strategic way, that is, to gain access to important markets and to create room for a cautious reform of the Common Agricultural Policy (CAP). The disappointing effectiveness of the Lomé preferences did not constitute a barrier to this line of action. As a result, the EU is now setting up a network of reciprocal trade agreements with third countries. The two options that the Cotonou Agreement offers the ACP countries – reciprocal free trade areas or Generalised System of Preferences (GSP) – are in line with the new external economic policy of the EU.

The end of the cold war. Another impetus for transforming ACP–EU relations was the collapse in 1989–90 of the communist regimes of the erstwhile Soviet bloc and the resultant end of the cold war. The dismantling of the Berlin Wall that had partitioned the European landscape during much of post-World War II affected ACP–EU relations in at least two significant ways. On the one hand, it broadened the horizon and scope of the external economic relations of the EU, that is, the Union had to redefine its relationship with its Central and Eastern Europe (CEE) neighbours, but in the broader context of its overall external economic relations. In redefining the relationship, the EU had to consider short- and long-term perspectives, both of which had profound consequences for the ACP group. In the short term, the EU provided immediate assistance to the governments concerned, especially as they began reforming their economies. In the long term, the EU also provided financial and non-financial resources in the manner of the Phare programme (*Pologne, Hongrie Assistance à la Reconstruction Economique*) to prepare the CEE countries for eventual EU membership. Already, the accession of eight CEE countries to the EU has been agreed to take place in 2004. The ACP group feared that funds that had previously been earmarked for it were being redirected to Eastern Europe. To be sure, the flow of economic assistance from the EU to the CEE countries increased dramatically during the 1990s, while the ACP's share of total EU aid dropped considerably during the same period. In other words, ACP countries would now have to compete for the attention (and resources) of the EU, because of a more immediate and urgent need in the Union's backyard.

Endogenous impetuses

Widening of the European Union. Every enlargement of the EU since 1957 has certainly influenced the need for a different EU–ACP relationship. Each time the EU has welcomed new members to its fold, the relationship between the EU and the ACP group has been affected. Before the first enlargement of the 1970s, EU–ACP relations were tilted in the direction of former French and Belgian colonies in Africa. UK accession in 1973 brought about a more comprehensive and expanded relationship

between the EU and its ACP partners. Specifically, former British colonies were brought into the EU–ACP picture. The enlargement of the 1980s further sensitised EU external relations to Latin America, to the former colonies of Portugal and Spain. Following the 1986 accession, EU contacts with Latin America steadily grew, as Spain, in particular, lobbied for the region within the EU both in the Commission, when policies are being formulated, and in the Council, when the fate of policies are being decided. The 1986 enlargement arguably marked the beginning of the ebbing of the ACP group's importance with respect to the EU's pyramid of privileges. The enlargement of the 1990s, when Austria, Finland, and Sweden joined the EU, continued the ebbing of ACP importance in Brussels, especially as the new EU member states historically had no colonial ties with the ACP countries.[9] The 1989–90 political earthquakes in Eastern Europe and the impending accession of CEE states to the EU in 2004 will further challenge the importance of the ACP group in the EU. Moreover, it is unlikely that given the magnitude of their own economic problems, the acceding CEE countries, upon accession, would enthusiastically support, for example, a considerable increase in the European Development Fund 10 (EDF 10).

Commission reforms. A second European impetus that informed the changed environment of EU–ACP relations is the growing competence and bureaucratic apparatus of the EU. The increased number of Directorates General (DGs) of the European Commission and of its Eurocrats has translated into a proliferation of ideas and of policies, as well as the diffusion of influence within the supranational entity. More poignantly, the cultivation of an ACP–EU relationship, for which the DG for Development was created, is no longer the only (external/development) policy which has a bureaucracy to lobby on its behalf. Given the importance the EU has attached to enlargement,[10] for instance, the DG and the Commissioner for Enlargement are nowadays among the most sought-after in Brussels.

Deepening integration. The consolidation of European integration is also forcing changes in ACP–EU relations. Most notably and most recently, the entering into force of the European Union Treaties of Maastricht (1993), Amsterdam (1999), and Nice (2003) necessitated the modification of some aspects of its relationship with the ACP countries (and others). For example, the Common Foreign and Security Policy (CFSP) pillar of the Maastricht Treaty provided the legal underpinnings for the inclusion of political dialogue, economic partnership, and social development in the negotiation of Cotonou. Article 11 of the Maastricht U Treaty provides that the CFSP shall 'preserve peace and strengthen international security ..., promote international co-operation, develop and consolidate democracy, rule of law, and respect for human rights and fundamental freedoms'. In order to comply with the provisions of the article, the EU overtly pushes for development co-operation policies to promote pluralist democracy, human rights, the rule of law, and good governance in ACP societies.

Likewise, ACP–EU relations have had to adjust to the launching of the Single European Market (SEM) initiative, which sought to eradicate trade barriers within the EU. The Banana Protocol of Lomé, for example, restricted the distribution of imported ACP bananas within the EU, which was a clear violation of the free movement of goods. The negotiation of ACP–EU relations also had to be altered by yet another attempt by the EU to consolidate its integration, namely, the debut of the euro. For instance, in 1998 the Council of Ministers for Finance agreed to allow the CFA Franc, which is widely used by France's former colonies in Sub-Saharan Africa (SSA), to be pegged to the euro. This development would likely open up additional EU markets and reduce the colonial mentality of many ACP states *vis-à-vis* their economic relations with the EU.

The conclusion of this section is that a number of factors have necessitated changes in ACP–EU relations. At the turn of the century a fundamental overhaul of the Lomé Convention had become virtually inevitable.

The effectiveness of the Lomé model

The Lomé Conventions were intended to promote the development of the signatory ACP states pri-

marily via trade, economic assistance, and technical co-operation. Granted that the Lomé Conventions were not the only development stimuli to which the ACP countries were subjected between 1975 and 2000, we would expect, all other things being equal, that to the extent that Lomé's were the most assured (at least over a five-year period during the Lomé era) and more generous than any external concessions, there should be, *a priori*, noticeable improvements in pertinent ACP indicators. In other words, between the inception of Lomé in 1975 and its expiry in 2000, we should see evidence of improvement in, say, economic growth, capacity development, etc. Also, compared to non-ACP states that did not receive any or quite as generous concessions ('control group'), there should be evidence of better indicators for the ACP countries.

A non-reciprocal duty-free trade arrangement constituted the cornerstone of the conventions. Thus, more than 90% of ACP exports, predominantly primary commodities, qualified to enter the EU duty-free. The concession was predicated on the neo-liberal view of trade as an engine of economic growth and of development. The evidence, however, is that the share of ACP products in total EU imports from third countries precipitously declined from roughly 8% in 1980 to about 3% in 2001 (see Table 2 above). Non-ACP developing countries of Asia and Latin America performed much better in terms of shares in EU imports from third countries. With respect to the poor performance of the ACP group, most of its members still depend, today, as they did at the start of the first Lomé Convention in 1975, on the exports of essentially the same handful of primary commodities for foreign exchange, thus implying lack of diversification. Indeed, labour-intensive primary products constituted over 80% of ACP exports to the EU, while the share of such products in total extra-EU imports declined during the same period.

Another privilege of the pact was the provision of economic assistance to the ACP countries via the European Development Fund (EDF). Every Lomé Convention was accompanied by a contemporaneous EDF allocation. The five-year EDF scheme earmarked €3 billion (Lomé I), €4.7 billion (Lomé II), €7.4 billion (Lomé III), €10.8 billion (Lomé IV-a), and €12.9 billion (Lomé IV-bis), primarily in grants and special loans. The EDFs also financed two commodity insurance schemes, STABEX and SYSMIN, for countries that were dependent on agricultural exports and on exports of mineral products respectively. Purposely, the two mitigating insurance schemes were intended to maintain export capacity by compensating ACP exporters of agricultural and mineral products for short-term losses suffered in export earnings.

A third major privilege was the provision of industrial and technical co-operation that would enable the use of the EU's know-how for the industrial development of ACP societies. Other major concessions of the Lomé conventions included special protocols for bananas, sugar and rum.

How have the ACP countries performed? In short, they did not successfully avail themselves of the opportunities that the Convention offered. Despite two-and-a-half decades of EU privileges, 40 of the 63 countries in the World Bank's unenviable category of least-developed countries (LDCs) in 2000 were ACP member states.[11] In other words, over half of the membership of the ACP group was among the world's poorest countries the year Lomé expired. If one looks at disaggregated data, it appears that some ACP countries, most notably Mauritius, Seychelles and the Caribbean member states, seem to have successfully taken advantage of the Conventions. The fact remains, however, that most ACP economies struggled and even regressed during the Lomé era. In Sub-Saharan Africa (where 95% of the ACP population lives), average growth of gross domestic product (GDP) was 1.7% during the 1980s and 2.4% in the 1990s. Annual population growth, however, was 2.9% and 2.6% respectively. This led to falling per capita incomes during both decades. Poverty increased dramatically in SSA. At the end of the millennium, there were 292 million people living on less than US$1 a day in SSA. This number had grown by 75 million over 1987–98.[12] According to the Human Development Index, which presents an alternative measure for level of development, only Mauritius and Seychelles among the African ACP states, all but Haiti among the Caribbean ACP countries, and all but Papua New Guinea, Solomon Islands, and Vanuatu among the Pacific

ACP states, ranked above 100.[13] It is no wonder, therefore, as noted by some observers, that the EU, especially the European Commission suffered from a case of 'donor fatigue' and felt it necessary to transform the Lomé Convention. Thus, a 'business as usual' renewal of the Lomé Convention had become virtually impossible.

The innovations of Cotonou

The text of the Cotonou Agreement differs substantially from the Lomé Conventions in a number of ways. These differences are reviewed in this section.[14]

The nature of the agreement

The Cotonou Agreement is a framework agreement consisting of objectives, principles and options for instruments, while the Lomé Conventions were self-contained rule systems. This appears from several facts. First, the text of the Cotonou Agreement contains only 100 Articles, while Lomé IV-bis contained 369 Articles. Many of the implementation rules have been shifted to the annexes of the Cotonou Agreement. This applies to the trade rules during the preparatory period (2000–08) and the implementation of financial co-operation. Second, the Cotonou Agreement itself has been scheduled to run for a period of 20 years. The practical parts will or can be renegotiated at shorter intervals. The Financial Protocol applies for a five-year period, while the trade regime has to be negotiated before the preparatory period lapses.

The objectives

The Cotonou Agreement is explicit as to its objectives: the reduction and eventual eradication of poverty is the prime goal of the co-operation, 'consistent with the objectives of sustainable development and the gradual integration of the ACP countries in the world economy' (Article 1). This is more precise than and different to Lomé IV, in which the parties said that their central objective was 'to promote and expedite the economic, cultural and social development of the ACP States and to consolidate and diversify their relations...' (Lomé IV, Article 1). It was only in Lomé IV-bis that improving international competitiveness was included as an objective of trade development (Article 15a), but it was not an overall objective as it is in the Cotonou Agreement. Thus, the objectives of the new agreement are highly consistent with the objectives of the EU's policy of development co-operation as formulated in Article 177 of the EC Treaty.[15]

The principles of co-operation

The principles of co-operation have been reformulated and refined in the Cotonou Agreement. Under Lomé IV, the principles were equality between partners, the right to self-determination, and security in the EU–ACP relationship. The change in the Cotonou Agreement is striking. There is still the principle of equality and sovereignty of ACP states in determining their development strategies. However, this is now qualified in the sense that there should be 'due regard for the essential elements ...' (Article 2). These essential elements are respect for human rights, democratic principles, and the rule of law (Article 9). The three other principles are new:

- participation of other sections of society in the co-operation between the ACP and the EU 'in order to encourage the integration of all sectors of society, including the private sector and civil society organisations, into the mainstream of political, economic and social life';
- dialogue and fulfilment of mutual obligations; parties will be accountable to each other for meeting their obligations;
- differentiation and regionalisation; this enables the parties to attune the ways and means of co-operation to the level of development, needs, performance and long-term strategy of the ACP country concerned.

The changes in the principles make it clear that there is a strong wish – at least on the part of the EU – to put the ACP–EU relationship on a new footing: broaden the co-operation from state-to-state activities to state-to-civil society and private sector organisations, make partners more accountable, and demand fulfilment of mutual obligations. Under

Lomé, the EU was obliged to support an ACP country even if it was implementing policies that were contrary to development, human rights, rule of law, etc.

Political dialogue

The political dimension of the ACP–EU relationship has received special attention, in order to make the principles mentioned above effective. To that end, the parties have agreed to regularly engage in 'comprehensive, balanced and deep political dialogue, leading to commitments on both sides' (Article 8). Subjects to be discussed in the dialogue include arms trade, excessive military expenditure, drugs and organised crime, and ethnic, religious or racial discrimination. The dialogue will also regularly assess the 'developments concerning the respect for human rights, democratic principles, rule of law and good governance'. Conflict prevention and peace promotion will be discussed as well.

The political dialogue has got teeth: if a country does not meet its obligations concerning human rights, democratic principles, and the rule of law, 'appropriate measures' may be taken. Suspension is a measure of last resort (Article 96). A comparable procedure applies for the obligation of good governance (Article 97).[16]

Trade arrangements

For 25 years, Lomé granted the ACP group non-reciprocal preferences that were more generous than the other preferential systems the EU operated. There are two options for the replacement of this system after 2007. Regional groups of ACP countries can negotiate economic partnership agreements (EPAs) with the EU that liberalise trade in a reciprocal way during a 10- to 12-year period. Least-developed ACP countries can opt for the continuation of non-reciprocal preferences under the EU's preferences for the least-developed countries (LDCs) that cover almost all products.[17] Non-LDC ACP countries that are not in a position to conclude an EPA can try to export under the EU's Generalised System of Preferences (GSP) after 2007, which is also non-reciprocal in nature. These options are WTO-compatible, and do away with the discrimination that, based on history and geography, favoured the ACP group. The EPAs are characterised by the mutual obligation to liberalise trade.

From a historical perspective, one might argue that the trade arrangement of the pré-Yaoundé period (1958–63) as embodied in the Fourth part of the Rome Treaty is being re-introduced. This arrangement created one reciprocal free trade area between the dependent 'associated countries and territories' and the six original member states. The associates were allowed to levy tariffs for reasons of development, industrialisation and their budgets. The First Yaoundé Convention (1963) *de facto* abolished this unified free trade area and instead created 18 separate FTAs between each independent associated state and the EU.[18] In 1975, non-reciprocity superseded reciprocity at the introduction of the first Lomé Convention.

Financial support

The EDF for 2000–07 contains €13.5 billion.[19] The changes in the aid mechanism are in line with the foregoing. The distribution of resources will be made on more explicit criteria than before: need and performance. The latter is a striking innovation. Under Lomé, ACP countries got indications of the amounts of EDF money they could expect for the five-year period of a particular EDF. There were no general criteria for the allocations. The performance yardstick now introduced will be assessed 'in an objective and transparent manner on the basis of the following parameters: progress in implementing institutional reforms, country performance in the use of resources, effective implementation of current operations, poverty alleviation or reduction, sustainable development measures and macroeconomic and sectoral policy performance' (Annex IV to the Cotonou Agreement, Article 3). The financial co-operation will be reviewed on a country-by-country basis. There will be annual operational reviews and mid-term and end-of-term reviews. Following the latter two 'the Community may revise the resource allocation in the light of current needs and performance of the ACP state concerned' (Article 5 of the same Annex). The result of this could be that a non-performing ACP country loses most of its EDF support.

A second major change in the aid section is the pledge to support the capacity building of 'community organisations and non-profit non-governmental organisations in all spheres of co-operation' (Article 7). The priority for the development of the private sector is reflected in the fact that private companies of ACP states are eligible for financial support (Article 58), and that an Investment Facility has been created that should supply risk capital and ordinary loans to ACP enterprises (Cotonou Agreement, Annex II, Article 2).

A third change is the demise of the STABEX and SYSMIN mechanisms. Hailed as the major innovation of Lomé I, but unable to effectively tackle the instability of export receipts, these aid instruments have now almost disappeared. ACP states can still use part of their programmable aid for this purpose.

The new agreement in practice

At the time of writing, the Cotonou Agreement has been around for three years.[20] An interesting question is whether the fundamental changes show up in the practice of ACP–EU co-operation. We will first take a look at the preparations and negotiations for EPAs. Experiences with political dialogue will be discussed in a subsequent subsection.

The options for a future trade regime

The Cotonou Agreement does not contain a blueprint for the future regime of ACP–EU trade relations. It can be argued that individual ACP countries can choose the most appropriate option out of a range.[21] However, we will show in this section that the options are constrained.

The Cotonou Agreement stipulates that the transition period between 2000 and 2007 will be used to negotiate EPAs between (groups of) ACP countries and the EU that '... shall aim notably at establishing the timetable for the progressive removal of barriers to trade between the Parties in accordance with the relevant WTO rules' (Article 37.7). This hints at the reciprocity of the trade preferences under the EPAs, which will require the ACP countries to give EU exports free entry to their markets. However, another way to realise a WTO-compatible trade regime is by way of non-discriminating trade preferences. In this line, the non-LDC ACP countries 'might decide that they are not in a position to enter into EPAs' (Article 37.6). Alternatives will be examined for these countries, which are likely to be found in bringing their exports under the GSP. For the LDCs in the ACP group, 'duty-free access for essentially all products' will be introduced (Article 37.9), which is equal to the 'Everything But Arms' (EBA) initiative for all LDCs. It is striking that the non-reciprocal solutions get comparatively little attention; by going into much more detail the agreement as such seems to prefer the reciprocal trade arrangements for the post-2007 period. The European Commissioner for Trade, Pascal Lamy, confirmed this right before the start of the EPA negotiations in September 2002: '... we ... expect our ACP partners to do their bit to contribute to the common goal. They have to establish sound policies. They must, above all, foster regional integration in return for EU market opening'.[22]

The options that the ACP group has for its trade arrangements with the EU are depicted in Figure 1. The least-developed ACP can choose between an FTA and EBA. However, this choice is constrained for many of them. LDCs that belong to a regional trading arrangement (RTA) will be confronted with frictions if they opt for EBA plus membership of the RTA if that latter organisation concludes an EPA with the EU. One could argue that there is no problem as long as the RTA is an FTA itself.

However, most RTAs in SSA (CEMAC, COMESA, ECOWAS, SADC, SACU, UEMOA) are – or pretend to be – custom unions (CUs) or a higher form of integration. A CU has a common external trade policy, which entails the loss of national sovereignty over trade policy. Thus, an EPA will give EU exports free entry to the market of all members of the ACP RTA, including the LDC members. The EU–South Africa Trade, Development and Co-operation Agreement is a case in point. As a result of this agreement, the other SACU (of which South Africa is a member) members have in actual fact entered into a reciprocal free trade arrangement with the EU.[23]

Figure 1. Options for future ACP-EU trade arrangements

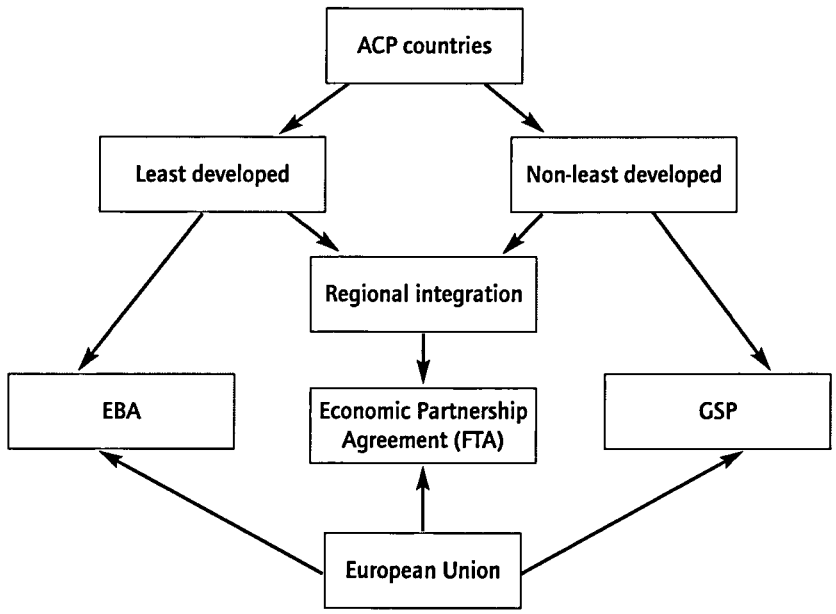


Table 3. Membership of RTAs in Sub-Saharan Africa, 2002

Name ACPRTA	Member states	Of which least-developed
ECOWAS	16	12
UEMOA	8	6
CEMAC	6	2
SADC	13	7
SACU	5	1
COMESA	19	12
EAC	3	2
IOC	4	2
IOR-ARC	6	3

As a result, those LDCs that want to remain members of the RTA to which they belong cannot make use of EBA. The other option is to give up the membership of the RTA in order to profit from EBA and retain the MFN trade barriers with respect to imports from the EU and other third countries. This comes closest to the continuation of the present non-reciprocal Lomé preferences. The inclusion of free entry for bananas (2006) and sugar and rice (2009) in EBA may increase the attractiveness of this option. However, reform of the CAP and liberalisation of trade in agricultural products will have reduced prices in the EU for these products at the moment of their inclusion in EBA. Furthermore, EBA has an escape clause: safeguard measures may be introduced when LDC exports grow at a high rate ('surge'). Many ACP LDCs now export limited quantities of sugar under the Lomé Sugar protocol to the highly protected EU market. It remains to be seen whether quota-free entry under EBA with more competition and lower EU prices will be an improvement for these countries. In any case, it is expected that ACP countries without sugar quotas under the Lomé Sugar protocol – Malawi, Tanzania and Zambia – will benefit most.[24] Another drawback of EBA is that it is a unilateral initiative by the EU, not a contract between parties. The upshot is that ACP LDCs have two options – EPA or EBA – that will both bring fundamental change. The EPA option makes the changes explicit and subject to a time schedule, the EBA option less so. Perhaps that is also the risk of EBA: it might create the illusion with policymakers in ACP LDCs that things will not change and reforms to adapt to the world economy can be postponed to an undefined date in the future.

For the 36 non-LDC ACP countries, the choice

is between EPA and GSP. The EU GSP is regularly adapted to different forces: developmental, protectionist and political pressures play a role. The system is meant to stimulate exports of primarily manufactured goods by developing countries. At the same time it differentiates between sensitive and non-sensitive goods. For the former category, tariffs are only partially lowered (in the 2002/04 version by 3.5 percentage points). Non-sensitive products enter duty-free, except those products for which there are particular core standards in environmental and labour protection. The product coverage of the GSP is narrower than is the case with EBA and the Lomé trade preferences. Furthermore, the GSP suffers from institutional weaknesses. These include lack of contractuality and the presence of rules of origin that are relatively onerous.[25] Thus, the GSP will not be a very attractive alternative for most non-LDC ACP countries. This is the more so as the commodity protocols will disappear. If these countries want to maintain their present access to the EU market they will have to enter into EPAs, preferably based on existing RTAs.

Negotiations on the future trade regime

The mandates for the EPA negotiations were drawn up in the summer of 2002. Although these mandates only indicate starting positions, a few differences of opinion are worth mentioning. The sequencing of the negotiations is clearly an issue. The ACP mandate maintains that regional integration among ACP countries could be stifled or undermined by EPAs. For that reason 'ACP States must be allowed to first consolidate their own regional integration processes. Moreover, they do not have the capacity to liberalise in parallel and concurrently with the EU.'[26] The EU recognises the problems ACP countries have in realising regional integration. During the transition period, regional integration processes among the ACP should be supported, and EPAs should be introduced after the period has lapsed. The implicit conclusion of the EU is that after 2007, regional integration and EPAs should develop in parallel.

This is a more promising strategy than waiting until effective ACP integration bodies have been created before commencing the EPAs, as the ACP group prefers.[27] Adjustment costs are a related issue. The ACP mandate argues that: 'The positive impact of EPAs needs to be maximised and their adjustment costs minimised so that their implementation is sustainable. In addition, EPAs should result in trade creation and not in trade diversion so as to avoid any welfare loss.' This contradicts the theory and practice of economic integration. The positive welfare effect of trade creation is produced by a better allocation of factors of production, which means a restructuring of economic activities. Trade creation and adjustment are two sides of the same coin. In addition, the ACP mandate calls for 'the provision of additional resources, with rapid and flexible disbursement procedures'. The EU mandate does not mention additional resources and instruments for adjustment. Instead, it contains a plea to use the period up to 2008 to strengthen the ACP capacity to define and implement appropriate trade strategies and policies in order to enhance competitiveness, to strengthen regional organisations and integration 'where appropriate with assistance to budgetary adjustment and fiscal reform ...'. This seems to imply that the EU wants to use existing EDF funds for adjustment.

A third important issue will be market access. The ACP countries want a guarantee that they will not be worse off after 2007 in their trade relations with the EU compared to their present position. Given the interdependent nature of trade policies, this guarantee is difficult to imagine. On the other hand, improved market access for ACP-sensitive products in agriculture, clothing and other sectors would be helpful in creating quick results from EPAs. The EU is reluctant to offer this. After repeating that at present 93% of ACP exports enter the EU duty- and quota-free, the EU promises that 'The EU will further abolish remaining tariffs, focus on co-operation with the ACP countries to remove non-tariff barriers and assess technical hurdles (such as rules of origin), with a view to facilitating market access for the ACP'.[28]

Given these starting positions, it is doubtful whether viable EPAs will come out of the negotiations. Both sides are reluctant to invest large amounts of political capital in EPAs. The ACP countries are afraid of restructuring and adjustment

and for that reason 'cannot *a priori* accept to provide reciprocity in EPAs with the EU' according to the ACP mandate. This is a denial of the basic presumption of the EPA concept. The EU is setting high expectations on dynamic and non-traditional effects of FTAs. The problem is that these effects, if they materialise, will do so only in the long run, while successes in the short run are vital to keep the integration going. These could be produced by improving market access for the ACP in the EPA framework and by creating funds to cushion external shocks on ACP RTAs that are implementing EPAs with the EU.

Political dialogue

The EU and the ACP are conducting political dialogues both collectively during negotiations and between the EU and individual ACP countries. Some cases in the latter category will be briefly analysed, in order to illustrate the practical applications of Article 96 of the Cotonou Agreement.[29]

In 2000, a consultation meeting was initiated by the EU, in reaction to irregularities during the elections in Haiti earlier in the year. There appeared to be a relatively sharp ACP–EU difference of opinion on the significance of the irregularities involved, and more generally on the reading of the situation in Haiti and the necessity for and appropriateness of sanctions. The EU broke off the discussions with Haiti and imposed sanctions. The second tranche of the financial resources available for Haiti under EDF 8 (Lomé IV-bis) was blocked and direct budget aid was stopped. Remaining aid funds were redirected, and the procedure for allocating resources under EDF 9 was halted.

In mid-October 2000, consultations were held with Fiji in response to a coup. It was reported that Fiji came forth with sufficient information on the measures it had adopted for a return to constitutional rule. In response, the EU took note of Fiji's plans and made a number of suggestions for concrete measures such as restoring the constitution and bringing the authors of the coup to justice. The EU also took Fiji's request for additional aid into consideration. The consultation process was wrapped up the following year.

The EU Council of Ministers had taken relatively mild countermeasures in this case. Only the notification of the allocation of Cotonou resources for Fiji, and the financing and implementation of new projects from Lomé EDF funds, were postponed until elections had taken place.

A consultation procedure with Cote d'Ivoire was begun in 2001, because of human rights violations, irregularities and violence during presidential and legislative elections. Cote d'Ivoire reportedly answered EU questions adequately. Both sides stressed that consultations were held to remedy problems, and not merely to apply sanctions. Several months of intensive dialogue ensued, after which the EU Council of Ministers ended the consultation process. As a result of the measures taken by Cote d'Ivoire, the Council decided to gradually resume co-operation, including the allocation of EDF 9 resources.

Consultations were held with Zimbabwe as the situation with respect to democracy and human rights deteriorated in 2001.[30] In the run-up to the presidential elections in March 2002, frictions in the country escalated. The EU Council of Ministers expressed its concerns in January 2002, despite the promises of the Zimbabwean government that the elections would be free and fair. The Council threatened to discontinue consultations if Zimbabwe prevented the deployment of an EU delegation of observers. One month later the Council decided to withdraw the observers and to introduce 'smart' sanctions against President Robert Mugabe and 19 of his associates. The coverage was expanded to a larger number of officials and the wife of the president in the summer of the same year. The sanctions included a ban on travel to the EU, a freezing of the assets of the individuals concerned and a ban on arms sales to Zimbabwe. Humanitarian aid and support for the population in social sectors were not affected.

These four cases show that the EU is prepared to use the expanded opportunities for political dialogue under Cotonou to effect change in ACP societies. Thus, the EU is monitoring the ACP much more closely than before, and starts consultations in the relatively early stage of a deteriorating situation.

Summary and conclusions

This paper argues that a 'business as usual' approach for ACP–EU co-operation was no longer tenable for the EU for different reasons. The old model had proven to be vulnerable to complaints under the WTO regime, and was no longer compatible with the interests and aspirations of the EU as a serious international actor. Due to its rising dependencies on international markets, reciprocity has become an essential mechanism for the EU to open up foreign markets. The failure of the Lomé model to produce visible progress in standards of living had seriously undermined the credibility of the EU as a leading actor on development issues. At the same time, the changes in the post-cold war climate for development also induced the EU to urge extensive amendments to ACP–EU co-operation. The Cotonou Agreement introduces a new approach that is characterised by reciprocity, but that is still to be worked out. The Cotonou Agreement has introduced some major changes into the ACP–EU relationship. A few phrases that are indicative of the philosophical underpinnings of the new agreement include:

- mutual obligations: the time that ACP countries had unquestioned entitlements for aid and non-reciprocal trade preferences is history;
- dialogue and reviews in order to keep the partners accountable and eventually to redistribute the benefits of co-operation to those countries that perform better;
- participation of non-state actors in order to increase ownership and improve the distribution of the benefits of co-operation;
- private sector development; the emphasis on this sector has been translated into an action programme and facilities for support.

The practical consequences of the aforementioned have been analysed in more detail above for the new accord. Although the ACP countries have different options (EPA with reciprocal free trade or GSP treatment), the GSP option is not attractive for the non-least developed ACP countries as a result of more limited coverage, smaller and eroding preferential margins, and an absence of contractuality. For the least-developed ACP countries, the EBA option seems attractive, but suffers from the same non-contractuality, and offers preferences in areas/products whose benefits are fast eroding due to global trade liberalisation and CAP reforms. Thus, most ACP countries will opt for the conclusion of EPAs, and will have to offer the EU free access to their markets. This is a time-consuming process, which will not start until 2008 and is not expected to be fully implemented before 2020. But the fundamental change is there, and has been set in the Cotonou Agreement.

The idea that human rights, the rule of law, and democracy are part of, or closely linked with, development has been amply acknowledged in the Cotonou Agreement. There is now a demonstrated preparedness by the EU to demand a minimum application of the aforementioned from ACP countries.

This article has not tried to determine whether the new approach is a better instrument for development. That assessment is premature at this point. To that end, it is worth reiterating the following observations. First, not much should be expected from the new trade arrangements during the first eight years of the agreement, as they are still being negotiated. Second, the new aid regime should reward countries that perform well; more aid will flow to non-governmental and private sector organisations. In combination with improved human rights implementation and democratic institutions, this might contribute to stronger incentives for individuals and organisations to direct their energy into productive activities, thus increasing the rate of economic development. However, ACP–EU co-operation is only one of the many factors impacting the development process in ACP countries. Even if the Cotonou instruments are put into practice in an optimal way, ACP development might be impeded by armed conflicts, global economic shocks, the success or failure of multilateral trade negotiations, and ACP governments that decide to follow policies that do not necessarily promote development.

In the final analysis, the Cotonou Agreement should not be regarded as just another version of the Lomé Conventions. The new agreement introduces more reciprocity, more mutual obligations in politi-

cal and economic terms, and more pressure for liberalisation in ACP economies. What perhaps is the most revolutionary change in the Cotonou Agreement is that the EU appears to be determined to put the new approach into practice.

Endnotes

1. G. Faber (1982) *The European Community and Development Co-operation*, Van Gorcum, Assen and E.Z. Grilli (1993) *The European Community and the Developing Countries*, Cambridge University Press, Cambridge.
2. G. Forwood (2001) 'The Road to Cotonou: Negotiating a Successor to Lomé' in *Journal of Common Market Studies* 39, pp. 438–9.
3. A. Oyejide and D. Njinkeu (2001) 'African Preparation for Trade Negotiations in the Context of the ACP–EU Cotonou Partnership Agreement'. Background document prepared for the Conference of African Trade Ministers held in Abuja (Nigeria), August 2001, p. 1.
4. See, among others, Eurecom (October 1995) p. 2, (October 1997) p.1, and (November 1998) p. 2.
5. The Central American countries were Ecuador, Guatemala, Honduras and Mexico.
6. The ACP group and the EU indeed requested such a waiver from the WTO after the mid-term review as a transitional measure to help mitigate the impact of the cessation of non-reciprocity in EU–ACP relations. The waiver was granted in 1997 and expired in February 2000.
7. *The Courier*, No. 173, 1999, pp. 72–4 and *West Africa*, 9–22 November, 1998, pp. 798–802. See also, European Commission, *Green Paper on relations between the European Union and the ACP countries on the eve of the 21st century: Challenges and options for a new partnership* (Brussels, 1996).
8. L.A. Winters (2000) 'EU's Preferential Trade Agreements: Objectives and Outcomes' in P. van Dijck and G. Faber (eds) *The External Economic Dimension of the European Union*, Kluwer Law International, The Hague, pp. 195–223.
9. Sweden, however, has a credible history of generously assisting LDCs (especially SSA) financially.
10. A Commissioner with the enlargement portfolio was created under the Prodi presidency to underscore the seriousness with which the EU treats the issue.
11. The World Bank (2000) *World Development Indicators*, The World Bank, Washington, DC,.
12. The World Bank (2001) *World Development Report 2000/2001*, Oxford University Press, Oxford, p. 4.
13. *The Courier*, September 2000.
14. For a more detailed analysis of the text of the agreement, see K. Arts (2003) 'ACP–EU Relations in a New Era: The Cotonou Agreement' *CML Rev* 40, pp. 95–116. The text of the Cotonou Agreement is reproduced in *The Courier*, September 2000.
15. One might argue that poverty reduction has a higher priority in the Cotonou Agreement compared with the EC Treaty.
16. For a more elaborate discussion on good governance in the Cotonou Agreement, see P. Hilpold (2002) 'EU Development Co-operation at a Crossroad: The Cotonou Agreement of 23 June 2000 and the Principle of Good Governance', 7 *EFA Rev*, pp. 53–72.
17. Exceptions are arms, and, temporarily, some temperate zone agricultural products. This system is indicated as the Everything But Arms (EBA) initiative. See next section for more details on EBA.
18. G. Faber (1982) *The European Community and Development Co-operation*, Van Gorcum, Assen, p. 10.
19. There remained €9.9 billion of previous periods and the European Investment Bank has € 1.7 billion available.
20. Although formally speaking the agreement only went into force on 1 April 2003, as a sufficient number of parties (including all EU member states) had ratified by that date, it has been implemented since its signing on 23 June, 2000.
21. F.A.S.T. Matambalya and S. Wolf, 'The Cotonou Agreement and the Challenges of Making the New EU–ACP Trade Regime WTO Compatible' (2001) *Journal of World Trade* 35, pp. 123–44.
22. Interview with Pascal Lamy in *The Courier*, No. 193, July–August 2002.
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25. C. Stevens (2004) 'The Generalised System of Preferences, the Cotonou Agreement and Development in ACP Countries' in O. Babarinde and G. Faber (eds) *The Cotonou Agreement and Development: The ACP Countries and the EU in the 21st Century*, Chapter 5, Martinus Nijhoff Publishers, Leiden Boston.
26. EPAwatch, 2002, available at <www.epawatch.net/general/start/php>.
27. G. Faber (2004) 'Economic Partnership Agreements and Regional Integration among ACP Countries' in O. Babarinde and G. Faber (eds) *The Cotonou Agreement and Development*, Chapter 4 (see Note 24).
28. EU Press release, 2002.
29. These cases are analysed by K. Arts (2004) 'Political Dialogue in a "New" Framework' in O. Babarinde and G. Faber (eds) *The Cotonou Agreement and Development*, Chapter 7 (see Note 24).
30. This case is based on EU Council, General Affairs and External Relations Council of the EU, summaries of the debates as published by the EU at <www.europa.eu.int/comm/external_relations/human_rights/gac.htm>.

3

Towards Greater Flexibility in Article XXIV of GATT 1994 in the Context of Reciprocal Trade Agreements beween ACP States and the EU

Bonapas Onguglo

The Partnership Agreement (PA) signed between the 77 ACP states and the 15 EU states in Cotonou, Benin, in June 2000 (but which has been in effect since March 2000 under special arrangement) is one of the most important instruments of development co-operation contracted between a group of developing countries and a group of developed countries. It retains and builds upon the *'acquis'* of the four Lomé Conventions, the last of which expired in February 2000, and provides a new framework for economic and trade co-operation to respond to challenges and opportunities arising from the rapidly changing and globalising world economy. A central tenet of the partnership is ensuring that the content and intent of the new trade relations is in full conformity with WTO provisions, *including special and differential treatment*, and promotes the active participation of ACP states in the multilateral trading system (Article 34, PA).

Building on this premise, the new framework for economic and trade cooperation can be construed as comprising four key pillars, namely (i) temporary non-reciprocal preferential treatment for ACP states, (ii) economic partnerships agreements (EPAs) between ACP states and the EU, (iii) alternative arrangements to EPAs, and (iv) special treatment for ACP least-developed countries (LDCs). The modalities of the LDC pillar has been addressed by the every-thing-but-arms (EBA) market access initiative of the EU, as an extension of its Generalised system of preferences (GSP) scheme, which entered into force in March 2001 for an indefinite period.[1] Such special GSP treatment for LDCs is compatible under the WTO with the Enabling Clause,[2] in particular paragraphs 2(a) and (d). It is also consistent with the market access provision of the decision taken by the First WTO Ministerial Conference in 1996 on a Plan for LDCs, and the conclusions of the High-Level Meeting on Integrated Initiatives for LDCs' Trade Development, held in Geneva in October 1997. The modalities of the EPAs and alternatives to EPAs would be defined through consultations and negotiations during a preparatory period lasting from September 2002 until the end of 2007. In designing and negotiating the modalities for EPAs, the WTO compatibility of the resultant agreements is a critical issue, in keeping with the underlying principle of the new trade relations as mentioned above. This issue is being addressed in this article. The modalities and WTO compatibility of the non-reciprocal preferential treatment is addressed briefly below (as a prelude to the examination of EPAs and WTO compatibility).

During a preparatory period from 1 March, 2000 to 31 December, 2007, the EU would continue to provide non-reciprocal market access treatment for ACP exports, as under the Lomé Conventions, and maintain the access arrangements under the commodity protocols (Article 36, PA). This agreement between the two concerned parties also required WTO endorsement. Thus in March 2000 the EU, supported by the ACP states, requested from the WTO a waiver of the PA from the EU's obligations under the dictates of Article 1:1 of GATT 1994 (MFN principle). It can be recalled in this connection that for the Lomé Conventions, the EU (and ACP states) have consistently maintained that the non-reciprocal preferential tariff treatment for ACP

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products is compatible with Part IV of GATT read in conjunction with GATT Article XXIV. However, disagreement with some GATT and then WTO members over this interpretation led the EU (and ACP states) to request a waiver for the Fourth Lomé Convention. With this difficult experience in mind, the EU (and ACP states) directly submitted a waiver request for the new PA. Concurrently, some legal ambiguity emerged as to whether this waiver request could also encompass the preferential treatment in quota allocations to ACP states in the EU's new interim banana import regime until December 2005, when it would be converted into a tariff-only system. Thus the EU requested in June 2001another waiver from its obligations under paragraph 1 and 2 of GATT 1994 Article XIII, for the preferential allocation of a banana quota to the ACP states under its interim banana-import regime.

After a long delay in the WTO in launching examinations of the two waiver requests, both requests were considered and granted on 14 November, 2001 by the Fourth WTO Ministerial Conference in Doha, Qatar.[3] The GATT Article I:1 waiver exempts the EU from its MFN obligations until 31 December, 2007 in respect of the preferential tariff treatment provided for ACP products under the ACP–EU Partnership Agreement. The GATT Article XIII waiver permits the EU to provide a preferential banana quota of 750,000 tonnes for ACP states between 1 January, 2001 and 31 December. 2005. At the same time, the preferential tariff treatment for ACP bananas are covered by the GATT Article I:1 waiver, and this would include the new tariff-only banana regime which would be subjected to a special arbitration system prior to entering into force to ensure that the market access opportunities for MFN suppliers are guaranteed at the present-prevailing level at least. These waivers have been important in that they have removed the ambiguity surrounding the consistency of the PA with the EU's WTO obligations, and allow the ACP states and EU to concentrate their negotiations on the modalities of the new trading arrangements.

Also during the preparatory period, starting in September 2002 and lasting until December 2007, the ACP states and the EU will negotiate and conclude economic partnership agreements which will then enter into force from January 2008 (and replace the system of non-reciprocal trade preferences). The EPAs will be comprehensive in scope, encompassing trade in goods (Articles 37 and 38, PA). They will also be extended to cover both trade in services and the building of the services supply capacity of ACP states (Articles 41 and 42, PA) and trade-related areas (Articles 44-52, PA). The negotiations on EPAs will be undertaken by ACP states that consider themselves in a position to do so, at a level they consider appropriate and in accordance with the procedures set by the ACP group of states (Article 37:5, PA). The EPAs shall aim to establish timetables for progressively removing barriers to trade between the concerned ACP states and the EU, in full conformity with relevant WTO provisions, and thus implying reciprocity in the granting of trade preferences, namely free trade areas (FTAs). As the EPAs involve developed countries (the EU), the relevant WTO provisions pertain to GATT 1994 Article XXIV on free trade agreements, customs unions, and interim agreements and the Uruguay Round Understanding on the interpretation of that article. In fact, recent mixed North–South regional trade agreements (RTAs) such as those concluded by the EU with North African countries (Algeria, Egypt, Jordan, etc.) and Canada and Chile have been notified to the WTO under the terms of GATT 1994 Article XXIV. The main requirements for FTAs are substantial trade coverage; no raising of trade barriers against third countries; a 10-year transition period for interim agreements unless exceptionally extended by the WTO; and notification and examination.[4]

Notwithstanding full compliance with WTO provisions then prevailing, the EPAs shall be as **flexible as possible** in establishing the duration of a **sufficient transitional period**, the **final product coverage** (taking into account sensitive sectors), and the **degree of asymmetry in the timetable for dismantling tariffs** (Article 37:7, PA). The transitional period is directly linked to the dismantling of tariffs as it comprises two aspects, namely the absolute duration of the period and the asymmetry between the ACP states on the one hand and the EU on the other in dismantling tariffs during the fixed transitional period. GATT 1994 Article XXIV

and the 1994 Understanding accept the need for transitional periods by allowing for interim RTAs. In addition, the 1994 Understanding sets a maximum period of 10 years for the interim RTAs unless exceptionally extended. GATT Article XXIV is silent on the asymmetric period (within the fixed absolute transitional period) for the dismantling of tariffs between parties, so this can be assumed to be acceptable. The Enabling Clause is silent on the transitional period and, within it, the asymmetric elimination of tariffs. In this sense, the Enabling Clause sets no upper or lower limits. Thus the only limit placed on a possible transitional period for EPAs by WTO provisions is by GATT Article XXIV and the 1994 Understand (although this limit can be extended). This possible limitation has to be juxtaposed against the adjustment needs of ACP states for sufficient flexibility to allow them to seek a period longer than 10 years in view of the trade, financial and development needs of ACP states.

With regard to the trade and product coverage under EPAs, the flexibility to be sought for ACP states is to be accorded a lower level of coverage for liberalisation compared to the EU for reasons of revenue, industry and employment sensitivity. ACP states should be able to exclude certain products from trade liberalisation under EPAs, but on a temporary basis and they must allow their gradual integration into the liberalisation programme. This flexibility can to be woven into current WTO provisions that recognise the need for less than total trade and product coverage in the context of RTAs. GATT Article XXIV requires the liberalisation of substantially all the trade between the parties, meaning that not all the trade has to be liberalised. There is thus a certain implicit flexibility already integrated into GATT Article XXIV. Also, various SDT provisions in the legal architecture of WTO, in particular Part IV of GATT 1994 (Article XXXVI:8) and the Enabling Clause (paragraph 5), provide that developed countries do not expect reciprocity from developing countries in removing barriers to trade and shall not expect commitments from developing countries inconsistent with their development, financial, and trade needs. Furthermore, GATS Article V:3(a), which is a counterpart to GATT Article XXIV, allows a lower level of services liberalisation by developing countries.

Finally, flexibility in the application of EPAs could also be sought in terms of the treatment of possible non-tariff barriers, or what is referred to as 'other restrictive regulations of commerce' in GATT 1994 Article XXIV:8, which must be eliminated on substantially all the trade of the parties. In particular, the non-reference in this article to contingency protection measures such as anti-dumping and countervailing duties (GATT Article VI), or safeguards (GATT Article XIX), and given the increasing use of these measures, there is debate as to whether and how members of an RTA (like an EPA) are allowed or obliged by GATT Article XXIV to apply those measures among themselves and with regard to third parties. ACP states may be interested, within the framework of EPAs, in setting stricter conditions on the use of such measures (against them) by the EU and more flexible conditions for ACP states to deal with sudden and unpredictable surge in imports. Another issue in terms of 'other regulations of commerce' in the context of EPAs concerns the preferential rules of origin that would underpin the FTAs. The PA provides for the EU to review its rules of origin pertaining to preferential treatment to ACP products to improve market access conditions. This needs to be closely studied to assess what flexibility could be usefully provided to ACP states in promoting industrial transformation to take advantage of the EPAs.

Accordingly, the flexibility in EPAs should allow for the differentiated application of reciprocal trade liberalisation commitments – with the EU liberalising faster, maybe even immediately – for a greater range of products with less stringent rules of origin, while the ACP would have a slower liberalisation pace and gradual integration of products. The EU liberalisation shall build on and improve current market access for ACP states. The emphasis on flexibility in the EPAs for ACP states despite maintaining WTO compatibility is justified on several grounds. One reason is the level of reciprocity that would be required under GATT Article XXIV. It is likely to pose greater adjustment costs on the part of ACP states, for example in establishing alternative sources of fiscal revenue to deal with the dismantling of tariffs, or in developing measures to deal

with uncompetitive industries and improve their competitiveness *vis-à-vis* European products and industries, or support their adaptation or the formation of new industries to exploit the wider EU market. Small and vulnerable ACP states in particular may not be in a position to bear the cost of full liberalisation given their high level of economic protection in general; the high dependence of governments on tariff revenue (and for some of them on stable revenue from the commodity protocols); low mobility of capital; and underdeveloped social security systems. This rationale is implicit in the provision of the PA (Article 37:7) that the EPA negotiations shall take into account the capacity of ACP states to adapt and adjust their economies to the liberalisation process. Another reason, not specifically mentioned in the PA, is the potential for region-to-region EPAs, i.e. a regional economic partnership agreement (REPA) between a regional group of ACP states, such as UEMOA (West Africa Monetary and Economic Union), and the EU. The conformity of the UEMOA–EU REPA to GATT Article XXIV might prove contestable (unless full liberalisation in keeping with GATT Article XXIV is pursued) given that UEMOA has been formed and accepted by the WTO membership under Enabling Clause conditions and as such, by definition, is likely to be a 'GATT Article XXIV-minus' agreement while the EU is a GATT Article XXIV agreement. This possibility raises the need for flexibility, but more so for special and differential treatment (SDT) for ACP states that form, via their economic grouping, an EPA with the EU.

Having argued the case for flexibility and SDT in EPAs for ACP states, there is a need to establish whether there is a case for introducing provisions for flexibility and SDT into the relevant WTO provisions. The question is how do EPAs fit into existing WTO rules on RTAs, and if they do not, how such WTO rules could be modified to benefit ACP states parties to an EPA or, for that matter, a mixed North–South RTA. The ACP states and the EU both recognise the need for such a case. The PA itself (Article 37:7) provides that the parties shall cooperate in the WTO in defending the EPAs, in particular with respect to the degree of flexibility accorded. The Third ACP Trade Ministers' Meeting in December 2000 reiterated the need for flexibility in the new trading arrangements and for this flexibility to be reflected in the relevant WTO rules. Furthermore, the trade ministers directed the ACP Group to seek to 'modify' the WTO provisions to cater for the flexibility required by ACP states. The call for the modification of WTO provisions to provide greater flexibility for ACP states has also been made by eminent persons from the ACP Group and other gatherings of ACP states.

In addition to the political impetus, it makes perfect economic and legal sense for an appropriately designed, well-targeted and reasonable degree of flexibility in the form of SDT for ACP states in WTO rules governing RTAs. The economic rationale lies in the need to facilitate the integration of particularly the small and vulnerable ACP states into the EPAs at a pace and level that would be economically viable and sustainable, and that adequately address their development needs.

The legal case arises from several considerations. First, the ACP states and EU need to pre-empt possible future legal challenges against flexibility measures introduced within EPAs. There is, however, a possibility that given the current implicit flexibility in GATT Article XXIV, future EPAs with flexibility might be covered under the prevailing WTO provisions without any reform. The difficulty with this assumption is that a reliance on implicit flexibility introduces uncertainty as to whether an ACP state (or the EU) in the case of a dispute can invoke GATT Article XXIV, as presently crafted, as a defence against an MFN violation complaint by third parties. Thus, reaching some formal understanding on the type and degree of flexibility and SDT permissible under GATT Article XXIV would serve to clarify and enhance the legal security. Second, there is a more universal, systemic consideration in respect of the relevance, equity and overall coherence of the WTO Legal architecture in dealing with mixed, North–South RTAs. GATT Article XXIV was designed in the 1940s to deal with RTAs among developed countries. It is thus irrelevant in catering for mixed RTAs, such as would comprise the EPAs, between highly developed countries (the EU) and developing countries (the ACP states), several of which are characterised by

small and vulnerable economies. There is no explicit SDT in GATT Article XXIV for developing countries in the context of mixed RTAs, although SDT is and has become even more so a fundamental principle of the WTO. Neither is a provision made in the Enabling Clause for mixed RTAs. In contrast, SDT for developing countries is clearly recognised and locked into GATS Article V for economic integration agreements (a counter part of GATT Article XXIV).

Thus there is a case for introducing explicit SDTs into WTO rules for mixed, North–South RTAs to address this phenomena (and thus update WTO disciplines to present-day realities) and to redress the legal lacuna and inconsistency in WTO legal architecture in terms of SDTs for developing countries. In the case of ACP states and the EU, the incorporation of flexibility and SDTs into WTO rules would provide a sound legal basis for WTO-compatible EPAs with flexibility for ACP states. Such reforms can be most usefully negotiated in the context of the negotiations launched at Doha on WTO rules governing RTAs in 'clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements,' and which would take into account 'the development aspects of regional trade agreements' (paragraph 29, Doha WTO Ministerial Declaration).[5] Moreover, the SDTs dimension of RTAs can also be linked to the Doha negotiations on SDTs provisions 'with a view to strengthening them and making them more precise, effective and operational' (paragraph 44, Doha WTO Ministerial Declaration).

In order to incorporate flexibility and SDTs within the scope of WTO rules, three modalities are conceivable, namely (i) through reforming the Enabling Clause; (ii) through reforming Part IV of GATT 1994; and (iii) through reforming GATT Article XXIV. These are the relevant WTO provisions disciplining RTAs. The Enabling Clause option would involve extending the scope of the clause to encompass mixed, North–South RTAs such as EPAs. This would ensure that the maximum flexibility enjoyed by developing countries under this clause in the formation of RTAs among themselves would also apply to RTAs they formed with developed countries. It would also in effect exclude the future EPAs from the purview of GATT Article XXIV and its tougher terms (as compared to the Enabling Clause). In this respect, paragraph 2(c) of the Enabling Clause dealing with RTAs can be targeted for review and modification. A serious shortfall with this option, however, is that the legal validity of the Enabling Clause in general, and its coverage of agreements formed among developing countries in particular, has increasingly been subject to pressure from some WTO Members.[6] For example, Australia has proposed that RTAs formed pursuant to the Enabling Clause should be brought under the disciplines of GATT 1994 XXIV and the purview of the Committee on Regional Trade Agreements. It has been contested whether the Enabling Clause covers at all all the RTAs agreements formed among developing countries. In the light of these attacks on the Enabling Clause, there is the danger that opening discussions on the reform of the Enabling Clause may lead to a weakening of the clause. This is not in the general interest of developing countries in terms of retaining the legal validity of the Enabling Clause for receiving unilateral preferences under the GSP and for maintaining the SDTs provided to RTAs formed among developing countries.

The option of amending Part IV of GATT is useful in the context of the broader review by the WTO under the Doha agenda of the generic SDTs concept under WTO architecture to make SDT operational and effective. Part IV of GATT could be amended to render it explicitly legally binding and applicable to mixed, North–South RTAs. This reform would be directed at ensuring that the concept of non-reciprocity by developed countries in their relations with developing countries can be made to become enforceable – and not just in terms of best endeavour language – and rendered applicable to negotiations in the regional context, for example the EPAs by ACP–EU, as is not currently the case. It is not presently the case because the contracting parties of GATT have argued that the Lomé Convention does not conform to GATT Article XXIV taken in conjunction with Part IV of the GATT, as argued by the EU and ACP states. The amendments could be focused on GATT Article XXXVI:8 on non-reciprocity including the footnote which could be

modified to be applicable to RTAs negotiated outside of GATT/WTO framework but in pursuance of reciprocal trade agreements. A key difficulty with this option of modifying Part IV Article XXXVI(8) to be applicable to RTAs is that it would also authorise unilateral preferences to be provided under mixed-RTAs (developed contracting parties do not expect reciprocity ... to the trade of less-developed contracting parties). While this may appear to be a preferred outcome for ACP states, as it provides an excessive degree of flexibility to members of mixed RTAs, it is likely to meet stiff resistance from other WTO members, and thus cannot be a workable basis for negotiations.

The GATT 1994 Article XXIV option could prove to be a sounder and more viable option to cater for EPAs with flexibility for ACP states. A modification and reform of GATT Article XXIV could be done either (1) through an amendment of the Article itself or (2) through a reinterpretation by way of the revision of the interpretative notes contained in the Understanding on the Interpretation of Article XXIV of the GATT 1994. There is a practical difficulty in formally reopening, renegotiating and amending GATT 1994 Article XXIV itself, as it needs consensus by the Ministerial Conference (Article X of Marrakesh Agreement). The adoption of new interpretations through a revision of the 1994 Understanding, which may be agreed by a three-fourths majority, may prove to be more feasible option (Article IX:2, Marrakesh Agreement). This was indeed the approach adopted in the Uruguay Round that clarified the meaning of articles by agreeing on their interpretation through Understandings and various substantive agreements, which were adopted in the end as a 'single undertaking.' Such an approach would also prove to be more realistic because the wording of GATT Article XXIV is open enough to allow for various interpretations, leaving room for certain flexibility to be incorporated depending on the way they are interpreted. Nonetheless, to the extent that the rules negotiations under the Doha agenda are subject to a 'single undertaking,' which needs consensus, there would appear to be little difference between the two approaches in that both need consensus at the end of negotiations.

Three options are conceivable in introducing flexibility as a form of SDT within GATT Article XXIV, with the second and the third options appearing to be the more feasible. These are (i) a special case for ACP–EU relations in GATT Article XXIV; (ii) generic provisions on SDTs within GATT Article XXIV in favour of developing countries; and (iii) a review of specific provisions in GATT Article XXIV. Option (i) would seek provisions for special derogation for ACP–EU relations only in line with Article XXIV:11 on special arrangements between India and Pakistan. However, an exception is open to criticism as ACP–EU relations cannot be the only exception. Other 'mixed' RTAs may arise, such as from the Free Trade Agreement of the Americas.

Option (ii) could consist of inserting a generic paragraph in GATT Article XXIV or the 1994 Understanding stating that flexibility is to be provided for developing countries in terms of key requirements stipulated in Article XXIV:5 and 8. Some guidance on such an option could be drawn from GATS Article V, which provides flexibility to developing countries in integration agreements liberalising trade in services. The flexibility would seek longer transitional periods, and product and trade coverage that allows developing countries to retain sensitive sectors of key importance to their economies, and tariff reduction approaches that allow developing countries to pursue a slower pace of liberalisation. Option (iii) is an alternative to option (ii); it consists of revising and modifying specific provisions on the key requirements under GATT Article XXIV so as to allow differentiation, or SDTs, for developing countries, in particular GATT Article XXIV:5(c) and XXIV: 8. The distinction between the latter two approaches is rather arbitrary and depends on actual negotiations. The aim of these changes in any option would be to allow flexible interpretation of key requirements of GATT Article XXIV for developing countries in the form of SDTs while clarifying and improving general disciplines applicable to all countries.

In conclusion it is important for ACP states to be aware of the sequence of negotiations under the Doha agenda and the built-in agenda of ACP–EU Partnership Agreement on trade and economic cooperation, so as to elaborate negotiation options

in both fora that promote ACP objectives in a systematic, coherent and mutually reinforcing manner. The Doha negotiations, including on RTAs, are scheduled to be completed and adopted as a single undertaking in 2006. By then the ACP states and the EU would have been mid-way through their deliberations and negotiations of regional economic partnership agreements, and would be able to gauge the WTO compatibility of the evolving terms of future EPAs with the newly adjusted WTO rules then prevailing. The EPAs would have to conform to these rules.

Endnotes

1. For an assessment of EBA, see UNCTAD and Commonwealth Secretariat, *Duty and quota free market access for LDCs: An analysis of Quad initiatives* (UNCTAD/DITC/TAB/Misc.7), London and Geneva, 2001.
2. Decision of 28 November, 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries.
3.. For a review of the ACP Group's efforts in securing the WTO waivers, see Julian Melissa, 'The Cotonou Waiver: An Unlikely Doha Deal Maker' in *Bridges: Between Trade and Sustainable Development* (Year 5, No. 9, November/December 2001).
4.. The integration of services into EPAs will oblige the EU and ACP states to ensure conformity of the services agreements with WTO provisions in respect of Article V of the General Agreement on Trade in Services (GATS). GATS Article V requirements parallel those articulated in GATT Article XXIV namely, 'substantial sectoral coverage' with no *a priori* exclusion of any mode of supply of services and 'the absence or elimination of substantially all discrimination'. Unlike GATT Article XXIV however, GATS Article V:3(a) specifically allows flexibility for developing countries' members of economic integration agreements in meeting the two aforementioned requirements.
5. The WTO surveillance of RTAs has increased and become more regular, unlike under GATT 1947. However, as under GATT, the WTO examinations of GATT Article XXIV RTAs under the Committee on Regional Trade Agreements has so far been inconclusive. While over 60 RTAs notified under GATT Article XXIV have been reviewed by the Committee, no report as yet has been released on the compatibility or not of any agreement to the WTO rules. This deadlock in the examination process has led some WTO members (Japan, Korea, Hong Kong–China and Australia), during the preparatory process for the Third WTO Ministerial Conference, to seek to clarify, improve and tighten the existing WTO rules on RTAs and strengthen procedures to examine the notified RTAs. In response, several other members (Hungary, Turkey and Romania), while agreeing to reforming GATT Article XXIV, sought to ensure that new disciplines should apply only to new agreements and not existing ones. One proposal by Jamaica emphasised the development dimension of RTAs and sought flexibility for adjustments costs for developing countries. RTAs among developing countries continue to be notified under the Enabling Clause and are examined by the Committee on Trade and Development. These different concerns will re-emerge under the Doha negotiations on RTAs.
6. The EU's GSP schemes have been the subject of complaints by some WTO members such as Brazil in respect of the preferential treatment provided to soluble coffee from Andean Group countries; by Thailand regarding the EU's GSP scheme in general but motivated by a concern (voiced together with the Philippines during the Doha discussions with the ACP States on the waiver request for the PA) over the treatment of their tuna products; and by India for the EU's positive incentive schemes for combating drug production and trafficking, and ensuring international labour and environmental standards. Also, unilateral preferences provided by developing countries to LDCs (i.e. South-South preferences) could not secure agreement from WTO membership as its compatibility with the Enabling Clause, and thus a waiver was sought and granted.

4

Preparing for EPAs: Creating ACP Offensive and Defensive Agendas

Christopher Stevens and Jane Kennan

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

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

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

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

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

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

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

The ACP 'Offensive' Agenda

Although the scope for further improvements in the EU's market access regime is limited by the commodity composition of ACP exports, there is room for improvement in three areas:

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

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

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access, which is the benchmark against which EU offers are to be judged.

The goal

On residual tariffs and TQs it is easy to identify the ultimate goal: EBA-equivalent access for all ACPs. An early internal European Commission proposal was for precisely this, and it is still sufficiently widely supported by certain member states and parts of the EU bureaucracy for it to be a realistic goal. For the rules of origin the recent recommendation of the Africa Commission[2] might be a good place to start. It proposed that the origin rules require only a minimum of 10% value to be added within a country.

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

National priorities

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

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

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

Forging a regional position

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

The ACP 'defensive' agenda

Under Lomé and Cotonou the ACP were required merely to treat the EU no less favourably than any other industrialised trade partner. In complete contrast, the new EPAs will offer duty-free access for 'substantially all' EU exports to the ACP. In the jargon, the ACP are expected to offer 'reciprocity'. This has been the focus of most discussion so far, but with little quantification.

The requirement for reciprocity is the critical element in the EU Commission's mandate, even though this includes a range of other demands (see Box 1). It is critical in three senses and is the demand on which the defensive agenda must be researched as the first priority. The three facets of its centrality are:

- it underpins the WTO justification for EPAs (which in turn must have a bearing on the EU's own bottom line in the negotiations);

- it has major implications for the production structure and government revenue of ACP states; and
- the potential impact can be quantified and scenarios constructed on the basis of reasonably realistic assumptions.

For these reasons this chapter will concentrate on the ACP defensive agenda. The ACP must also prepare for the other areas in Box 1 – but these require separate treatment.

Choices and effects

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

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

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

This chapter, which summarises some results from an IDS project of EPA support aims to help the debate be an informed one. Building detailed scenarios is very time consuming and requires specialist skills. There is a need, therefore, for a widely usable dataset and methodology which can facilitate discussions within countries. Such discussions can contribute to the definition of the very limited number of scenarios that it will be possible to simulate rigorously.

Box 1. Other key EU demands

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

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

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

Rules and precedents

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

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

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

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

It remains to be seen what proportion of ACP imports the EU will ask to be liberalised but if the spirit of the TDCA were applied then the range of products that would need to be liberalised by the ACP would be even smaller than has applied to South Africa. The EU already provides duty-free access on over 98% of ACP exports so that, without any further liberalisation, the 'average of 90%' could be achieved by the ACP liberalising only 82% of the value of their imports from Europe.

A recent presentation by a European Commission official[3] has indicated that the ACP might be expected to liberalise on an even smaller share: it puts forward the following proportions of imports from the EU:

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

Three questions

IDS has sought answers to three questions:

1. How much liberalisation would each ACP country have to undertake to meet different definitions of 'substantially all' trade?
2. How difficult is it likely to be to forge common regional positions under EPAs that do not store up problems for the future?
3. What effect will EPA liberalisation have on ACP government revenue?

How much liberalisation?

Using the four alternative definitions of 'substantially all' described in Box 2, IDS has calculated for each ACP state which items could be excluded and which would have to be included in the liberalisation package under the new EPA regime. Since EPAs will only 'open the door' to imports if they remove restrictive tariffs, it is important to know the highest tariff currently levied on any liberalised item – what IDS calls 'the marginal tariff'. If country A could exclude from any liberalisation all those products on which it currently applies a tariff of 21% and over, the 'marginal tariff' would be 20%.

Creating regional consensus

Establishing national priorities for liberalisation is only a first step in the EPA negotiations. The second step is to reach a regional consensus. Some ACP

Box 2. Assumptions made

Assumptions are required on the proportion of trade that will be liberalised under EPAs, and the choices that ACP governments make on which items to include and exclude from the liberalisation process. On the proportion of trade, the Institute of Development Studies (IDS) has analysed the results of four different assumptions. On government strategy it has made the only assumption that is possible for a third party – that current trade policy reflects government preferences over which sectors to protect, by how much, and is reflected in tariff levels. It is assumed that those products currently facing the highest tariffs will be excluded.

The 'baseline' assumption is that 80% of ACP imports are liberalised, and is derived from the precedent of the EU–South Africa Trade, Development and Co-operation Agreement (TDCA). This provides for the asymmetrical removal of tariffs over a transition period on a basket of goods that accounted for 90% of the value of trade between them during the negotiating period. If it is assumed the EPAs offer all ACP members access to the European market equivalent to the 100% duty-free access provided under the 'Everything but Arms' (EBA) regime for least-developed countries, then the average of 90% can be achieved by the ACP liberalising on just 80% of their imports.

A variation of the base case has taken an informal suggestion made by a EU Commission official that the proportionate liberalisation of the ACP could vary between regions.[3] The proportions suggested range from 67 to 83%, and these have also been applied.

IDS has also looked at the issue from the other direction. Instead of identifying how many high-tariff items could be excluded from liberalisation on a predetermined threshold for 'substantially all', we have asked: in order for the ACP to be able to liberalise only on goods with a current tariff that is at or below 20% (or 10%), what proportion of trade would need to be excluded? Is this proportion plausibly consistent with the 'substantially all' requirement?

states expect to sign any deal agreed with the EU as part of a customs union that includes some or all of their EPA partners; others do not. The customs union signatories can have only one, common, schedule of tariff liberalisation towards the EU, which they will have to agree formally in advance of concluding the EPA. For those states that belong to a regional FTA, but not to a customs union, such pre-EPA agreement is not required. But if no attempt is made to harmonise each of these countries' liberalisation schedules there will be post-EPA integration problems. For example, if country A excludes widgets from liberalisation and maintains a 100% tariff, but its neighbour, B, removes all duties, traders may circumvent A's restrictions by transporting EU goods across the border from B. To avoid this, either the tariff difference between A and B must be sufficiently small to make such trans-shipment commercially unviable or rigorous border controls must be maintained to prevent trans-shipment, which will hurt intra-regional trade in the process.

Such differences in national inclusion/exclusion lists are likely. They arise not only from different tariff structures among the EPA members but also from differences in their imports from the EU. The latter is a very important cause of difference. Lesotho and Botswana have identical tariffs, as members of the Southern African Customs Union (SACU), but whereas the former could fill its basket of 'inclusions' with items that are already duty free, Botswana's liberalisation would have to include all products currently facing tariffs of up to 42.5%. The difference is simply that Lesotho's imports of high-tariff items from the EU are very small, and Botswana's are larger.

ACP states will have three chances to deal with such problems.

The first is **natural overlap** in their initial strategies for product inclusions and exclusions. Countries may autonomously choose the same products to include or exclude. This has been tested by IDS – and the results suggest that it will be rare.

The next step is for **pre-EPA negotiation** to determine whether countries can compromise on their initial liberalisation schedules in order to obtain a better overlap with their partners.

This will leave a core group of products where compromise is not possible and for which **post-EPA accommodation** will be needed. The key products are those for which cross-border trade is probable (e.g. because the tariff differences are large and/or they have a high value-to-weight ratio).

Revenue effects

ACP countries rely heavily on tariffs for government revenue because they are relatively easy to collect. The items that ACP governments would need to exclude from liberalisation to protect revenue may be different from those thrown up by the exercises just described. It is often the medium-level tariffs that yield the most revenue, since the highest level tariffs are so restrictive that there are few imports on which to collect the tax. If countries choose to exclude from liberalisation only their highest tariff items, they may find that they have to liberalise on their key revenue-generating items. A balance must be struck.

Liberalisation

Would the ACP countries have to eliminate substantial barriers that they currently maintain on imports from the EU? The broad picture presented in Table 1 is that a few countries would need to do so, but many would not.

The table takes all of the EPA regions, except the Pacific (due to a lack of data) and shows the most frequently encountered marginal tariff on the 'base assumption' about the proportion of trade to be liberalised. Thus, for example, if the 15 Caribbean countries[4] were able to exclude 20% of their imports from any liberalisation, most would liberalise only items with a tariff of 20% or less at present. But some would have to cut slightly higher, and some lower, tariffs. In Guyana the current highest tariff on any item that would be liberalised is only 15%, but in St Kitts and Surinam it is 25%, and in St Lucia 30%.

For some countries, though, the marginal tariff would be much higher. The highest is that of the Seychelles, at 100%, followed by Botswana at 42.5%, but there are special factors for both of these. For Seychelles (as for all the italicised countries in the table) some very high- value high-tariff items absorb a substantial share of the 20% excludable imports. For the Seychelles it is tuna; if four fish items are ignored, its marginal tariff would be only 25%.[5] In Botswana it is one category of vehicle; its removal reduces the marginal rate to 0%.[6] Apart from these two, only a handful of states would have to liberalise tariffs that severely restrict imports at present.[7]

How quickly would these cuts have to be made? That, again, will be part of the negotiations, but it is extremely unlikely that it would be less than 12 years, which is the time period available to South Africa. If the recent Africa Commission proposals were adopted, it could be 20 years.

Reducing a tariff that is currently set at only 25 or 30% over a period stretching out to 2020 or 2028 cannot be described as a 'shock'. Much will have happened between now and the end of the transition period; several WTO Rounds, for example, may have pushed bound tariffs below current applied ones.

But not all of the cuts could be deferred until the end of the transition period: would some moderately high tariffs have to be cut soon? It is not possible to give a short, definitive answer for such a diverse group, but a pointer can be provided from one of the IDS tests.

This is the one that asks what proportion of trade would need to be excluded from cuts if the highest current tariff on any liberalised item were not to exceed 10%. The answer to this question allows us to determine whether restricting liberalisation in the first rounds of EPA implementation to those products with a 10% tariff or less would result in implausibly low proportions of trade being liberalised.

The answer is that in most cases it would not. Ample scope exists to restrict liberalisation in the early rounds to products facing low tariffs at present. If one were to say that at least 50% of imports have to be liberalised during the early rounds, only 12 of the 55 countries[8] would be forced to cut tariffs that

Table 1. Broad regional picture

Region[a]	Marginal tariff (%)[b]	Range	High outliers[c]
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

Notes:
[a]The Pacific region is not shown, as tariff data were unavailable for 12 of the 14 countries. Tariff data were also unavailable for the following countries in the regions which are listed:
Caribbean: Haiti
Central Africa: Sao Tome and Principe
East and Southern Africa: Comoros
West Africa: Cape Verde, Gambia, Guinea, Liberia, Sierra Leone.
[b]The most frequently encountered marginal tariff for all countries in group if they liberalise on 80% of imports.
[c]In italicised countries a small number of very large imports absorb a high proportion of the 20% excludable basket.

are over 10%. And half of these face the problem of 'lumpy' imports as noted for the Seychelles. One other just fails to meet the 50% threshold.

Regional overlap

Whilst the charges of radical liberalisation may be overstated, the problems that EPAs may pose to ACP regionalism look to be profound. Table 2 summarises the extent to which the application by each country of the IDS methodology results in similar lists of inclusions/exclusions to those of other members of the regional group. There is very little natural overlap.

There is not a single product that would be in the exclusion lists of all the members of any of the groups![9] And there would be very few that are common to even half of the members of a group. Indeed, in all cases apart from East and Southern Africa, over half (and as much as 92% for West Africa) of the products included in any one country's basket of exclusions would be absent from the exclusion lists of all its partners.

If there is very little natural overlap in the initial negotiating strategies devised, independently, by each country in a group, the task of pre-EPA negotiation between countries will be a substantial one. Hopefully the application of the somewhat mechanistic IDS methodology overstates the problem, and the countries will be able to modify their product schedules sufficiently to produce a compromise that covers a larger number of products than suggested in Table 2.

Table 2. Regional differences

Region[a]	Proportion of exclusions (%)[b]		
	Common to all	*Common to half*[c]	*No overlap*
Caribbean	0	1	58
Central Africa	0	12	51
East and Southern Africa	0	2	43
SADC	0	3	64
West Africa	0	0.2	92

Notes:
[a]The Pacific region is not shown, as tariff data were unavailable from the international source used for 12 of the 14 countries.
[b]Shares calculated in relation to the items excluded by any member if 80% of imports are liberalised.
[c]Or, where there is an uneven number of countries within the group for which the necessary data are available, just over half.

But it is optimistic to assume that post-EPA accommodation will not also be required. Countries will have to make hard choices on whether to change their trade policy in order to allow a compromise where there are real differences of approach. Otherwise they will defer the problem until the implementation stage of EPAs and face the consequent disruption to intra-regional integration.

Revenue

Will a strategy of minimising the competitive effect of EPAs by excluding items with the highest tariffs maximise the adverse revenue impact? Probably.

IDS has calculated the revenue theoretically derived from every good imported from the EU (by applying the set tariff to the value of imports). This almost certainly overstates the revenue actually collected (because it assumes 100% effective implementation and the absence of any duty draw-backs or other exemptions[10]), but as this applies to both the numerator and the denominator, the calculations – which provide an upper limit to the potential effect – may not be that far off the mark.

Table 3 shows the proportion of theoretical revenue that would be lost on the base scenario. The top row shows that three-quarters of the ACP countries could lose 40% or more of their tariff revenue from the EU, and for over one-third of countries it could be 60% or more. This revenue would need to be replaced in full only over the 12–20 years of EPA implementation.

The second row suggests how much needs to be replaced in the early stages. Taking the suggestion above that only goods facing tariffs of 10% or less be liberalised in the first phases, it shows the share of total theoretical revenue contributed by these goods. The initial 'cost' of reciprocity in terms of tariff revenue forgone would be much lower. Two-fifths of the countries would lose less than 20% of their revenue, and for almost three-quarters the loss would not exceed 40%.

Implications for EPAs

One point on which both supporters and critics of EPAs seem to agree is that they will force open ACP markets –for some this is a desirable outcome and for others an undesirable one. But will it happen? EPAs seem likely to give ACP governments substantial opportunities to avoid significant liberalisation. There are good reasons to expect, therefore, that one of the economic arguments made in favour of EPAs will not be sustained.

Another major argument advanced in favour of EPAs is that they will foster regional integration. Here it looks likely that there will be a significant effect – but a negative one. Part of the problem arises from differences in the commodity composition of countries' imports from the EU. Research into whether this could be overcome by, for example, the calculation of 'substantially all' being made at a regional rather than a country level is highly desirable. But until the European Commission negotiators provide guidance on what they would expect, the range of possible options is so large that informed speculation is difficult.

The task of adjusting to tariff revenue loss could be substantial. The IDS finding that the costs need not be high for many countries in the initial period adds urgency to the need to define the length of this period – which may be critical for both the liberal-

Table 3. Revenue implications

	Share of liberalised items in total theoretical revenue			
	<20%	*20–40%*	*40–60%*	*≥60%*
Base scenario (80% liberalisation)				
No. of countries[a]	2	4	24	21
All items with tariffs of 10% or less				
No. of countries[a]	24	20	5	2

Note:
[a]Botswana, Lesotho, Namibia and Swaziland, covered by the SACU revenue formula, are excluded.

isation and revenue effects of EPAs. How long have ACP states got to roll in new systems such as a general sales tax? Should the final phase of EPA liberalisation be made conditional on such new systems being in place? These are the sort of informed questions that need to be directed to the negotiators.

In the meantime, the more countries that undertake their own calculations of ideal inclusions/exclusions and potential revenue effects the better. These can then be compared with the autonomous schedules of other regional group members and a more accurate picture obtained of the extent of possible natural overlap.

The methodology and datasets that IDS have developed can be used by both governments and civil society in each ACP state to identify which products should be included or excluded from liberalisation under an EPA. The methodology has been described in a *Handbook*, which is available electronically to all ACP organisations upon request together with a *dataset* for the country concerned.[11] The data cover the country's imports from the EU and applied tariffs. They allow users familiar with Excel to build simple lists of EPA inclusions/exclusions on the basis of different assumptions on sensitivity.

Endnotes

1. **West Africa:** Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo.
   Central Africa: Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Sao Tome and Principe.
   East and Southern Africa: Burundi, Comoros, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia, Zimbabwe.
   Southern Africa Development Community: Angola, Botswana, Lesotho, Mozambique, Namibia, Swaziland, Tanzania.
   Caribbean: Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Surinam, Trinidad and Tobago.
   Pacific: Cook Islands, Federation of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu.
2. 'Our Common Interest: Report of the Commission for Africa', March 2005 (www.commissionforafrica.org).
3. Maerten, C. (2004) 'Economic Partnership Agreements: A New Approach to ACP–EU Economic and Trade Co-operation', presentation to TRALAC Annual International Trade Law Conference, November.
4. Plus Haiti.
5. The fish are 'imports' only in the sense that they are caught on EU vessels. They are then canned in the Seychelles and exported. The EPA negotiations will allow the Seychelles to identify an alternative way to levy a tax on this trade.
6. Also, as part of SACU, it will effectively have to apply the provisions of the TDCA, and so its tariffs are likely to fall anyway.
7. The marginal tariff for Burundi is 40%, for Djibouti 33%, and for seven others it is 30%. For all of the remaining 44 countries (for which data are available) the marginal rate is 25% or less.
8. For which data are available.
9. Other than the Pacific group – for which data are available for only two of the 14 members.
10. And because, where a range of tariffs applies to the national-tariff-line-level items within an HS6 subhead, it is the *maximum* that has been used – which is not necessarily the one applicable to the sub-item actually imported.
11. Subject to data availability. Contact Paula Lewis (P.Lewis@ids.ac.uk) for a copy.

III

The Development Dimension and Preferences in ACP–EU Relations

5

The EPAs and Sustainable Development: Benchmarks for Pro-Development Monitoring of the Negotiations

ICTSD and Aprodev

Introduction

The African, Caribbean, and Pacific (ACP) countries are facing trade negotiations on several fronts simultaneously over the next few years. These include the Economic Partnership Agreements (EPAs) with the European Union (EU) under the Cotonou Agreement, the Doha Round of the World Trade Organization (WTO) launched in 2001, and negotiations within economic groupings in their own regions. A clear and positive link between development strategies and the new trade rules to be generated by these negotiations has still to be developed and articulated in practical terms. After a first phase of negotiations, the six ACP regional trading blocs[1] have now started the second phase of negotiations with the EU.

In terms of development content, little substantive progress has been achieved in the EPA negotiations due to the widely differing approaches of the two parties on how to integrate the development dimension of EPAs in practice. This is the current state of play in relation to development issues despite official declarations by the EU and the ACP about shared objectives and negotiation guidelines on development, competitiveness and poverty alleviation, as well as on asymmetrical liberalisation and EU assistance for the structural transformation of ACP economies.

In other words, even though the EPA process appears to have been conceived with sustainable development goals in mind, progress in the negotiations has yet to reflect this ambition. However, recent concern over the issue as expressed by political actors and civil society organisations in the ACP countries and Europe has created a new opportunity to put the EPA process back on a development track.

In an apparent response to these concerns, recent statements issued by EU Trade Commissioner Peter Mandelson refer to a new start for the EPAs, and seem to establish political guidelines that might lead to a more open and pro-development course for future EPA negotiations. According to these guidelines, development considerations should be central to the EPAs, suggesting that the EPAs become trade and development tools explicitly, as opposed to the classical, hard-nosed, free trade agreements. Furthermore, the EPA process would be put under continuing review, 'to ensure that at every stage in the negotiations, we really do put development first'.

Based on these premises, this chapter proposes a system of development benchmarks that could be instrumental in the development-focused monitoring of the EPA negotiations. The first section discusses the role and priorities of the EPAs and the basis for a continued review of the process. In response to the perspective offered in the first part of this chapter, the second section outlines a proposal for a set of development benchmarks. The annex summarises the findings of the ICTSD assessment on the progress of the EPA negotiations which were used to inform the proposal.

The aim of this chapter is to stimulate actors participating in the negotiations, as well as members of parliaments and development-concerned communities in the ACP countries and the EU, to use development points of reference for assessing the substantive progress of the EPA negotiations towards the development goals they should serve.

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The EPAs and sustainable development: Substantive priorities and bases for a continued review process

Since the EU's initial proposal in 1996 to negotiate EPAs with ACP regional groupings, all parties have stressed the necessity for EPAs to not be standard reciprocal free trade agreements (FTAs), but instead to constitute 'tools for development'. This objective was reaffirmed in the Cotonou Agreement and in numerous declarations since, including the Cape Town Declaration[2] and the EPA negotiating mandate and guidelines of the EU and the ACP countries, as well as in political statements recently issued by Commissioner Mandelson.

The development aims and priorities agreed for the EPAs, as well as the bases for a continuing review of the EPA process, are outlined in the first half of this chapter, followed by a targeted definition of the benchmarks in the second half.

The EPAs as enabling frameworks for pursuing sustainable development goals

From a development perspective, not all kinds of developing country integration into the global economy may be considered positive because trade liberalisation on its own cannot ensure the attainment of development objectives in economic, social and environmental arenas. Balanced growth and poverty reduction do not necessarily flow as automatic outcomes from liberalisation processes, rather these objectives must be actively promoted by policies in conjunction with appropriate adjustment to the opening up of an economy.

Lessons learnt over the last 30 years should be used to create international trade agreements that not only seek to integrate developing countries into the global economy, but are in and of themselves pro-development instruments. In other words, these agreements should not focus solely on trade liberalisation policies and the negotiation of trade rules for market access in favour of developing countries' exports. Although these aspects of international trade agreements are clearly important, they are not sufficient if development and equity are the goals.

Official declarations by the EU and the ACP Group on objectives and guidelines for negotiating the EPAs, issued since the initiation of the negotiations,[3] have shown fundamental agreement about the instrumental role that the EPAs should have in pursuing the sustainable development goals of the ACP. Furthermore, these official declarations have expressly recognised the importance of implementing competitiveness and poverty alleviation strategies, ensuring EU assistance for structural transformation of ACP economies, and embracing the principles of asymmetrical liberalisation between ACP countries and the EU.

Box 1 shows excerpts from selected declarations confirming these ideas, including recent statements issued by Commissioner Mandelson.

Competitiveness and equity: Ensuring relevant results

Competitiveness and equity goals are repeatedly addressed as priorities for the EPAs in the official texts of the EU and the ACP. These goals should serve as a fundamental guideline in terms of the strategic response to the EPA's aims agreed by the two parties, and should become a basis for any monitoring of progress in the negotiations:

- EPAs are to facilitate the structural transformation of ACP economies; therefore they should encompass co-ordinated programmes to address the major supply-side constraints which inhibit competitive production of internationally tradable goods and services in ACP countries.[4]
- Trade liberalisation should be co-ordinated with efforts aimed at strengthening the capacities of domestic manufacturing and service sectors, so as to avoid closing off areas of potential growth and development-oriented structural change in ACPs.
- Equity issues in development – such as poverty alleviation and elimination of gender discrimination in access to economic opportunities – must be simultaneously addressed in many public policy areas, including policies related to enhancing competitiveness.[5]

The priorities mentioned above can only be addressed if a policy package for competitiveness aimed at fulfilling social, economic and environ-

Box 1. The role of EPAs as instruments for sustainable development and the importance of development policies and asymmetrical liberalisation in the ACP

Two objectives summarise the main goals established for the EPA negotiations in the *Cape Town Declaration* and other political statements issued by the EU and ACP states:

- To promote sustainable human development, whose outcomes should be expressed not only in economic terms but also in the social and political dimensions of development, which implies putting equity goals at the forefront of trade negotiations and including a broad range of non-state actors in discussions of trade policy options.
- To improve the level of productivity and the range of value-added products of ACP economies, and to foster their structural transformation so that their production systems shift away from extreme dependency on basic commodities towards the production of goods and services with higher demand growth and favourable price trends.

In a speech and memorandum issued on the occasion of his participation in the Civil Society Dialogue Group held in Brussels on 20 January, 2005 EU Trade Commissioner Peter Mandelson expressed his views on 'what the agreements must now be about':

- Until now, the EU–ACP relationship has simply not delivered on trade. It has adhered to the *status quo* and to a cycle of dependency... EPAs need to change so their development focus is strengthened. They should become explicitly what they really are: trade and development tools. They are not classical, hard-nosed, free trade agreements...
- The Agreements should be geared towards South–South economic integration, region by region. The EPAs are there to build markets in the ACP, primarily for the ACP's own benefit, not aggressively to open them to us!
- The EPAs are about strengthening the ability of the ACP to tap into market openings. This means reducing, through well-targeted development support, capacity constraints, and helping to overcome poor economic and social infrastructure. Economic capacity building must come first in the EPA negotiations. Therefore, while EPAs themselves will be mainly trade agreements, what could be called the 'EPA process' will definitely be much broader and cover issues linked to development policy and support.
- The trade opening part of these agreements is not at their forefront: it comes towards the end, after regional integration has kick-started growth, after long transition periods, after Europe has invested aid and support in these least-developed countries capacity to trade.

mental goals is implemented. It must constitute a Competitiveness Policy for Sustainable Development, defined as one conducive to:

> ... *Strengthening and enhancing the production structures, trade capacity and policy institutions of a country, with a view to improving its ability for a positive integration in the global system securing long term, stable economic growth, based in producing goods and services that meet the test of international competition under fair market conditions, while expanding the real incomes and real freedoms of their citizens and using their natural resources and the environment in a sustainable manner, preserving their values for the benefit of present and future generations* ...[6]

As the EPA negotiations will eventually reach agreement on rules that may establish limits to the scope of competitiveness policies, careful attention must be given at all stages of the negotiations to guarantee coherence between these rules and the development priorities established for the EPAs. Accordingly, a point of reference is necessary to judge how closely the EPA outcomes will fulfil the priorities of competitiveness and equity. In other

words, benchmarks should be defined to monitor the extent to which the outcomes of the EPAs effectively enable ACP countries to undertake reforms and implement competitiveness policies as defined above (see Box 2).

Countries that have successfully used trade to promote development have done so by progressively adjusting their production structures, improving their competitiveness by shifting trade specialisation towards higher value-added goods and services, and purposefully creating dense sets of connections between enterprises. These connections help to sustain growth and are vehicles for positive spillovers to the rest of the economy in the form of more and better jobs and higher domestic income.

A three-dimensional perspective for monitoring the progress of the EPA negotiations in terms of development outcomes

An assessment of the progress of the EPAs on development issues was carried out as part of the preparation for this proposal.[7] The conclusions of the study, highlighting the very poor progress in relation to development issues until 2004, are in stark contrast to the recent statements by Commissioner Mandelson which indicate raised expectations in the treatment of development issues in future negotiations.

The study reveals that only general principles relating to core development issues have been established in the EPA negotiations to date, which are reflected in declaration-type agreements on generalities. However, fundamental disagreements on substantive practical issues remain. In terms of development content and fulfilment of ACP development expectations, so far progress in the EPA negotiations has been mainly formal.

The negotiating approaches by the two parties on the practical integration of the development dimension of the EPAs have diverged widely. Despite official declarations by the EU on the EPAs' development objectives and guidelines supposedly shared with the ACP Group, in practice the negotiating position adopted by the EU until 2004 contradicted such objectives and guidelines.

However, according to Commissioner Mandelson's recent statements:

> *'[EPAs] should become explicitly what they really are: trade and development tools ... I intend this to be a new start for the EPAs – to give the negotiations a new impetus – and to ensure that from now on, until the final implementation of what we will negotiate by 2008, development concerns have pride of place... Therefore, the EPA process will be broader than pure trade arrangements and cover issues linked to development policy and support'.*[8]

This chapter defines three broad categories of issues in which priorities for a monitoring process of the EPAs should be clearly identified: **market access and fair trade; policy spaces; and access to resources for development support.** These categories correspond to the dimensions in which trade-supportive policies may be implemented by ACP countries as they address the main development challenges of competing in the global economy.

Market access and fair trade

In terms of *market access and fair trade*, ACP countries would expect the EPAs to provide:

- effective conditions of asymmetry in the liberalisation process *vis-à-vis* the EU;
- improved entry to EU markets through traditional mechanisms (involving preferential tariff treatment and resolving problems associated with preference erosions, rules of origin, and the case of 'residual tariff barriers' mainly affecting non-LDC ACP countries);
- improved conditions for the insertion of their commodities exports into global value chains (GVCs); and
- solutions to deal with the negative impacts that European trade policies may have on limiting ACP exports (e.g. technical barriers to trade (TBT) and sanitary and phytosanitary standards (SPS); EU Food Safety policy; and anti-dumping and countervailing measures) or the impacts of the EU's Common Agricultural Policy (CAP) in generating agricultural trade imbalances.

As part of the guiding principles of the EPAs it has been agreed that the eventual agreement on market

Box 2. Free trade agreements as enabling frameworks for the implementation of competitiveness policies for sustainable development

Free Trade Agreements (FTAs), including Agreements on Investment, should not be limited to enhancing market access for developing countries' traditional exports, or improving conditions for FDI flows in sectors of long-established comparative advantages. FTAs should enable developing countries to implement policies aimed at transforming their economic structures, diversifying production, and increasing the spillovers that trade expansion may have on the domestic economy. These policies, as a set, constitute **Competitiveness Policies for Sustainable Development.**

Therefore, the enabling effect of FTAs should not only facilitate an appropriate macroeconomic environment, and promote FDI with the expectation that any foreign investment would automatically bring diversification or technological spillovers, but also ensure that developing countries can undertake policy actions directly aimed at:

- **Overcoming quality and coverage limitations of infrastructures that result in poor connectedness to global markets**

Relevant examples in the majority of developing countries may be found in poor transportation and access facilities to shipping infrastructure and telecommunications.

- **Enhancing the ability of firms and productive chains in general to innovate and incorporate technology**

This must be done in a way that facilitates changes in the country's trade specialisation towards value-added goods and services. In addition to gaining effective market access and competing in diversified exports, continuous innovation and adaptation of technology is highly important to sustain productivity and real income growth.

- **Building strong and dense fabrics of firms, mainly SMEs, effectively linked to major enterprises and corporations connected to international trade**

This is the most effective way for enhancing on a sustainable basis the capacity of the productive sector to create better jobs and to amplify the positive impacts of trade into the domestic economy.

- **Implementing specific programmes addressing equity issues in combination with the rest of competitiveness policies**

A contribution to the social effectiveness of economic policy in general, and the effective incorporation of objectives related to poverty alleviation and elimination of gender discrimination, may require a focused application of trade-related policies for competitiveness, such as government procurement preferences and financial support in favour of urban informal sectors and low-productivity rural production (e.g. micro-enterprises, co-operatives and groups of 'poor farmers').

- **Mainstreaming environmental goals and criteria as cross-cutting issues in all policies related to competitiveness (horizontal and selective policies)**

Policy actions in these directions help ensure sustainability in terms of the intervention of natural resources, and enhance the opportunities for developing countries to successfully compete in world markets that increasingly demand environmental performance.

Source: Adapted from W. Corrales (2003) 'Ideas for an integrated approach to initiatives related to Competitiveness and Spaces for Development Policies in the road to UNCTAD XI, UNCTAD, Geneva

access arrangements should not leave any ACP state worse off than its current state and that market access arrangements should build on and improve their current positions. These general considerations, however, have yet to become practical instruments.

Policy space

Issues under the dimension of 'policy space' (or 'space for sustainable development policies') encompass flexibilities in trade rules and trade-related disciplines that ACP countries might need in order to implement Competitiveness Policies for Sustainable Development[9] as defined under 'Competitiveness and Equity' (see Box 2):

- Some of these policies aim to overcome supply-side constraints and attain competitiveness and productive sector development goals (e.g. fostering diversification, enterprise networks and innovative clusters of SMEs; supporting R&D activities; and promoting domestic capacities for exporting high value-added services).
- Others are focused on social objectives and equity goals (e.g. poverty alleviation and reduction of gender gaps, support to poor farmers, micro-enterprises and cooperatives; health-related programmes for HIV/AIDS and other pandemic diseases).
- A third group corresponds to trade policies aimed at selective import liberalisation and strategic trade integration (e.g. regional integration among developing countries before proceeding to deeper integration with the EU or other countries).

EU resources for development support

Mechanisms in this dimension encompass those ensuring effective access to net financial inflows (resource transfers) from the EU that would contribute to covering the costs of overcoming supply-side constraints, institutional adjustment, technical assistance and capacity building.

The political basis and scope of a mechanism for continued review of the EPA process

Various EU–ACP Declarations – particularly the Cape Town Declaration – call on both parties in the EPA process to make a commitment to open, transparent and inclusive negotiations, with effective participation by diverse stakeholders. The guidelines aim to guarantee the accountability, political follow-up and scrutiny of the process by means of an on-going monitoring mechanism to be established by the Joint Parliamentary Assembly.

These mechanism for monitoring the EPA negotiations would ensure that future ACP–EU development, economic co-operation and trade arrangements lay the basis for sustainable development which focuses on reducing poverty, involving the structural transformation of the basis for the integration of ACP economies into the world economy.

No practical moves or political decisions towards establishing the monitoring mechanisms had taken place until very recently, however, when Commissioner Mandelson announced the decision to set up a mechanism that would monitor the whole EPA process. The idea of reviewing the entire EPA process, including the negotiations and the EPA-related programmes of development assistance, would be to guarantee that 'the link between trade negotiations and development co-operation is going to work in practice on the ground'.[10]

According to Commissioner Mandelson's statements, the mechanism would monitor, on a publicly available basis, the rollout of the EU's development and trade-related assistance, with a view to checking, at regular intervals, whether or not Europe's assistance is delivering the right results. In his terms, the focus would be on priority areas of competitiveness, private sector development and infrastructure, as well as on institutional capacity building.

The review process would be undertaken in full partnership with the ACP countries, and Commissioner Mandelson recommended that they and the EU should deal systematically with the development dimension of the EPAs when Ministers meet at political level in the course of the negotiations.

A monitoring system based on development benchmarks: A civil society perspective

The case for a set of development benchmarks that would serve as an instrument for monitoring the EPA negotiations is put forward below. The monitoring mechanism – as explained above – would be a component of a broader pro-development system for the continued review of the whole EPA process, as publicly announced in January 2005 by the EU Trade Commissioner.

The proposals on development benchmarks embody a civil society perspective on the role of international trade agreements as enabling frameworks for the implementation of sustainable development strategies. Competitiveness and equity, priorities politically agreed for the EPAs by the EU and the ACP, constitute the main focus of the benchmarks outlined here.

Various sets of benchmarks for a pro-development monitoring of the EPAs are preliminarily identified here using the three-dimensional approach introduced in the first half of this chapter (i.e. market access and fair trade; policy spaces; and access to resources for development support).

The list of benchmarks is non-exhaustive and responds to priorities identified in each of the three dimensions according to two criteria: the development relevance of the issues for ACP countries; and the apparent political will to introduce adjustments in the treatment of development in the EPA negotiations implicit in recent EU statements.

The ideas presented here on particular benchmarks should be considered preliminary. They require further development which should include the involvement of regional stakeholders to ensure that the benchmarks are operational, effective and represent the specific interests and priorities of countries in the different EPA regions.

A broad view of a monitoring process based on development benchmarks

To ensure the accountability of the negotiating process, the emerging agreements should be subject to political scrutiny that examines how the trade rules would generate development benefits and conform to the mandates received by the negotiators. The role of a monitoring mechanism in this context would be to provide relevant information, thus allowing affected stakeholders to assess the process in terms of competitiveness and equity.

The monitoring mechanism should facilitate looking at development-motivated concerns such as: How are these trade rules affecting the development objectives? What effective markets access is achieved? Is **policy space** and flexibility increased or curbed by accepting specific conditions in the rules? What is the likely impact of a trade-related discipline on employment and equity goals in limiting the application of competitiveness policies? To what extent are competitiveness goals and restructuring targets attainable if particular sequencing conditions are accepted for disbursement of development support? Do existing impact studies identify the likely development benefits of the EPA negotiations in the various dimensions?

In simple terms, the functioning of a monitoring system based on development benchmarks can be described in four steps:

- Define priority issues and benchmarks (and update them periodically if needed, in cycles of perhaps twelve to eighteen months).
- Continuously gather information from the negotiating groups.
- Process the information received from the negotiations, assessing progress using the benchmarks and producing reports every three to six months.
- Disseminate the results of the assessments and facilitate multi-stakeholder dialogues based on the reports.

The first step (defining priority issues and benchmarks) must involve stakeholders from the different EPA regions, in order to guarantee the 'legitimacy' of the priorities and the relevance of the benchmarks.

The information gathering can be based on primary and secondary sources – many of them available on the internet[11] – if the monitoring mechanism is to be managed by the public institutions of the ACP and/or the EU. If the monitoring mechanism is managed independently, the informa-

tion gathering process could use secondary sources, validated through selective interviews with negotiators if necessary.

Production of the assessments and reports corresponds to the practical application of the benchmarks to the information flow from the negotiating groups. This task would be the responsibility of the institution(s) managing the monitoring system.

Finally, the fourth step can be undertaken unilaterally (dissemination of results from the assessments) or on an interactive, participatory basis by means of multi-stakeholder dialogues. In addition to those managing the monitoring mechanism, many institutional actors could engage in organising and promoting dialogues based on the reports of the assessments.

The main purpose of this initiative is to stimulate actors participating in the negotiations, as well as members of parliaments and development-concerned communities in the ACP and the EU, to adopt an approach based on development benchmarks for monitoring the EPA negotiations in terms of development goals. A by-product of the initiative could be the use of the development benchmarks in policy dialogues and discussions by parliamentarians, negotiators and affected stakeholders, who have an interest in the same issues.

Whether the monitoring mechanism is implemented by public institutions, or by civil society organisations or independent groups concerned by development issues, it requires development points of reference or benchmarks to respond to development concerns and establish comparisons between objectives and outcomes.

Benchmarks on market access and fair trade[12]

Four broad issues may deserve prioritisation in a monitoring process under the **market access and fair trade** dimension:

- Solving the existing differences on asymmetrical liberalisation in goods and services[13] and maintaining the 'Lomé *Acquis*', as these matters may become broad systemic obstacles that should be removed to enable progress in other areas.
- Effectively improving access of ACP goods to the EU, which may imply focusing the negotiations on rules of origin, SPS and TBT (e.g. issues arising from EU food safety policy) and issues relating to agricultural domestic support and export subsidies derived from the European CAP.
- Facilitating effective support regarding the enhancement of conditions of commodities trade.[14]
- Obtaining substantial EU market access concessions for ACP service exports, to be implemented right at the beginning of effectiveness of the EPAs. Mode 4 might represent the channel through which ACP countries can gain the most in this regard.

There is reason to be positive about convergence on these issues if the basic ideas included in recent statements issued by Commissioner Mandelson are taken as guidelines by EU negotiators:[15]

> *There will be a high level of asymmetry vis-à-vis the EU in the opening of [the ACP] market. ... there is no lobby of EU vested interests clamouring for easier access... ACP regions will open their markets first of all among themselves, building larger regional markets in accordance with their own political objectives and agenda ... Only in a second and later phase will the EU pursue the objective of introducing reciprocal access for EU goods or services ... The CAP reform has provided a viable framework for restructuring agriculture in the EU, making our policies much less trade distorting. ... Access for ACP agricultural products to the EU market and export competition, however, will be fully addressed within the EPA negotiations.*

Box 3 shows an illustrative list of ideas on benchmarks for market access and fair trade. Benchmarks on 'horizontal issues' are identified in relation to asymmetrical liberalisation and rules of origin, and benchmarks on sectoral matters for agriculture and commodities, as well as for trade in services.

Benchmarks on policy spaces:[16] Flexibility on policy issues related to competitiveness and supply-side constraints

It has been repeatedly confirmed that competitiveness and equity goals constitute the most important

Box 3. Selected benchmarks on market access and fair trade

Benchmarks must be derived from agreed EPA guidelines and should represent the priorities defined under the market access and fair trade dimension (see main text). They should be considered 'moving targets' that outcomes of the negotiations move towards. The illustrative list below shows how benchmarks can be applied to issues affecting all trade as well those issues that are mainly sectoral.

Selected benchmarks on issues affecting trade in general

- **On asymmetrical liberalisation**

  Progress in negotiations should effectively pursue 'a high level of asymmetry *vis-à-vis* the EU and allowing ACP regions to open their markets first of all among themselves'. The phasing-out of ACP tariffs should be linked to the attainment of predefined development indicators and not to predetermined timetables.

- **On rules of origin**

  To effectively favour regional integration while facilitating ACP incorporation to global markets, rules of origin should recognise the increasingly global nature of input procurement (non-originating raw materials) while still allowing substantive value addition to take place in ACP countries.

Selected benchmarks on issues affecting agriculture and commodities

- **On impacts originating from the CAP reform and SPS issues derived from the EU Food Safety Policy**

  Positive progress on the negotiations could be linked to the opening of a dialogue which explores the options for: (a) addressing the trade consequences of new forms of CAP distortions linked to its new instruments and export refunds; (b) establishing new arrangements in order to maintain the value of the *acquis*, potentially undermined by the CAP reform; and (c) meeting genuine EU health concerns without placing undue burdens on ACP exporters.

- **On commodities**

  Positive progress regarding the issue of declining prices of commodities implies making operational the EU Commodities Action Plan launched in February 2004, including ensuring sufficient deployment of resources.

Selected benchmarks on issues affecting trade in services

- **On movement of natural persons (Mode IV)**

  Positive progress could be linked to: (a) more liberal conditions in general (e.g. an ACP business travel card; facilitation of the recognition of professional credentials); and (b) a relevant reduction of restrictions (e.g. economic-needs test; diploma requirements; linking movements of short-term workers to commercial presence of ACP firms; certification of profession and employment contracts with authorised enterprises in the case of recreational and cultural services).

- **On expanding opportunities for service exports in other modes of supply**

  Favouring the expansion of opportunities would imply: (a) removing restrictions in health services in mode III (economic needs test) or including it as committed sectors (as many EU health sectors are unbound or uncommitted); and (b) providing additional funds with rapid and flexible disbursement procedures to support ACP service sector development.

ambitions of the EPA process. Therefore, the utmost political attention should be given to the risks involved in negotiating trade-related disciplines that might hinder the capacity of ACP countries to implement policies in these areas. Any monitoring process in this regard should be supported by benchmarks to help guarantee that ACP countries would be enabled to undertake reforms and implement policies targeted at competitiveness and equity (see above and Box 2 on Competitiveness Policies for Sustainable Development).

The use of four classes of policy instrument,

which may be necessary for the implementation of these kinds of policies, might be at stake in the EPA negotiations. Instruments in the first class are linked to trade rules, while mechanisms in the other three belong to 'trade-related disciplines', such as:[17]

- border measures (e.g. tariffs, rules of origin and market defence mechanisms) aimed at protecting domestic or regional production under specific development circumstances (e.g. limiting the negative impacts of the EU CAP reform),[18] and/or promoting regional integration;
- mechanisms providing incentives to firms or conditioning their economic performance towards contributing to goals on diversification, SME clusters development, technology upgrading and technology transfer; and export service development, among others;[19]
- preferences in procurement regimes of government agencies and state-owned enterprises oriented to the same kinds of policy goals and to supporting equity-focused programmes; and
- flexibilities in the implementation of other trade-related disciplines (e.g. flexibilities in intellectual property rights disciplines, related to public health policy goals).

Only a limited number of these mechanisms are currently restricted by WTO rules, while minimisation of flexibilities or **policy spaces** regarding most of them was unsuccessfully proposed by some developed countries – the EU among them – in the failed 'Singapore Issues'. Within the EPA negotiations, however, the EU has emphasised that the EPAs must address 'trade-related issues' covering Investment, Government Procurement, Competition and Trade Facilitation, as these are considered essential tools for development.

Box 4 presents a broad view of benchmarks that could be used in monitoring the EPA negotiations in relation to policies targeting competitiveness and supply-side constraints. Many of the rules involved belong to the categories of 'trade-related disciplines'.

Recent declarations of Commissioner Mandelson have confirmed the strong position of the EU regarding the inclusion of trade-related disciplines in the EPAs:

> *We recognise the concern among NGOs that the EU is 'trying to reintroduce the so-called Singapore issues by the back door' . However everyone should acknowledge that investment, public procurement and competition policy are essential parts of successful economic governance...The EU's aim is that EPAs offer a framework where these important issues can be addressed in a development friendly way and only as, with our assistance, the capacity of the ACP itself grows to deal with them in a meaningful way'.*[20]

Due to these concerns, negotiations in this area may become very difficult, as it would not be easy to reconcile the **policy space** needed by the ACP with the implementation of disciplines that may constitute *per se* a reduction of such space.

Recognition of the right of ACP countries to implement policies aimed at development goals on competitiveness and equity would seems necessary from the outset if development concerns are to be placed at the centre of the negotiations.

Benchmarks on resources for development support

The effectiveness of adjustment programmes associated with the process of trade liberalisation with the EU, as well as the success of policies for improving competitiveness and overcoming supply-side constraints (see the section 'Will special and differential treatment emerge as an important negotiating issue in the future?' in the Annex), are linked to the availability of resources for development support.

Two broad issues in this dimension deserve prioritisation in any review mechanism of the EPA process, given the problems that apparently occur in accessing existing resources, as well as the current deadlock and the new paths that negotiations would probably take in this area. The first is related to monitoring the course of negotiations in the resources for development support dimension and the second is linked to real access and administration of the resources available:

- negotiating access to additional EU resources needed for adjustment and overcoming supply-side constraints; and
- agreeing criteria for rationalising the use of EU

Box 4. Selected benchmarks on policy spaces: Competitiveness and supply-side constraints

Benchmarks must be derived from agreed EPA guidelines and should represent the priorities defined in the **policy space** dimension (*see main text*). Benchmarks in this area involve guiding principles, as well as 'points of reference' for negotiations on sectors and specific rules. The latter should be considered 'moving targets' which the outcomes of the negotiations should move towards. The use of supply-side policy instruments is generally associated with complementary financial support, for which benchmarks are defined in Box 5 (e.g. additional EU development support related to service sector development and institutional capacity building in policy implementation and follow up).

Guiding principles for the negotiations

- **On the right to implement policies for competitiveness and productive sector development**

  A clear recognition of the right of ACP counties to implement these kinds of policies under any framework of trade rules or trade-related disciplines should be a pre-condition for considering negotiations on disciplines potentially hindering such capacities.

- **On coverage and scope of commitments in trade-related disciplines**

  The coverage and the eventual timeframes for implementing agreements on trade-related disciplines should be limited to those where ACP countries have the necessary expertise or can develop the capabilities needed by making use of additional development support from the EU. The scope of commitments should be subject in principle to those agreed in WTO.

Selected benchmarks affecting food production and exports: Agriculture and fisheries

- **On impacts originating in the process of EU CAP reform**

  Positive outcomes should be associated with addressing in an effective manner the potential negative impacts of the CAP reform on the prospects of agriculture-based industrial development in ACP countries. (Tariff levels, safeguards and exclusion of 'sensitive products' from the EPAs.)

- **On fisheries**

  A balanced outcome of the negotiations supporting ACP fisheries sector development should imply agreeing on fundamental principles in relation to sustainable fisheries management, obligatory landings and other measures ensuring that ACP countries maximise the long-term benefits of their resources.

Selected benchmarks on issues affecting manufacturing and service sectors

Pro-development progress in the negotiations implies agreeing on (a) home country measures in the EU to increase technology transfer to the ACP service sectors; and (b) flexibilities in rules for the application of supply-side instruments (e.g. conditioned incentives and performance requirements; public procurement preferences; intellectual property rights (IPRs) flexibilities; domestic regulations in services) to support goals related to diversification; development of domestic capacities in service sectors; SME development and clustering; programmes focused on productivity in informal activities and poor farmers; technological upgrading of firms and strengthening of innovation systems.

resources already available for development support and for simplifying and speeding-up the procedures for aid deployment.

Despite the apparent changes that have occurred since Commissioner Mandelson took office regarding the scope of the EPAs (i.e. if the EPAs should cover financial assistance or trade and trade-related measures only), what the EU may be prepared to concede in additional resources seems to depend on first using the available resources up to

their limit. Commissioner Mandelson's priorities and conditions on development support were explained in the following terms, in his recent statement:

> *Our main priority will be to make sure that the financial envelopes available under the Cotonou agreement will be used up to their limit, in support of the capacity building and support that ACP countries need ... It is about delivering in practice, on the ground, by getting the most out of our existing development tools ... This will require a greater focus on priority areas in our assistance: on competitiveness and diversification programmes linked to the EPA, including private sector development and infrastructure, as well as on institutional capacity building.*

Box 5 shows a limited number of initial ideas on benchmarks for monitoring negotiations related to EU resources for development support.

Box 5. Selected benchmarks on resources for development support

Benchmarks must be derived from agreed EPA guidelines and should represent the priorities defined under the resources for development support dimension (see main text). Benchmarks in this area involve guiding principles and general criteria, as well as 'points of reference' for development support aimed at specific sectors' adjustment programmes, supply-side policies and institutional capacity building.

Guiding principles and general criteria

- **Comprehensiveness of development support and access to resources**

  A comprehensive approach is necessary to define the development support needed in the adjustment processes associated with phasing in free trade with the EU. Therefore the EPA negotiations should give rise to specific instruments and programmes with additional resources, addressing the challenges that arise from the adjustment; i.e. the issues of fiscal and economic restructuring, and social programmes. At the same time, criteria and guidelines for rationalising the use of funds, both existing and additional, should be agreed so as to avoid diverting financial resources away from pre-existing legitimate priorities and to ensure that funds can be spent swiftly and effectively.

- **Sequencing of liberalisation and restructuring programmes**

  Restructuring assistance should be made available and programmes implemented before free trade is fully introduced, so that ACP economies are equipped to meet the challenges posed by moves towards free trade with the EU (see examples in specific sectors below).

Illustrative Benchmarks on issues affecting specific sectors

- **On agriculture and commodities**

  Over a short period of time, progress should be achieved in (a) extending and deepening technical assistance programmes referred to SPS issues, and (b) addressing commodities issues before the impact of free trade with the EU is realised in its entire dimension. This implies putting in place processing, marketing, distribution and transport (PMDT) programmes before the phasing in of free trade, and immediately starting a comprehensive implementation of the EU Commodities Action Plan.

- **On services**

  A comprehensive strategy for ACP service sector development must be put in place in terms of market access measures and supply-side policies (see Boxes 3 and 4). The potential success of this strategy would depend on making available additional resources with rapid and flexible deployment procedures.

Annex

Assessing Progress of the EPA Negotiations from a Sustainable Development Perspective

Background

The African Caribbean and Pacific (ACP)[21] group of states face trade negotiations over the next few years on the Economic Partnership Agreements (EPAs) with the EU under the Cotonou Agreement. A clear and positive link between development strategies and the new trade rules to be generated in these negotiations has still to be developed in practical terms.

This Annex presents the results of a development oriented assessment of the objectives of the EPAs and the progress attained so far in the negotiations, undertaken by ICTSD in December 2004 and January 2005. The study aims to support the process of defining objectives and strategies that would serve as guiding principles for a 'Programme on Development Benchmarks' for monitoring the EPA negotiations.

The assessment was prepared under the 'Building a Trade and Sustainable Development Agenda' and the 'Africa Trade Programme' initiatives of ICTSD. It draws extensively from papers, articles and strategic reports on the EPA process published in Trade Negotiation Insights (TNI),[22] a joint publication of ICTSD and the European Centre for Development Policy Management (ECDPM). The sources are based either on analyses undertaken by the ICTSD's experts or studies published in TNI by other authors.

After a first phase of negotiations, each of the six ACP regional blocs, starting with Western and Central Africa in October 2003, have now commenced the second phase of negotiations with the European Union (EU) – a process which is set to run through to 2005. Road maps have been agreed between specific regions and the EU, detailing 'priority areas' as well as negotiating structures and schedules.

In terms of development content, little substantive progress has been achieved in the negotiations due the widely differing approaches of the two parties on how to integrate the development dimension of EPAs in practice. The remainder of this Annex summarises the practical results attained in relation to the development interests of the ACP. These results are in marked contrast to the official declarations by the EU and the ACP on shared objectives and negotiation guidelines on sustainable development, competitiveness enhancement, and poverty alleviation, as well as on asymmetrical liberalisation and EU assistance for structural transformation of ACP economies.

ACP countries' development and capabilities: How should negotiations address the EPA objectives?

Since the EU's initial proposal in 1996 to negotiate EPAs with ACP regional groupings, all parties have stressed the necessity for these new trade arrangements to provide fresh impetus to the sustainable development of ACPs; EPAs should not be standard reciprocal free trade agreements (FTAs), but rather they should constitute 'tools for development'. This ultimate objective was reaffirmed in the Cotonou Agreement and in numerous declarations since, including the Cape Town Declaration,[23] the EPA negotiating mandate, and in the guidelines of the EU and the ACP.

Development-motivated objectives and guidelines can also be recognised in ideas expressed by high officials of the EU responsible for Free Trade Agreements. The EPAs should be used for fostering competitiveness improvements and facilitating development-oriented adjustments in ACP country structures; they should not be subordinated to progress in the Doha Development Agenda of WTO; and they should be supported by development-targeted funds and by efforts to attract private capitals to ACP countries:[24]

The EPA process is aimed at defining new development-friendly rules of trading between the ACP and the EU... In market access, the aim is to maintain and, where possible, increase the element of preference...In agriculture, beyond market access, we should also be willing to discuss export refunds without necessarily waiting for an all inclusive WTO solution... In services, we should focus on the real needs and aspiration of the respective EPA regions and build a competitive economy ... We know that public support will be an element in the structure adjustments necessary for development. The European Development Fund (EDF) is geared towards supporting our efforts. We should not, however, make the mistake of only looking at public finance. We need to attract private capital – both local and foreign. This can be done through EPAs, we hope, because we can define more transparent, more stable conditions that would be laid down in international agreements between the respective regions and the EU ...'

The Cape Town Declaration introduces the values of political accountability to the negotiations as measured against sustainable development benchmarks, when it calls for a transparent process and for appropriate monitoring mechanisms to ensure that wider human development objectives are fully taken into account. The inclusion of non-state actors in the process is an additional innovation in the Declaration, which recognises the need to engage all bodies in the ACP and EU concerned with promoting sustainable development.

Formal agreements on development objectives and guiding principles of the EPA negotiations

Official declarations by the EU and the ACP on objectives and negotiation guidelines for the EPAs show fundamental agreement over sustainable development goals, competitiveness enhancement and poverty alleviation objectives, and on the principles of asymmetrical liberalisation and EU assistance for structural transformation of ACP economies.

Sustainable development: Aims apparently shared

The following two objectives summarise the main goals established for the EPA negotiations in the Cape Town Declaration, and other political statements issued by the EU and ACP states:

- To promote sustainable human development, a process whose outcomes should be expressed not only in economic terms, but also in the social and political dimensions of development, such that equity goals (e.g. reduction of poverty and gender gaps) remain at the forefront of trade negotiations; as well as the recognition of the need to include a broad range of non-state actors in active discussions of future trade policy options.
- To improve the level of productivity and the range of value-added products of ACP economies; and foster their structural transformation so that their production systems shift away from extreme dependency on basic commodities with stagnant or declining prices, towards the production of goods and services with higher demand growth and favourable price trends.

Guiding principles for the EPA negotiations

Several principles have also been declared by the two parties as guidelines for the negotiations:

- Ensuring that no ACP country is left worse off in terms of conditions of access to the EU market than under the current trade arrangements.
- The recognition that trade liberalisation – in particular tariff reductions – should occur on an asymmetrical basis[25] in order to ease or avoid economic difficulties for the less-developed partners. In the case of LDCs (which make up 60 per cent of the ACP population) this entails respecting the right to continued non-reciprocal trade preferences.
- The need for wide-ranging and effective programmes to address the supply-side constraints of ACP economies.
- Addressing comprehensively the external effects that the EU's Common Agricultural Policy (CAP) might have on the ACP economies.

- The importance of extending direct and effective assistance to fiscal restructuring in those ACP countries that depend heavily on customs revenues generated from trade with the EU.

A declared focus on competitiveness and equity

In official texts of economic and political character – not only in inter-parliamentary declarations – competitiveness defined in sustainable development terms is repeatedly addressed. This fact should be interpreted as a fundamental guideline in terms of a strategy responding to the aims of an EPA agreed by two parties:

- EPAs are to facilitate the structural transformation of ACP economies; therefore they should encompass (or be accompanied by) co-ordinated and integrated programmes to address the major supply-side constraints which inhibit the competitive production of internationally tradable goods and services in ACP countries.[26] This calls for a review of existing institutional arrangements for extending assistance to address supply-side constraints, including policies aimed at productive sector development and competitiveness.
- Equity issues of development – such as poverty alleviation and elimination of gender discrimination in access to economic opportunities – must be simultaneously addressed in many public policy areas including in the conception and follow-up of competitiveness policies. This calls for the establishment of programmes designed to enhance SME networks that multiply job creation, as well addressing supply-side constraints that are gender-sensitive in a way that seeks to systematically improve women's access to economic resources.
- While addressing supply-side constraints, account will have to be taken of the effects of the implementation of reciprocities in market access, and the impacts of introducing rigidities in trade rules that may negatively affect strategies aimed at strengthening the capacities of domestic manufacturing and service sectors. This is to avoid the closing-off of areas of potential growth and development-oriented structural change.

In particular the value of service sector development and the need for fostering ACP country capacities for exporting services within the context of EPAs are frequently recognised, for example in the EU and the ACP agreement to extend their partnership to encompass the liberalisation of services in accordance with the provisions of GATS, or through the reaffirmation of GATS commitments and the emphasis given to strengthening the ACP supply capacity of services and the need for S&DT for ACP services suppliers.[27]

The EU agrees that the ACP countries should be placed under no fixed obligation to liberalise services, but believes that it is in their best interests to do so.

Accountability and relative negotiating capacities: Requisites for a balanced outcome

Two issues merit special attention in negotiations involving countries with highly different economic leverage and institutional strength, as they may influence the prospects of a balanced outcome.

The first is the relative negotiating capacity of the parties, in which an effort must be made to 'level the playing field'.

The second relates to the governance of the negotiating process, which involves promoting transparency and the effective participation of diverse stakeholders, and guaranteeing the accountability, political follow-up and scrutiny of the process by means of on-going monitoring mechanisms.

On the topic of the negotiating capacities of the ACP states three conditions are highly important. The first refers to planning and implementing the process in a manner that allows ACP countries to optimise the use of their limited institutional mechanisms and human resources.[28] The second is related to making financial resources available so that ACP negotiators and policy analysts receive capacity-building support from independent sources. And the third is ensuring that ACP countries have timely access to relevant information, including assessments on the development impacts of the EPAs.

Regarding governance, various EU–ACP Declarations – particularly the Cape Town Declaration –

call for both parties to make a commitment to open, transparent and inclusive negotiation processes that include the effective participation of diverse stakeholders. In addition, the guidelines aim to guarantee the accountability, political follow-up and scrutiny of the process by means of on-going monitoring mechanisms that would be set up by the Joint Parliamentary Assembly.[29]

In practical terms resources have been allocated to undertake impact assessments and capacity-building programmes, but no specific guidelines with a development focus are identified in the Cape Town Declaration or other official documents.

A reality check: Current achievements and expectations on development issues in the EPA negotiations

In terms of development content and fulfilment of ACP development expectations, progress attained in the EPA negotiations has been so far mainly formal, expressed in declarations-type accords with very little practical value, and disagreement on most potentially useful matters. The negotiating approaches of the two parties on how to integrate the development dimension of EPAs in practice have diverged widely.

Notwithstanding official declarations by the EU on EPAs development objectives and guidelines supposedly shared with the ACP Group (e.g. on sustainable development, competitiveness enhancement and poverty alleviation, as well as on asymmetrical liberalisation and EU assistance for structural transformation of ACP economies), in practice the negotiating position adopted by the EU has contradicted such objectives and guidelines.

In negotiating terms the EU maintains that an EPA is essentially a free trade agreement which must abide by WTO rules on free trade areas. ACP states insist that if EPAs are to be development tools they cannot simply be free trade area agreements, but must include concrete measures to promote the structural transformation of ACP economies aimed at producing a higher proportion of value-added goods and services and reducing their extreme dependence on exports of basic commodities.

Development objectives have been elusive so far, but opportunities may exist for successfully influencing development-motivated EU actors so that a more development-oriented path in EPA negotiations is regained. Clear contradictions are present between guidelines issued by EU political bodies and EU negotiating positions, and it is possible that even within the executive branch these contradictions might exist and remain to be resolved.

Core development issues: Negotiations seem to evolve without convergence

Only general principles relating to core development issues have been discussed to date. These are reflected in declaration-type agreements on generalities, but fundamental disagreements exist on more substantive and practical issues.

For instance, based on the officially shared idea that EPAs should be a means of achieving wider objectives and not ends in themselves, parties concur on the general statement that EPAs should contribute directly to the development of ACP countries through supporting the development of ACP productive sectors and the regional integration processes in which ACP countries participate.

Agreement seems also to exist on the principle of taking into account the capacity of ACP economies to adjust to the introduction of free trade with the EU and to accompany EPAs with appropriate development support measures so as to enable ACP countries to maximise the benefits they gain from the Agreements. These basic ideas have served as a framework for the assertion that EPAs should be mainstreamed into ACP policies and EU development co-operation programmes, accompanied by general capacity building measures.

The EU's current approach to commodity questions has also been brought to the attention of ACP negotiators in a very general manner, as an example of 'positive ways' that could be explored together in order to give appropriate solutions to one of the issues that most limits the opportunities of ACP countries for obtaining benefits from trade liberalisation.

However, beyond these general statements there seems to be little agreement when it comes to con-

crete policy initiatives, sequencing of policy changes and development support programmes envisaged or under discussion.

On the character of EPAs as development tools or Free Trade Agreements

The issue of asymmetrical liberalisation – including in practical terms the timeframe within which ACP countries should dismantle tariffs under an EPA agreement – has become highly contentious. This is in spite of ' officially shared views' , as the EU maintains in negotiations that an EPA must be essentially a free trade area agreement subject to WTO rules on the matter, often expressed as 'substantially all trade', covering as much as 90 per cent of current imports and exports.[30]

The ACP Group has decided to address this issue at the 'all-ACP level', and more importantly within ongoing WTO talks, as Article XXIV of the GATT on regional trade agreements[31] is not flexible enough to ensure that EPAs reflect the inequality of the partnership with the EU. To this end, in April 2004, the ACP submitted a proposal to the WTO calling for the amendment of this provision to include appropriate special and differential treatment (SDT) mechanisms in favour of developing countries.

Given the different levels of economic development of EU and ACP economies, ACP countries fear that the implementation of these free-trade-only EPAs could profoundly undermine their economic development possibilities and contribute to increasing poverty, as local industries collapse under pressure from competition from imported EU goods.

Finally, the opening-up of ACP trade in services in the context of EPA negotiations should also be considered part of the asymmetric trade liberalisation issue. In addition to maintaining policy spaces that ACP countries would need for successfully promoting domestic capacities in service sectors' exports, a development-oriented strategy for trade liberalisation in services should consider a progression in which full liberalisation should occur first among countries within the same EPA region, then among countries across the EPA regions, and finally with the EU.

On legal instruments affecting core development issues

Other matters of divergence that could be considered 'core development issues' are related to legal frameworks; such legal structures should guarantee developing countries the stability of their rights and predictability of outcomes in regard to development-sensitive political issues.

One example of the divergence on these legal–development issues relates to the binding nature of outcomes from the first phase of negotiation. While the ACP states have maintained that the first phase should result in a legally binding agreement on various issues of common interest, the EU was of the view that this phase should be used for clarification, with no need for a binding outcome. In the end, ACP ministers agreed to continue discussions with the EU on these difficult issues as a group, at an 'all-ACP level', alongside region-specific negotiations.

A second example can be found in the rules that govern the settlement of disputes under EPAs and the inclusion of a 'non-execution clause' in EPAs – whereby 'appropriate measures', including suspension as a last resort, would be used against a party that breached any of the core principle of the partnership such as human rights, democratic principles and the rule of law.

The issues of market access and fair trade for ACP products

In terms of market access, ACP countries would expect the EPAs to improve entry to EU markets in three complementary ways: traditional mechanisms (e.g. preferential tariff treatment and preference erosions, rules of origin, and the case of 'residual tariff barriers' mainly affecting non-LDC ACP countries); improved conditions of insertion of their commodities exports into global value chains (GVCs); and solutions to the negative impacts that European trade policies may have on limiting their exports (e.g. TBT and SPS; EU Food Safety policy; and anti-dumping and countervailing measures) or the impacts that the EU's Common Agricultural Policy (CAP) would generate in their agricultural trade balances.

As part of the guiding principles of the EPAs it

has been agreed that, once concluded, market access arrangements should not leave any ACP state worse off than is currently the case, and market access arrangements should build on and improve the current *acquis*; it is also agreed that all EPAs should incorporate appropriate safeguard provisions.[32] These general considerations still have to become practical instruments in several issues of key interest to ACP countries.

The CAP, through bringing down EU agricultural market prices, is making the EU market less attractive for basic temperate agricultural exports from ACP countries; and simultaneously enhancing the price competitiveness of EU exports to ACP markets.[33]

Judging from the results of the first phase, addressing issues relating to EU SPS and TBT standards and preference erosion could be sticking points in negotiations on agriculture and fisheries. According to the ACP, maintaining the *status quo* under the Lomé arrangements – the so-called 'Lomé *Acquis*' – should be a paramount consideration in this area. Given that the Lomé *Acquis* was based on non-reciprocity, this goal could be a challenge.

Where agriculture is concerned, most ACP regions are undertaking Sustainability Impact Assessments (SIAs) which examine the impact of EPAs on agriculture. Within the context of this exercise, some have indicated difficulty, in terms of data availability and appropriate methodology, in identifying 'sensitive products' that would need to be excluded from the EPAs. Given the fact that developing countries have the space to exclude similar 'special products' from agriculture talks in the Doha negotiations, this could be a chance for ACP countries to establish the elements of such 'special products' at the national and then regional levels, that will then feed into multilateral trade talks.[34]

In all ACP regions, in-depth negotiations on key areas of market access for industrial and agricultural products have been postponed to 2006 to enable the ACP to give priority to regional integration initiatives. On other matters, divergent views have emerged from the first phase on how to address rules of origin, and the EU's sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT).

More recently, the ACP countries have also called attention to the problem of preference erosion at the all-ACP level of negotiations. At a joint ACP–EU Ministerial Trade Committee on 27 October 2004, the ACP sought assurances from the EU regarding the erosion of their preferences due to the impact of the EU's new reform proposals on sugar, bananas and textiles.

The former EU Trade Commissioner, Pascal Lamy, stressed that ' whatever the results, the EU will be able to help countries benefiting from the sugar protocol when faced with the adjustment process at [new EU] reduced prices'. Similar vague assurances were given on textiles and bananas.

Experts suggest that the simplest way to fulfil the commitment of 'improving the current market access conditions' of ACP exports to the EU is to provide all ACP countries with duty-free and quota-free access for all exports. However, ACP countries which have benefited from commodity protocols will be confronted with serious adjustment costs if this is done. Hence, appropriate assistance from development-motivated institutions may be required.

To effectively improve market access to the EU, it seems necessary to negotiate a radical simplification to the rules of origin associated with preferences in the context of the EPAs, as well as to place issues relating to agricultural domestic support and export subsidies, SPS measures, and non-competitive commodity market structures at the centre of the EPA negotiations.

With respect to trade in services, ACP countries should negotiate substantial EU market access concessions to be implemented as soon as the EPAs become effective. Mode 4 (on the temporary movement of natural persons in GATS, covering all skill levels and professional and industrial services provision categories) might represent the route through which these countries can gain the most in relation to Service Market Access in the EU.

Trade-related issues: Policy spaces at stake

Policy space issues encompass all flexibilities in trade rules that ACP countries might need in order to implement specific development policies. They

include policies directly related to social concerns (e.g. poverty alleviation; supports to poor farmers, and public health programmes addressing HIV and other pandemic diseases), as well as supply-side policies related to competitiveness and productive sector development (e.g. fostering diversification, enterprise networks and innovative clusters and supporting R&D activities; promoting domestic capacities for exporting high value-added services). Some of these policy actions are already limited by WTO rules, while minimisation of policy spaces in relation to other areas has been unsuccessfully proposed by some developed country members of the WTO in the failed Singapore package of issues.[35]

The ACP Group, as part of the G-90 Group of developing countries, successfully called for all the Singapore issues (with the exception of trade facilitation) to be excluded from the entire Doha Work Programme. Within the EPA negotiations, however, the EU has emphasised that the EPAs must address all the Singapore issues, arguing that they are essential tools for development.

Intellectual property rights (IPRs) and services will also be negotiated between regions and the EU. For ACP countries, especially those in sub-Saharan Africa where HIV/AIDS has ravaged societies, access to medicines and the ability to pay for them will be prime concerns in IPRs negotiations.

Some regions are either conducting or have completed studies on investment (including West Africa and the Pacific) and competition policy and government procurement (Eastern and Southern Africa). Regarding trade facilitation, which is a priority for most regions, ACP countries expressed concern at the 27 October, 2004 meeting that negotiations on this issue should not be prioritised at the expense of development issues.

Specific supply-side policy objectives regarding competitiveness and diversification in key sectors should be identified at the regional and country level, aimed at identifying 'policy spaces' to be maintained if government procurements and investment rules are to be negotiated. These should be regarded as priority issues in relation to the Singapore issues.

Will special and differential treatment emerge as an important negotiating issue in the future?

For the Pacific and Caribbean regions, SDT mechanisms that take due account of the vulnerable states among them – such as small island developing states and LDCs – have been emphasised during the initial stages of the negotiations. In this regard, the Pacific has called for SDT to go beyond longer transitional periods and technical assistance and address critical constraints such as dispersed land masses and populations, isolation from major markets, and sources of investment, among others.[36]

However, for all ACP regions the systemic issue of asymmetric liberalisation with the EU, and the eventual losses of policy spaces as outlined above may become equally important. If the EU positions on these issues remain the same, then SDT may become a major cross-cutting issue in the EPAs.

Basic divergence and opportunities not yet explored in relation to issues of capacity development support

ACP countries have pressed for detailed discussions on accompanying measures conceived to help their economies prepare for trade liberalisation and address supply-side constraints. The EU maintains, however, that the EPAs themselves will contribute to development by 'enlarging the ACP markets and by establishing an open, transparent and reliable framework for trade, which will mobilise private initiatives and attract investment'.

EU negotiators have resisted the broad call to reopen discussion on EU development support, arguing that provisions and financial instruments to that effect were already contained in the Cotonou Agreement and provided through the EDF.[37]

While some accompanying measures could be envisaged, the EU has continuously stressed that the EPA negotiations should focus on trade and trade-related issues and not be an opportunity for renegotiating the financial resources available to ACP countries. Speaking in the Caribbean in April 2004, former EU Trade Commissioner Pascal Lamy stressed how the EU does not have a mandate to 'negotiate development finance as part of EPAs.

The divergent views on this matter have been partly carried over to the second phase of EPA negotiations, at the regional level. For instance, the adoption of road maps for the Central and Western African regions, to be jointly agreed with the EU, has been delayed in part due to the insistence by the two regions and the refusal by the EU to effectively integrate development concerns with commitments for additional support into the EPA negotiating agenda.

In their quest for additional support to accompany EPAs, the ACP negotiators should not lose sight of the current process of reviewing priorities and resource allocation of EU aid in the Mid-Term Reviews (MTRs). The Regional Preparatory Task Force (RPTFs) established in each EPA region constitute complementary fora to address these issues at both the political and technical levels.[38]

Endnotes

1. The six ACP regions are Central Africa (CEMAC), West Africa (ECOWAS), Eastern and Southern Africa (ESA), the Caribbean, the Southern African Development Community (SADC), and the Pacific.
2. At the 4th ACP–EU Joint Parliamentary Assembly in Cape Town, South Africa, from 18 to 21 March, 2002, a Declaration on the EPA negotiations was issued. The Declaration, initiated by the ACP members of the Joint Parliamentary Assembly, seeks to 'establish benchmarks' against which the process of negotiations can be assessed.
3. See Objectives in Box 1; five principles have been agreed by the two parties that could be considered guidelines for the negotiations: (i) ensuring that no ACP country is left worse off in terms of conditions of access to the EU market than under the current trade arrangements; (ii) the recognition that trade liberalisation should occur on an asymmetrical basis; (iii) the need for effective programmes to address the supply-side constraints of ACP economies; (iv) comprehensively addressing the external effects that the EU's CAP may generate on the ACP economies; and (v) the importance of extending effective assistance to fiscal restructuring in those ACP countries that heavily depend on customs revenues generated from trade with the EU. See the report on the assessment of the negotiations conducted as part of this initiative: 'Assessing progress of the EPA Negotiations from a Sustainable Development Perspective', Brussels, January 2005.
4. Supply-side constraints in this context include low labour productivity and structural limitations in the institutions to overcome such restrictions (e.g. poor educational and health service systems); limited mastering of management know-how, lack of appropriate process technology and weakness in the national innovation systems; scarcity of input–output linkages between exporting sectors and domestic productive units, mainly SMEs, implying insufficient upstream impacts of job creation and knowledge spillovers; low quality and limited coverage of infrastructural supports resulting in poor connectedness to global markets (poor transportation and access to shipping infrastructure, telecommunications), and inappropriate macroeconomic policy frameworks leading to unstable exchange rates, and high inflation and interest rates.
5. This point is elaborated in the study by Aprodev (2002), 'EPAs – What's in it for Women? Women in Zimbabwe: Issues in future trade negotiations with the EU', Brussels, November 2002.
6. This definition has been reproduced from Corrales, W., M. Sugathan and D. Primack (2003) 'Spaces for Development Policy, revisiting Special and Differential Treatment', ICTSD, Geneva, May 2003. It results from a joint exercise undertaken by the UNCTAD–UNDP Global Programme and ICTSD in 2003.
7. 'Assessing Progress of the EPA Negotiations from a Sustainable Development Perspective'. ICTSD and APRODEV, Brussels, January 2005.
8. Peter Mandelson, Speech and Memorandum 'Economic Partnership Agreements: putting a rigorous priority on development' delivered in Brussels on 20th January, 2005. www.epawatch.net/documents/doc270_4.doc
9. It must be noted that referring to the policy space dimension or the need for flexibilities is not meant to imply a completely open-ended flexibility of 'policy space' for ACP countries in all circumstances. Clearly, a balance must be struck between the 'policy space' required by each country and the need to maintain the inherent value of a rules-based system, from which all countries would benefit.
10. Speech and Memorandum 'Economic Partnership Agreements: Putting a rigorous priority on development', by EU Trade Commissioner Peter Mandelson, January 20, 2005, op. cit.
11. Some of the websites with dedicated sections are: www.epawatch.net; www.acpsec.org; www.ictsd.org/tni/tni_english/; www.europa.eu.int/comm/trade/issues/bilateral/regions/acp/; www.comesa.int/trade/multilateral/epa/; www.acp-eu-trade.org/news.php; www.stopepa.org/
12. Under the **market access and fair trade** dimension developing countries seek improved market access and solutions to the negative impacts that other countries' trade policies may have on limiting their exports.
13. The issue of asymmetrical liberalisation has become highly contentious as the EU has maintained that an EPA must be essentially a free trade area agreement subject to WTO rules, and has often stressed that 'substantially all trade' has to cover as much as 90% of current imports and exports. The opening up of ACP trade in services has also become part of the issue.
14. Commodities issues affect all EPA regions, particularly countries in the ESA. Some 15% of their exports to Europe correspond to commodities, with seven of the 16 countries depending on basic commodities for more than 25% of their exports to the EU. Price reductions in six commodities from this region averaged more than 50% between 1995 and 2002.
15. Speech and Memorandum on 'Economic Partnership Agreements', issued by EU Trade Commissioner Mandelson; op. cit.
16. Under the **policy space** dimension developing countries implement actions aimed at diverse competitiveness-related goals (e.g. overcoming supply-side constraints and promoting diversification; supporting micro-enterprises and co-operatives as part of equity-focused programmes; and selective import liberalisation and strategic trade integration).
17. The Cotonou Agreement contains provisions on a range of trade-related areas, with the EU committing itself to assisting ACP countries in strengthening their regulatory frameworks with regard to: competition policy; intellectual property rights; standardisation and certification; sanitary and phytosanitary standards; trade and environmental issues; labour standards; and consumer policy.

18. Simple value-added products from the EU are invading ACP markets fuelled by the process of EU CAP reform (e.g. exports of 'products of the milling industry' increased in value terms in 83% between 1996 and 2002, while exports of 'preparation of cereals' increased by 163%. The massive export of frozen chicken to West Africa is another example of how import surges have already destroyed local markets even without involving major subsidies: premium parts – mainly chicken – generate the profits for EU producers and they can afford to 'dump' all other parts elsewhere at very low cost on the basis that any income from this practice is a bonus. This kind of trade potentially has the capacity to undermine the basis for agriculture-based industrial development in West and Southern Africa, with serious social consequences.
19. Examples among these mechanisms are incentives (some of them could be technically considered to be subsidies although they do not necessarily involve government disbursements) and incentive-based performance requirements (only a few of them are prohibited in the Trade Related Aspects of Investment Measures [TRIMs] Agreement of WTO); and the use of conditionalities for promoting domestic export capacities in service sectors. See Corrales, W., M. Sugathan, M., and D. Primack (May 2003) 'Spaces for Development Policy, revisiting Special and Differential Treatment', ICTSD, Geneva.
20. Speech and Memorandum on 'Economic Partnership Agreements' issued by Commissioner Peter Mandelson; op. cit.
21. The six ACP regions are Central Africa (CEMAC), West Africa (ECOWAS), Eastern and Southern Africa (ESA), the Caribbean, the Southern African Development Community (SADC) and the Pacific.
22. *Trade Negotiations Insights* (*TNI*), from Doha to Cotonou; available online at www.ictsd.org/tni and at www.acp-eu-trade.org/news.php
23. At the 4th ACP–EU Joint Parliamentary Assembly in Cape Town, South Africa, from 18 to 21 March, 2002, a Declaration on the EPA negotiations was issued. The Declaration, initiated by the ACP members of the Joint Parliamentary Assembly, seeks to establish benchmarks against which the process of negotiations can be assessed.
24. Karl Friedrich Falkenberg, Director, EC Trade Directory General, Trade Directory C – Free Trade Agreements. 'EPAs and DDA – Parallelism or Cross Roads? in *TNI* Vol. 3 No. 4, July 2004, www.ictsd.org/tni
25. This asymmetry should be expressed in the timing of the reduction and elimination of tariffs, and/or in the extent of total trade to be included.
26. Supply-side constraints in this context include low labour productivity and structural limitations to overcome such a situation (e.g. poor educational and health service systems); poor mastery of management know-how; lack of appropriate process technology and weakness in the national innovation systems; scarcity of input–output linkages between exporting sectors and domestic productive units, mainly SMEs, implying insufficient upstream impacts of foreign trade (job creation and knowledge spillovers); low quality and limited coverage of infrastructural supports resulting in poor connectedness to global markets (poor transportation and access to shipping infrastructure, telecommunications), and inappropriate macroeconomic policy frameworks leading to unstable exchange rates and high inflation and interest rates.
27. Dirk Willem Te Velde, 'Special and Differential Treatment in Post-Cotonou Services Negotiations', *TNI* Vol. 3 No. 3, May 2004, www.ictsd.org/tni
28. The Cape Town Declaration deals with this matter by means of general considerations about the fact that carefully planning a structured process of negotiations – in terms of agendas and timeframes – would allow the smaller countries to deal in parallel with trade negotiations at the regional, multilateral and interregional levels. In general such a structured process would permit the ACP countries to make use of the collective expertise of the Group and to bring all concerned stakeholders into trade policy debates, so as to systematically address the key issues and ensure that clear assessments can be made of the likely impact of specific trade measures on relevant sectors in their economies.
29. These mechanisms would be geared towards ensuring that the EPA negotiations effectively pursue the objectives and follow the guidelines summarised in previous paragraphs (e.g. that 'future ACP–EU development, economic co-operation and trade arrangements lay the basis for sustainable development which focuses on reducing poverty, involving the structural transformation of the basis for the integration of ACP economies into the world economy').
30. In terms of ACP countries further opening up to imports of EU products, the basic EU demand is likely to be the reduction of ACP applied tariffs to zero over a transitional period of 10 to 12 years, starting in 2008. An analysis of what the appropriate ACP response to this demand should be requires a review of what tariff barriers are now, how much movement is required to achieve the target, and what are the likely costs of adjustment, particularly in terms of fiscal revenue loss and de-industrialisation.
31. According to the EU an EPA based on WTO rules must involve: (a) the elimination of import duties and all taxes having an equivalent effect on 'substantially all trade' between the countries which sign the agreement; (b) be fully in place within a 10 to 12 year transition period; (c) exclude no economic sector from the coverage of the free trade area; and (d) include agreements on trade in services and trade-related areas.
32. Nonetheless, there is as yet no agreement on the nature and scope of such safeguards (for example, can they be pre-emptive, involving the monitoring and surveillance of trade in sensitive products and allow for swift and effective measures should a potential threat of market disruption emerge?).
33. The CAP, through bringing down EU agricultural market prices, is making the EU market less attractive for basic temperate agricultural exports from ACP countries, and simultaneously enhancing the price competitiveness of EU exports to ACP markets. If the EU reduces the internal sugar price by 40% as envisaged in one of the scenarios set out in the EU paper on sugar sector reform, this will result in annual income losses to ACP sugar exporters of around €390 million per annum.
34. These concerns were noted by various EPA negotiators and consultants at a workshop on 'Methodologies for Assessing the Impact of Economic Partnership Agreements for African Economies' organised by the Friedrich Ebert Stiftung Foundation (FES) in Geneva 27–30 September, 2004.
35. Some examples of trade rules flexibilities in the 'policy space dimension' are incentives (some of them technically subsidies) and incentive-based performance requirements (only a few of them prohibited by the TRIMs Agreement of the WTO, the rest proposed for prohibition in the failed multilateral agreement on investment); the use of conditionalities in the Agreement on Services (GATS) for promoting domestic export capacities in service sectors; and preferences in government procurement and flexibilities in relation to intellectual property rights commitments (TRIPs). See Corrales et al. (2003) 'Spaces for Development Policy: Revisiting Special and Differential Treatment', www.ictsd.org/dlogue/2003-05-06/ICTSD_SDT_draft_may03.pdf.

36. Jim Gosselin, 'Pacific ACP States – EC Launch EPA Negotiations,' *TNI*, Vol.3, No.6 available at www.ictsd.org/tni/index.htm
37. The ACP Group has further sought to argue that funding for restructuring needs to be made available under procedures which allow rapid and effective deployment. The EU maintains that there is no need for additional resources, while such large amounts of European Development Fund (EDF) financing remain unspent. The ACP Group maintains that additional funding is needed to address supply-side constraints and support restructuring so as to avoid diverting already available funds from existing priorities (e.g. meeting the Millennium Development Goals), and the EU argues that supply-side constraints can best be addressed through 'the identification and design of appropriate programmes and projects' under established aid programmes. Underpinning this discussion is the much broader issue of the efficiency of EDF aid deployment processes and the effectiveness of EU aid interventions in supporting economic restructuring.
38. Jonas Frederiksen and San Bilal, *TNI*, July 2004.

6

Economic Partnership Agreements (EPAs) between the EU and SSA: Risks, Rewards, and Alternatives

Lawrence E. Hinkle and Richard S. Newfarmer

Introduction

An overview of Africa's trade with the EU

Trade is vitally important for Sub-Saharan Africa's small economies, with total exports and imports of goods and non-factor services accounting, respectively, for 29% and 34% of GDP on average.[1] Partly for historical reasons, the EU is Sub-Saharan Africa's (SSA) largest single trading partner, buying on average 31% of SSA's merchandise exports and providing 40% of its merchandise imports.

Starting in the 1970s, the EU provided unilateral preferential access to its market to 77 African, Caribbean, and Pacific (ACP) countries under the Lomé Conventions (I through IV). The Cotonou Agreement (June 2000) provides for a continuation of this preferential access until 2008. Under the Cotonou trade preferences, all imports of manufactured goods from the ACP countries enter the EU duty-free, although these are still restricted by what are very demanding rules of origin (RoO) for small low-income economies. Many ACP agricultural products also enter the EU duty-free except for 990 tariff lines covering agricultural and processed agricultural products produced in the EU, which are granted less favourable tariff preferences. The most valuable of the EU's preferences for SSA have been those extended to a few traditional primary exports – sugar, meat, and fish – some of which are governed by separate commodity protocols. Subsequently, in 2002 the EU unilaterally began providing complete tariff-free, quota-free market access for all imports other than arms from the 49 least-developed countries – 33 of which are in SSA – under its 'Everything but Arms' (EBA) initiative.

Despite the trade preferences accorded to SSA under the Lomé and Cotonou Agreements, SSA's share of the EU market for its exports has declined in parallel with the decline in its share of world exports. The share of the SSA EPA countries' exports in the EU market has fallen steadily from 3% in 1985 to 0.9% in 2003, a reflection of competitiveness problems and supply constraints as well as declining real prices of some primary commodities and restrictive rules of origin. In addition, SSA's exports to the EU are heavily concentrated in primary products and petroleum, which themselves are concentrated in a handful of countries. There has been little diversification of SSA merchandise exports to the EU under the Lomé and Cotonou Agreements.

Trade between Africa and the EU is much less important for the EU than it is for Africa because the EU's economy is much larger than the economies of the SSA countries. Africa accounts for only 1.4% of the EU's total merchandise exports and 1.7% of its merchandise imports. Thus, the impact on the EU of free trade arrangements with Africa under the planned Economic Partnership Agreements is likely to be quite limited and much easier for the EU to adjust to than for Africa. Furthermore, if the EPA negotiations were conducted on commercial terms, the differences in economic size and in the relative importance of EU–SSA trade to the two sides would give the EU a much stronger bargaining position than the SSA countries.

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The views expressed in this paper are those of the authors. These views are not necessarily those of the World Bank, its Board of Directors, or the governments that they represent, and should not be attributed to them.

A development perspective on EPAs

The trade relationship between SSA and the EU is thus quite important for the region's development. The planned economic partnership agreements (EPAs) between the EU and Sub-Saharan African countries, which are to replace the Cotonou trade preferences in 2008, could offer considerable potential benefits for SSA. This chapter examines the planned EPAs from a **development perspective.** It seeks to clarify some of the issues faced by the EU and SSA countries and to suggest changes needed to make EPAs internally consistent and development friendly. (The terms 'pro-development' and 'development friendly,' as used here in assessing EPAs, refer to policies that will accelerate the growth of real GDP and global and regional trade integration in Africa.)

EPAs as envisaged by the Cotonou Agreement and the EU

The Cotonou Agreement, signed in June 2000 between the EU and the ACP countries, provides for negotiation of Economic Partnership Agreements (EPAs) between them. EPAs are intended to reformulate the trade preferences accorded to the ACP countries under the Cotonou Agreement and the previous Lomé Conventions to make them more supportive of broader development goals, more effective in promoting ACP–EU trade, and more compatible with World Trade Organization (WTO) rules.

EPA negotiations were launched at the all-ACP level in September of 2002. According to the Cotonou Agreement's timetable, the negotiations are to be completed by December 2007, and the EPAs are to become effective as of January 2008, although these deadlines could be modified by mutual agreement. Implementation is to take place gradually over the next 10 to 12 years, but this time limit could also be extended by mutual agreement.

Objectives of the EPA process

Development. The overarching objective of the EPAs is supposed to be to support the development of the SSA countries. Both the EU and the ACP countries have repeatedly emphasised their desire to use the EPAs as instruments of development. The EPAs are expected to support economic development in the ACP countries by establishing free trade agreements (FTAs) with them, by strengthening regional integration among them, and by increasing 'aid for trade' under the EU's technical and financial co-operation programmes.

Regional integration. The second central objective of the EPA process is to promote outward-oriented regional integration in the ACP countries. Intra-SSA trade is fairly limited, amounting to only about 12% of the average SSA country's merchandise exports and 7% of its merchandise imports. Intra-SSA and transit trade is, however, particularly important for landlocked SSA countries and for a handful of coastal countries (such as South Africa, Nigeria, Cote d'Ivoire, and Kenya) that have some manufacturing capacity. Increasing the integration of their economies with their regional neighbours is a longstanding concern of African countries.

Traditionally, the 77 ACP countries have been divided into six broad regional groupings: the Caribbean, the Pacific, and four loosely defined African sub-regions – Western, Central, Eastern, and Southern Africa. The EPAs are intended to establish free trade areas between the EU and each of these regional EPA groupings, the precise composition which is to be determined by the ACP countries themselves. The Cotonou agreement envisages a model of outward-oriented parallel North–South–South integration, regionally within the EPA groups and bilaterally between each of them and the EU.

In the case of free trade agreements like the EPAs, when a hub country or region (the EU) signs FTAs with various small countries like those in SSA (the spokes) and the latter do not sign FTAs among themselves, the hub country tends to benefit more because it has free access to all markets whereas the spokes only have free access to the hub market. This 'hub-and-spoke effect' increases the incentive for exporters to invest in the hub country, rather than in the spokes, in order to serve all of the markets. The 'hub and spoke' effect that a series of bilateral free trade agreements just between the EU and individual ACP countries could have would be miti-

gated by the regional integration aspects of the EPAs.

Four key features of EPAs

EPAs are intended to have four key features: (a) replacement of unilateral preferences with reciprocal free trade arrangements in order to make the EPAs WTO-compatible; (b) comprehensive coverage of trade and trade-related measures; (c) differentiation in the treatment of LDCs and non-LDCs; and (d) 'aid for trade'.

Reciprocal free trade and WTO compatibility. In order to make EU–ACP trade relations compatible with WTO rules, the Cotonou Agreement provides for replacing the existing relationship of unilateral preferential access by ACP countries to EU markets with reciprocal free trade agreements between the EU and the SSA countries. Under such reciprocal free trade, the EU would provide tariff-free access to its markets for ACP exports, and ACP countries would reciprocate by providing tariff-free access to their own markets for EU exports.

The WTO-compatibility problem arises because the EU's special unilateral preferences for the ACP countries under the Cotonou Agreement, like those under the preceding Lomé Conventions, are inconsistent with WTO's 'enabling clause'. This clause permits industrial countries to give unilateral preferential treatment to only two groups of countries: to LDCs or to all developing countries. Because the Cotonou preferences, like the earlier Lomé ones, are not part of the EU's general system of preferences (GSP) extended to all developing countries – and some of the ACP countries are not LDCs – these preferences do not conform with the WTO's 'enabling clause'. Hence, the EU needed to obtain waivers from the WTO, first for the Lomé Convention in 1994 and then for the Cotonou Agreement at the Doha ministerial conference in 2001. Even with the waivers, the EU's commodity protocols governing preferential trade in bananas and sugar with the ACP countries have already been successfully challenged in the WTO.

To bring the EU's trade relations with the ACP countries into line with WTO rules, the Cotonou Agreement provides for replacing the unilateral trade preferences that the EU currently accords to the ACP with economic partnership agreements involving reciprocal obligations. The EPAs, like other free trade agreements between developed and developing countries would be governed by WTO's Article XXIV rather than by its enabling clause, which applies only to unilateral preferences granted to developing countries and to preferential trade agreements between developing countries. Article XXIV requires that the countries entering into a reciprocal free trade agreement liberalise 'substantially all trade' within a 'reasonable length of time', without distinguishing between developed and developing countries.[2]

WTO-compatibility is an important consideration for the EU and weighed heavily in its launching of the EPA process. In contrast, because of their small size, many of these countries have a low profile in the WTO, have thus far been exempted *de facto* from many WTO disciplines, and have not been involved directly in the disputes over the commodity protocols. Many SSA countries have argued that they should be exempted from Article XXIV or that it should be amended in the Doha round to permit less than full reciprocity by developing countries participating in an FTA with industrial countries.

Comprehensive coverage and the implicit reform model. EPAs are envisaged in the Cotonou agreement as including comprehensive coverage of trade in services, investment, competition, trade facilitation, and aid for trade as well as merchandise trade. The EU sees the EPAs as instruments for addressing many of the supply-side constraints that limited the expansion and diversification of SSA exports to the EU despite the trade preferences provided under the Lomé and Cotonou Agreements. The EPAs would thus be used to leverage and lock-in broad programmes of trade and investment climate reforms. The EU envisages the EPAs to be broadly similar in this respect to the accession agreements between the EU and Central and Eastern Europe, to the EU–Mexico FTA and NAFTA, and to Chile's FTAs with the EU and US. In contrast, despite having signed the Cotonou Agreement, many SSA countries are hostile to the inclusion of the 'Singapore

issues' (investment, competition, trade facilitation, and government procurement) in the EPAs, which they perceive as a 'divide and conquer' strategy for the EU to achieve through EPAs what it could not in the WTO.

Differentiation between LDCs and non-LDCs. In addition to reciprocity and comprehensive coverage, a third key feature of the Cotonou Agreement is intended to be differentiation between LDCs and non-LDCs. The last part of Article 2 of the Agreement states: 'differentiation and regionalisation: co-operation arrangements and priorities shall vary according to a partner's level of development, its needs, its performance and its long-term development strategy. Particular emphasis shall be placed on the regional dimension...' Part 1 of Article 85 adds that: 'The least-developed ACP States shall be accorded a special treatment in order to enable them to overcome the serious economic and social difficulties hindering their development so as to step up their respective rates of development'. For example, the LDCs may not be required to open their markets to EU exports as fast or as much as the non-LDCs in order to maintain their preferential access to EU markets as long as the differential pace of market opening does not undermine the overriding development and regional integration objectives. As we will discuss below, the differentiation principle creates some complications with respect to regional integration within SSA, and differentiation between LDCs and non-LDCs could end up being a temporary feature of EPAs.

Aid for trade. A fourth intended feature of EPAs is to more effectively co-ordinate trade and aid. The EU is one of SSA's largest aid donors. Thus, its financial and technical co-operation programme could, in principle, provide substantial assistance for overcoming problems and taking advantage of opportunities created by the improved market access and trade liberalisation under EPAs. The opportunity for effectively co-ordinating trade and aid with a major trading partner and aid donor is a distinct advantage of the EPA process relative both to multilateral trade negotiations and to most other bilateral trade negotiations, where the link between aid and trade is non-existent or, at best, tenuous. Co-ordinating the programmes of the EC's two large general directorates for trade and aid, each of which have different constituencies and different perspectives, and the finance and trade ministries in SSA countries, which have similar differences, is essential for a pro-development outcome but will be a challenge for all concerned.

One issue with particularly important implications for the EPA negotiations is the amount of financial resources that will be provided to support the trade liberalisation process in SSA. The amount of development finance available from the EU until the end of 2007 under the 9th European Development Fund (EDF) has already been set, and its regional integration support programmes have been worked out with the various country groupings. However, the ACP group has argued that the financial resources currently available from the EU are insufficient to support trade liberalisation and expansion as well as the ACP countries' other development needs.

Any effects from the changes in market access and liberalisation under the EPAs will only be felt after 2007, potentially long thereafter, depending upon the liberalisations schedules under the EPAs. The financial envelopes for the 10th EDF and subsequent ones for the period after 2007, when the EPAs will be implemented, have not yet been determined; and their size and operational features presumably could still be designed to support the EPA process.

As discussed later, because of the limited scope that the EU has for offering additional trade preferences under the EPAs to SSA countries, particularly the LDCs, 'aid for trade' will have to play a central role in creating a favourable economic and political environment for the comprehensive reforms envisaged under them. As part of the G8 effort to mobilise increased funding for development in Africa, the EU has pledged to double its aid to Africa by 2012. Trade Commissioner Mandelson has recently indicated that a 'substantial portion' of this increase will go to aid for trade and that a mechanism will be put in place to strengthen co-ordination between the trade and aid directorates of the EC.

The EPA negotiations thus far

The Phase I Negotiations

Phase I of the EPA negotiations, during which ACP-wide issues were to be addressed by the group as a whole, ran for one year from September 2002 through October 2003. The ACP group and the EC then issued a joint ministerial statement declaring that Phase I of the EPA negotiations had proceeded 'satisfactorily' and that there was a high degree of 'convergence' on matters of principle. Both sides agreed that discussions on common ACP-wide issues would continue during Phase II in parallel with the EPA negotiations at the regional level.

In fact, there appears to have been little agreement on many key issues between the ACP group and the EU and even disagreement on some issues within the ACP group itself. Issues that were still under discussion at the end of Phase I included: WTO compatibility; the treatment of non-LDCs not entering into EPAs; rules of origin; technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) issues; safeguards, anti-dumping, and dispute settlement; commodity protocols; an ACP–EU framework agreement on fisheries; the fiscal, economic, balance of payments, and social implications of EPAs; and implementation mechanisms.

Establishment of the regional EPA groupings in SSA

In parallel with Phase I, the EU initiated discussions of regional EPA groupings with SSA countries. These countries subsequently formed into the following four regional groups for negotiating EPAs with the EU:

- The Economic Community of West African States (ECOWAS) plus Mauritania form the ECOWAS EPA group.
- The Central African Economic and Monetary Community (CEMAC) plus São Tomé and Príncipe comprise the CEMAC EPA group.
- Sixteen countries, including most of the members of the Community of Eastern and Southern African (COMESA), constitute the Eastern and Southern Africa (ESA) EPA group, for which COMESA is serving as the Secretariat.
- Four Southern African Customs Union (SACU) members (all but South Africa) and three neighbouring SADC countries (Angola, Mozambique and Tanzania) form the SADC EPA group.

The Phase II Negotiations

In October 2003, the Phase II negotiations were launched with two of the four SSA sub-regions – CEMAC and ECOWAS. EPA negotiations were subsequently initiated with ESA in February 2004 and with the SADC group in July 2004. Broad road maps setting out the organisational arrangements for the negotiations have been agreed with all groups. The first year of the negotiations was devoted to two tasks: (a) establishing the status of regional integration within the four negotiating blocks in order to address measures for integrating and strengthening regional markets, including their outward orientation, before considering steps to liberalise EU–SSA trade and (b) discussing questions of priority interest to individual EPA groups such as fisheries, SPS, and TBT issues.

General issues concerning EPA regional negotiating groups in SSA

As noted earlier, an important objective of the EPA process is to promote outward-oriented regional integration among the SSA countries and to limit the 'hub and spoke' effect that bilateral free trade just between the EU and individual SSA countries could have. Although the composition of the four regional EPA negotiating groups in SSA has now largely been determined, a number of important regional trade integration issues remain to be addressed.

Very different initial conditions

Determining the nature of the EPA groupings in SSA has been no simple matter because of the multiplicity and heterogeneity in SSA's regional trade agreements, which include a number of overlapping preferential trade areas, free trade areas, and customs unions (CUs) with different structures, operational rules, and implementation levels. Significant barriers remain to trade integration within free trade

areas in SSA and even within customs unions. However, the interaction of the EPA process and the political support for regional integration in SSA creates a useful dynamic impetus for rationalising this situation and an opportunity for removing intra-regional trade barriers.

The role of customs unions in EPAs

Of the four EPA negotiating groups in SSA, three (ECOWAS, ESA, and SADC) are FTAs that contain smaller CUs: UEMOA in ECOWAS, EAC in ESA, and SACU in SADC. The fourth negotiating group, CEMAC, is a CU. The member countries of each CU share a common external tariff. The existence of a common external trade policy permits the members of a CU (that is, UEMOA, CEMAC, SACU, and EAC) to enter into trade agreements, including EPAs, as a group, since any trade agreement would apply equally to all member countries. The EC believes that, ideally, it would be desirable for all of the EPA regions to implement common external tariffs prior to the entry into force of the EPAs and that it may be desirable to pursue EPA negotiations first with customs unions to see how much can be accomplished in this format and establish good precedents for addressing regional integration issues.

Customs unions with LDC and non-LDC members

A complication in negotiating EPAs with customs unions is the potential inconsistency between the Cotonou Agreement's differentiation in the treatment of LDCs and non-LDCs and its regional integration objective. All four of the CUs in SSA consist of a mix of both LDCs and non-LDCs. As explained below, the EU has unilaterally granted full duty-free and quota-free EBA access to its market to the LDCs, without requiring preferential access to the LDCs' markets in return. Having already obtained EBA preferences, the LDCs now have little incentive in terms of improved access to the EU market to open their markets to the EU on a preferential basis under an EPA, although EPAs could provide other potentially important benefits for the LDCs (as discussed below).

In contrast, the non-LDCs in SSA must, in principle, agree to provide preferential access to EU exports in order to maintain preferential access for their own exports to the EU after the Cotonou Agreement trade preferences expire in 2007. This problem of differing negotiating incentives is particularly serious for the CUs: the CU's common external tariffs cannot be maintained if their non-LDC members provide preferential access to imports from the EU while their LDC members do not. Hence, as noted earlier, given the importance of the regional integration objective to all concerned, differentiation could end up being a temporary feature of the EPA process.

The role of FTAs in EPAs

The situation is different in free trade areas where each country is free to maintain its own external trade policy. On the one hand, because of the different tariffs and other trade policies among FTA members, arriving at a single unique EPA applying identical provisions to all of the SSA members of an FTA is unlikely to be feasible; instead, separate (similar) EPAs will need to be negotiated by the FTA's member countries. On the other hand, in an FTA it is easier to provide for differential treatment of member countries since they do not all have to follow a common external trade policy. In particular, the tariffs of LDCs and non-LDCs on imports from the EU could differ. Since all four of the EPA groupings are various combinations of CUs, FTAs, and countries with independent trade policies, it may not be feasible to establish customs unions with CETs including all countries in each EPA group as the EU has envisaged. Rather, a flexible variable-geometry approach may be needed, at least in the near term until regional integration is further advanced in SSA.

Barriers to intra-regional trade in SSA

Despite the proliferation of preferential trade agreements in Africa, significant barriers to intra-regional trade still remain within 'free' trade areas, and even within customs 'unions', in all four of the regional EPA negotiating groups in SSA. Intra-regional free trade, where it is has been effectively

implemented, is generally limited to a small group of selected products.

None of the three FTAs involved in the EPA negotiations (ECOWAS, COMESA, and SADC) yet has even relatively free internal trade among its members. The ECOWAS FTA has not yet been effectively implemented. Twelve of COMESA's members have only recently started implementing its free trade agreement, and some countries that are doing so still maintain substantial barriers to free intra-regional trade. Internal trade among the SADC group, except within SACU, is currently even more restricted.

Intra-regional trade is not much freer in SSA's four customs unions. All of the customs unions in SSA, other than SACU, are, in fact, partial ones – in the sense that, although they have common external tariffs, there is no pooling of customs revenue, member countries maintain customs barriers at intra-CU borders, and intra-CU trade is subject to restrictive rules of origin. In both CEMAC and UEMOA, both substantial obstacles to internal free trade and country deviations from the common external tariff remain. The EAC customs union just became operational and faces similar problems since its design is similar. Only SACU is a fully functioning customs union with relatively free internal trade, a common external tariff observed by all of its members, common administration of the external tariff, and pooling of the revenues from it. The advantages of a 'customs union' in which barriers to intra-CU trade remain in place or the members of which do not fully implement the CU's common external tariff are, of course, limited.

Rules of origin (RoO) restricting intra-regional trade in SSA are a particular problem in both FTAs and CUs. Internal trade within all the free trade areas and all of the customs unions other than SACU is subject to RoO, most of which are quite restrictive; and there are constant protectionist pressures to increase their restrictiveness. Liberalisation of internal rules of origin is thus an important regional integration issue in SSA. Inefficiencies and corruption in customs administration, cumbersome and costly transit arrangements, and informal road blocks and 'tolls' on key transit routes are additional major obstacles that need to be addressed under the rubric of intra-regional trade facilitation (Yang and Gupta, 2005).

In addition, some natural trading partners with substantial cross-border trade between themselves belong to different regional EPA groupings, and the trade between these countries is not covered by *intra*-regional liberalisation measures. For example, Nigeria belongs to ECOWAS, whereas Cameroon on its southern border belongs to CEMAC. Similarly, the Republic of Congo belongs to CEMAC whereas the bordering Democratic Republic of Congo belongs to the ESA group. The substantial cross-border trade between these countries thus does not benefit from measures designed to liberalise *intra*-regional trade within ECOWAS and CEMAC.

Measures to increase intra-SSA trade

Although the political support for regional integration is currently greater than for the liberalisation of external trade in goods and services, SSA countries will still need to overcome the political and administrative obstacles to liberalisation of intra-SSA trade, with which the EPAs may be able to help. To promote intra-SSA trade and minimise the hub-and-spoke effect of the EPAs, further intra-CU and intra-FTA liberalisation of trade in both goods and services are needed. There are several steps which could be taken in the context of the EPAs to strengthen regional integration in SSA.

- First, full intra-CU and intra-FTA free trade in goods and services and related trade facilitation measures could be implemented in all the EPA groups. Free movement of labour within CUs and FTAs also needs to be encouraged. These reforms are particularly important for the landlocked and poorer members of the regional groupings.
- Second, in addition to implementing internal free trade among their members, the regional EPA groups could implement free trade with each other at the same time as they do so with the EU to avoid distorting cross-border between members of different regional EPA groups and limit the potential hub-and-spoke effect of the EPAs that could result from the EU's establishing separate free trade areas with each regional EPA group in SSA.

- Third, SSA countries could take advantage of the EPA process to adopt simple, standardised, liberal RoO for the various FTAs and CUs in SSA and to address the other trade facilitation issues noted above.
- And, fourth, those member countries of customs unions that have not fully implemented their CU's common external tariff (CET) should do so when implementing other trade liberalisation measures under their EPAs..

In addition, as discussed below in the section on reciprocity, most-favoured nation (MFN) liberalisation would both increase outward orientation generally and facilitate expansion of intra-African trade since trading partners in other African EPA groups would benefit from it.

Implementation of the above reforms is, however, likely to be difficult. Some of these reforms have existed on paper for years in some regional trade areas in Africa, but little progress has been made in actually implementing them. Establishment of free trade with the EU could significantly reduce protectionist opposition both to effective implementation of free trade within Sub-Saharan Africa and to liberalisation of most-favoured-nation (MFN) trade. For, once a product can be freely imported from the EU, there will be much less incentive for protectionist interests to try to block similar imports from other SSA countries or the rest of the world.

Region-specific issues

In addition to the above general issues concerning all EPA negotiating groups, there are some important region-specific issues affecting EAC, SACU-SADC, and ECOWAS that have not yet been resolved.

EAC

An important unresolved geographical-organisational issue concerns the East African Community's (EAC) customs union, three of whose members (Kenya, Rwanda, and Uganda) are participating in the ESA group while the fourth (Tanzania) elected to join the SADC group. Since the four EAC countries are implementing a common external trade policy, they will need to negotiate a common EPA as a group. Consequently, some geographic realignment of the ESA and SADC regional EPA groups may be required.

SADC and SACU

The situation with the EPAs for the SACU countries is particularly complex. Four of the five SACU countries (Botswana, Lesotho, Namibia and Swaziland – or BLNS as they are known as a group) are participating in the EPA process and have joined the SADC regional EPA group along with Angola, Mozambique, and Tanzania. However, the fifth and by far the largest SACU member, South Africa, which plays a central role in determining SACU's trade policies, is eligible neither for the trade benefits of the Cotonou Agreement nor for an EPA. Furthermore, South Africa has already signed a separate FTA with the EU (the Trade Development and Cooperation Agreement, TDCA), many aspects of which apply *de facto* to the other four SACU countries. In addition, SACU is currently in the process of negotiating a free trade agreement with the US. More thought needs to be given to the roles of SACU and the EU–South Africa free trade agreement and to the membership in the SADC and ESA regional EPA groups in order to create a sound basis for the regional and global integration of the economies of the sub-region.

ECOWAS

The third issue concerns Nigeria's adoption of the planned ECOWAS common external tariff. The Economic Community of West African States (ECOWAS) is composed of the eight members of UEMOA and seven additional countries. An FTA has been adopted by the ECOWAS members, but its implementation has been very limited thus far. ECOWAS plans to create a CU, with the non-UEMOA countries adopting a three-rate CET similar to UEMOA's CET by 2008, when the EPAs are supposed to come into effect, and thus in principle may be able to negotiate a common EPA as CU. However, Nigeria's economy is larger than that of all of the other ECOWAS countries put together, and

its trade policy is currently much more restrictive than that of the UEMOA. It is an open question whether Nigeria will implement the ECOWAS CET any time in the near future or demand modifications in it. If full implementation of the ECOWAS customs union is substantially delayed, negotiation of the ECOWAS EPA could be more complicated than currently envisaged, involving variable geometry arrangements for some countries which have implemented the ECOWAS customs union arrangements and others which participate only in the ECOWAS FTA.

SSA's access to the EU market under EPAs and its 'Everything But Arms' (EBA) Initiative

In addition to giving trade preferences to ACP countries under the Cotonou Agreement, the EU now provides preferences to LDCs, including those in SSA, under its Everything but Arms (EBA) Initiative, adopted in 2001. The EBA Initiative has complicated the EPA process by creating different market access conditions and negotiating incentives for the 33 LDCs and 13 non-LDCs in SSA eligible for EPAs.

Implications of the EBA Initiative for LDCs in SSA

Under the EBA Initiative, the EU unilaterally grants to all 49 LDCs, including non-ACP LDCs such as Bangladesh, quota-free and tariff-free access to its market for all products except arms – without the LDCs having to give preferential access to the EU in return. Implementation of full market access was immediate except for transition periods for bananas, rice, and sugar, for which tariff-rate quotas restricting LDC exports of these products to the EU are being phased out over eight years. Thus, the 33 LDCs in SSA now have access to the EU market under the EBA Initiative as well as under the Cotonou Agreement. However, this improvement in market access does not yet appear to have led to substantial increases in SSA exports because of other constraints to export diversification and expansion.

The EBA Initiative is part of the EU's General System of Preferences (GSP) and is compatible with WTO's enabling clause as it grants special preferences to a permissible grouping of developing countries, the LDCs. In contrast to the EU's broader GSP, which is revised every three years, the EBA Initiative runs for an unlimited period and is not subject to periodic reviews. Market access is thus more secure under the EBA Initiative than under GSP and is presumably more likely to encourage investment in new exports for this reason. However, as countries develop, they can graduate from LDC status, which is determined by UNCTAD/WTO, as Cape Verde is doing, and thus lose their eligibility for the EBA Initiative. The EBA Initiative has also eliminated the preference margin of ACP countries relative to non-ACP LDCs, although the Cotonou rules of origin for the ACP countries are less restrictive than the EBA Initiative's RoO.

As the EBA preferences were provided unilaterally by the EU without a quid pro quo from the LDCs, the LDCs have little to gain in terms of lower tariffs on their exports from entering into reciprocal free trade with the EU under EPAs. For the LDCs to obtain something in return for giving EU imports tariff-free access to their markets, the EPAs need to offer benefits beyond those provided by the EBA Initiative Such benefits could, as discussed below, come from liberalisation of the EU's restrictive rules of origin and additional aid for trade to both deal with adjustment problems and support the growth and diversification of exports.

Market access for the non-LDCs in SSA

In contrast to the 33 LDCs in SSA which benefit from EBA and whose current access to the EU market would presumably not be greatly reduced (except possibly as result of the EBA Initiative's somewhat more restrictive rules of origin than the Cotonou Agreement's, as discussed below) if they decided not to enter into EPAs when the Cotonou Agreement's trade preferences expire in 2008, any of the 13 non-LDCs that do not sign EPAs would presumably revert to GSP status. The EU's GSP provides less favourable preferential access than the Cotonou Agreement: narrower product coverage, smaller margins of preference, and more restrictive rules of origin. The EU has also recently adopted a

GSP+ scheme that provides additional preferences for non-LDCs that comply with a list of international conventions on human rights, the environment, etc; but the GSP+ preferences are not as attractive as the EBA preferences accorded to LDCs.

The value of Cotonou preferences, and hence the impact of reverting to the EU's less favourable GSP, varies considerably among the 13 non-LDCs in SSA. For three non-LDCs, in 2002 the value of the tariff savings under the Cotonou preferences exceeded that under the GSP preferences by 16% to 39% of the value of their total exports to the EU: Swaziland 39% (meat), Mauritius 20% (sugar and knitted garments), and Seychelles 16% (fish). In contrast, for the other 10 non-LDCs the value of the tariff savings under the Cotonou preferences for current exports is small relative to that under the GSP. For five non-LDCs (Namibia, Zimbabwe, Ivory Coast, Cameroon, and Kenya) the loss would be 3% to 6% of the value of their merchandise exports to the EU, and for the remaining five non-LDCs (Ghana, Botswana, Congo, Gabon, and Nigeria) the loss would be 2% or less. Thus, these 10 countries would not lose much by way of reduced market access in the medium term from reverting to the EU's GSP.

Similarly, the immediate effect of moving from the Cotonou to the EBA regime would also vary significantly among the 13 non-LDCs in SSA. For four countries (Botswana, Namibia, Cameroon, and Ivory Coast), moving from Cotonou to EBA preferences would be worth from 3% to 8% of the value of their current exports to the EU. But for the other nine non-LDCs, the immediate gain from moving from Cotonou to EBA would be less than 1% of the value of their current exports to the EU. Thus, in the near term, the gain solely from moving from Cotonou to EBA access is likely to be small.

However, the above figures cover only current export products and quantities – they do not take into account the effect of improved prices or market access on either the expansion of existing exports or the diversification into new products that would be possible with EBA access to the EU market. The figures also underline the importance of addressing other constraints to export diversification such as the EU's restrictive RoO and competitiveness and supply problems in the SSA countries.

The non-LDCs in SSA will, in any case, need to obtain improved market access through EPAs to create opportunities for diversifying and expanding exports in the long term. Discriminating under EPAs between the exports of the LDC and non-LDC members of the same customs union or free trade area could slow the growth of the regional group's exports and the development of the group as a whole. Hence, the most development-friendly option would be for the EU to provide EBA market access to all SSA countries – both LDCS and non-LDCs – signing EPAs.

The EU's rules of origin

The rules of origin (RoO) under both the Cotonou Agreement and the EBA Initiative are complex and restrict SSA exports. The RoO under the EBA Initiative are the same as those under the EU's GSP and are more restrictive than those under the Cotonou Agreement. In fact, Brenton (2003) shows that SSA LDCs make little use of EBA preferences and continue to export to the EU under Cotonou preferences. The RoO that apply under Cotonou appear sufficiently less restrictive to make continuing to export under them more attractive for some SSA exporters of some products that face low tariffs under Cotonou than switching to EBA with its zero tariffs but more restrictive RoO.

Two examples that illustrate the potential benefits from liberalising restrictive RoO are: (a) the success of garment exports from SSA under the provision of the US Africa Growth and Opportunity Act's (AGOA) preferences which, as an exception to the US's standard RoO under FTAs, permit SSA garment exporters to use, for a temporary period, fabrics imported from third countries outside the region instead of having to source the fabrics from within the region or the US; and (b) Mauritius's exports of knitted products to the EU which get around the EU's two-stage processing RoO governing textiles and garments by producing knitted garments directly from imported yarn.

Unless the EU's RoO are liberalised and simplified under EPAs, the benefits of even full tariff-free,

quota-free market access will be limited. The liberalisation of the EU's RoO is particularly important for the diversification of SSA's exports to the EU as it is typically the development of simple non-traditional exports which is prevented by restrictive RoO as illustrated by the foregoing examples.

Thus, the Commission for Africa (the 'Blair Commission') has recommended that the EU's current complex RoO be replaced by a simple, uniform 10% value added requirement in the EPAs. An even less restrictive RoO would be to give SSA exporters the choice between meeting a 'change of tariff heading' rule or the uniform 10% value-added rule.[3] The EU's trade standards and import defence measures should also be reviewed to see if more development-friendly provisions concerning these can be included in the EPAs.

Reciprocity: Reductions in tariffs on imports from the EU, parallel MFN liberalisation, and complementary domestic reforms in SSA

In return for secure preferential access to the EU market under EPAs, SSA countries are supposed to reciprocate by making preferential reductions in tariffs on SSA's merchandise imports from the EU. Designing the required liberalisation of SSA imports (the 'reciprocity' issue) in a pro-development fashion is one of the more complex and controversial aspects of the EPA process. Two important complementary reforms to the preferential reductions in African tariffs on imports from the EU will be required to achieve pro-development outcomes: MFN tariff reductions and the restructuring of indirect tax systems.

Likely preferential reductions in tariffs on imports from the EU

As noted earlier, WTO's Article XXIV governing all free trade agreements involving industrial countries requires that tariffs be completely eliminated on 'substantially all trade' by the participants in a free trade agreement within a 'reasonable length of time'. Although precise definitions of the two phrases in quotations have not been established, 'substantially all trade' has been interpreted in previous EU free trade agreements to mean 90% or more of trade. The 90% figure refers to the existing level of trade – which is constrained by existing tariffs and other trade restrictions — rather than to the potential trade level once trade liberalisation has taken place.

The EU–South Africa FTA provides for the EU to eliminate tariffs on about 95% of its imports from South Africa and for South Africa to eliminate tariffs on about 86% of its imports from the EU to reach an average coverage of about 90% of total EU–South Africa trade. If, as seems likely, a similar approach is followed in the EPAs, the EU would probably liberalise 100% of its imports from SSA (that is, grant full tariff-free, quota-free access to imports from SSA); and SSA would liberalise 80–90% of its imports from the EU to arrive at a target average liberalisation of 90% or more.

Ten years has been considered to be a 'reasonable length' of time for implementation in EU free trade agreements except in special cases. A 12-year implementation period was allowed in the TDCA between the EU and South Africa, and the Commission for Africa has suggested extending this period to 20 years in EPAs. Thus, the implementation period for EPAs is likely to fall in the 12–20 year range.

Problematic effects of preferential tariff reductions

Many SSA countries still have high and distorted MFN tariffs. Even in countries where peak tariffs themselves have been reduced to the 20–25% range, tariff exemptions and special protective measures are often problems. Preferential bilateral tariff reductions under EPAs could, in the presence of high MFN tariffs, lead both to some costly diversion of trade from low-cost non-EU to high-cost EU suppliers and to some monopoly pricing by EU exporters and implicit transfers of forgone tariff revenues from SSA governments to them.

Little empirical work has been done on the risk of trade diversion and monopoly pricing by EU suppliers in SSA. On the one hand, advocates of EPAs tend to assume that the EU economy is sufficiently large and competitive that trade diversion and

monopoly pricing are not likely to be serious problems. But, on the other hand, observers familiar with supply conditions in small, isolated African markets that are costly to serve and with historical patterns of market dominance in the region tend to be more sceptical about the existence of effective competition among EU suppliers.

As explained above, it is likely that the preferential elimination of SSA tariffs on imports from the EU will cover only 80–90% of current imports and completely exempt some sectors and products. 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 liberalisation 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 free trade agreement. Limiting liberalisation to 80% of SSA's current imports would probably allow most of the important import-competing sectors in SSA to be exempted because, with their relatively small import-competing manufacturing sectors and current high protective tariffs (and quantitative restrictions in a few cases), imports of products that compete with domestic productions are likely to be a small percentage of total imports (Stevens and Kennan, 2005).

A tariff structure resulting from selective, *ad hoc* preferential reductions in tariffs on imports from the EU would be problematic both for the sectors for which imports are liberalised and for those for which they are not. The sectors for which tariffs on EU imports are eliminated may experience trade diversion or monopoly pricing by EU suppliers, and the sectors for which current high tariff rates are maintained would continue to have little incentive to increase their efficiency or reduce monopolistic profits. In addition, the 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 further distort existing tariff regimes by increasing 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. Subsequent negotiation of similar such selective partial 'free' trade agreements with additional OECD countries (as, for example, SACU is currently doing with the US) would aggravate these distortions.

Furthermore, the existing structure of tariffs within the various EPA groupings makes it likely that strong protectionist interests, including foreign firms producing behind high tariffs, will resist an efficient common external tariff. Stevens and Kennan (2005) find, somewhat surprisingly given the existence of three customs unions with CETs, that in the four African EPA groupings there is only a 1–12% overlap of the high tariff products that member countries may wish to exclude from liberalisation for protective reasons. This finding, if confirmed, would suggest that there will be hard negotiations over a common list of products to be excluded by all countries in EPA groups having a common external tariff, that very different lists of products may be excluded by each country in FTAs where there is no common external tariff, and that regional harmonisation of exclusions may be desirable to foster regional integration.

Need for parallel MFN tariff reductions

Because of the distortions that can result from *ad hoc*, selective preferential liberalisation, a number of pro-active developing countries (Chile and Mexico, for example) lowered their MFN tariffs to a uniform rate of 10% or so on a comprehensive basis before selectively eliminating tariffs on a preferential basis under free trade agreements with the EU and the US, and have followed up on these initial cuts with both further MFN liberalisation and adoption of free trade agreements with other large trading partners. The most successful regional trade agreements (the EU itself, NAFTA, AFTA) have also used low MFN tariffs to stimulate trade (World Bank, 2005).

Upfront MFN tariff reductions. Parallel preferential and MFN liberalisations are beneficial both because of the standard static benefits from increases in trade and the much larger dynamic gains from a more

open economy as well as because of the reductions in trade diversion and in monopoly pricing effects and the implicit transfer of forgone tariff revenues to foreign suppliers benefiting from preferential tariff reductions. MFN tariff reductions would need to be implemented by SSA countries before the preferential tariff reductions with the EU under EPAs take place so that trade diversion is minimised and EU suppliers do not have a chance to sell into highly protected domestic markets in SSA, and thus obtain large implicit transfers of forgone tariff revenues, before MFN tariffs are reduced. In order to increase competition and lower the prices of tradable goods in SSA, the tariff reductions would need to cover all sectors, including, in particular, the main domestic import-competing industries.

However desirable the adoption of a low uniform tariff of 10% or so may be economically, because of political and revenue constraints it may not be possible to lower the MFN tariff this much in all EPA groups before starting to implement preferential reductions in tariffs on imports from the EU under EPAs. In those EPA groups (ECOWAS and CEMAC) where the establishment of a common external tariff precedes the implementation of the EPA, adoption or lowering of the CET will offer an opportunity to start the necessary MFN tariff reductions in a co-ordinated way and to reduce the magnitude of the subsequent changes needed prior to implementing preferential liberalisation of imports from the EU under an EPA. For example, the ECOWAS/UEMOA CET with four rates of 0, 5, 10, and 20% is currently the most open tariff structure in SSA Its implementation by the ECOWAS countries that have not already done so would put them in a good starting position for the subsequent MFN reductions needed for an EPA. ECOWAS's common external tariff with its maximum rate of 20% and simple four-rate structure is also a good model for other EPA groups to follow in adopting or liberalising their own common external tariffs prior to preferential reductions in tariffs on imports from the EU under EPAs.

In the case of any FTAs (ESA or SADC) where it turns out not to be feasible to adopt an efficient common external tariff prior to implementation of the EPA, a well-designed MFN liberalisation would make it easier for the countries in the FTA to move towards a common external tariff and create a favourable environment for further liberalisation among themselves. On the other hand, as CETs are adopted by new countries, there will inevitably be protectionist pressures for high tariffs (as is possible, for instance, in the case of Nigeria's adopting the ECOWAS CET) that will need to be resisted.

Subsequent parallel MFN and preferential tariff reductions. The initial reductions in MFN tariffs in the regional EPA groups may not go as far as ultimately needed. However, the selective, phased nature of the likely preferential reductions in tariffs on imports from the EU, with 80–90% of EU imports becoming completely free with 0% tariffs over a 10-12 year period and the remaining 10–20% of EU imports continuing to face current tariffs, offers the possibility of a parallel two-track approach to MFN tariff reductions with different schedules of reform for these two groups of products.

In the case of the 80–90% of imports from the EU that will have no tariffs, the simplest approach for avoiding trade diversion and monopoly pricing resulting in implicit transfers of forgone tariff revenues to EU suppliers is for the SSA countries to lower their MFN tariffs on products that will be freely imported from the EU to no more than 5%. From a development perspective, the only rationale for maintaining even such a small preference margin (5% or less) for imports from the EU would be to use the availability of this margin as an incentive to encourage other countries to enter into similar free trade agreements, an unlikely prospect in current circumstances. A zero preference margin (that is, lowering the MFN tariff to the same level as the preferential EU tariff) would be the most development friendly outcome since it would minimise the risk of trade diversion or of monopoly pricing by EU suppliers. In addition, to limit revenue losses during the implementation period, instead of directly lowering to zero the tariffs on imports from the EU that are to be fully liberalised under EPAs, the preferential and MFN tariff reductions on these products could be carried out in steps, by first gradually lowering the preferential EU and MFN tariffs to a revenue tariff of 5% or so on these imports and then main-

taining the two tariffs at this level for as long as possible for revenue purposes.

In the case of the 10–20% imports on which there would be no preferential reductions in the tariffs facing the EU, EPAs by themselves would create no immediate urgency to reduce MFN tariffs except to offset the increases in effective protection that would result from eliminating the tariffs on many imported inputs. However, MFN liberalisations are often hard to engineer politically. Adoption of common external tariffs by some or all of the regional EPA groups will also complicate future liberalisations because their members will no longer be able to unilaterally reduce their tariffs and all (or a decisive majority) of an EPA group's members will need to support future liberalisations. Hence it would be desirable to take advantage of the reform dynamics of the EPA process to continue the trade liberalisation effort. In order to avoid increasing anti-export bias when tariffs on inputs imported from the EU are lowered and to put competitive pressure on import-competing sectors to operate more efficiently, the maximum tariff in the non-liberalised sectors should be lowered to 15% or less with the lower tariff bands being adjusted as necessary.[4] In cases where such MFN reductions are likely to cause particularly difficult adjustment problems, it would be better to allow a longer time period for phasing in the tariff reductions and to provide more adjustment assistance under the aid-for-trade programme than to postpone indefinitely the required structural adjustment by exempting some industries from the liberalisation. The15% maximum MFN tariff on the 10–20% of trade not subject to preferential liberalisation could subsequently be further reduced to 10% or so at an appropriate future date in accordance with the needs of individual customs unions and countries.

The MFN tariff reductions are essential if EPAs are to achieve their development objective. In the EPA process the EU needs, therefore, to support well-designed parallel MFN tariff reduction rather than just pushing for preferential reductions in tariffs on EU imports. If the MFN reductions cannot be formally included in the EPAs, the necessary MFN tariff reductions could be made by the SSA customs unions and countries, unilaterally lowering their MFN tariffs at the same time as they lower their tariffs on imports from the EU under EPAs.

Potential revenue losses and the restructuring of indirect tax systems

Magnitude of the potential revenues losses. Import tariffs are still an important source of government revenue in many SSA countries, and preferential reductions in SSA tariffs on merchandise imports from the EU could have significant fiscal implications for some. Revenues from import tariffs amount to about 2% of GDP and 15% of government revenues in the median SSA country, and some countries depend even more heavily on tariff revenues. In the one-third of SSA countries which are most dependent on tariff revenues, import tariffs amount to 3–6% of GDP and account for 25% or more of government revenues, reaching as much as 40–50% of government revenues net of grants in a few extreme cases (Hinkle, Herrou-Aragon, and Kubota, 2003).

Since the EU is the largest source of imports for most SSA countries, supplying 40% of total imports in the average country, some countries could lose significant tariff revenue from reducing tariffs on imports from the EU. For example, even assuming no trade diversion, an average country, in which tariff revenues are 2% of GDP and 40% of imports come from the EU, would lose tariff revenues equivalent to 0.8% of GDP (7–10% of government revenues) from eliminating tariffs on all imports from the EU if the same average tariff is paid on imports from the EU as on those from the rest of the world.[5] The revenues losses could be significantly greater in countries that are highly dependent on tariff revenues: countries in which tariffs account for 4% or more of GDP could lose revenues of 1.5% or more of GDP (15–20% of total government revenues) from eliminating tariffs on imports from the EU.

Any trade diversion from non-EU to EU suppliers because of the elimination of tariffs on imports from the EU would lead to further loss of revenues. For example, Busse, Borrmann, and Grossmann (2004) analyse the effects on the ECOWAS coun-

tries of preferential elimination of tariffs on all imports from the EU using a partial equilibrium model. They find that imports from the EU would increase by 5% (Guinea-Bissau) to 21% (Nigeria), rising by about 9% in the median country. The loss of government tariff revenues would range from a low of 0.3% of GDP (3.6% of government revenues) in Niger to a high of 4.1% of GDP (19.8% of revenues) in Cape Verde. Mid-range countries such as Ghana and Senegal would experience revenue losses of 1.8–1.9% of GDP (10–11% of total revenues).

The above figures are, however, for the ultimate effect of a fully phased-in elimination of duty on all imports from the EU and thus are indicative of the upper limit of the magnitude of possible revenue losses. Excluding 10–20% of imports from the EU from preferential liberalisation could ease the fiscal shock, particularly if tariffs on imports that are important sources of revenue are not reduced. If, moreover, the tariff reductions are phased in gradually over a 10–20 year period as envisaged in the EPAs, the adjustment should be more manageable (0.05–0.3% of GDP per year), except possibly in a few extreme cases that may require special attention.

Nevertheless, there are still valid reasons for concern about the difficulty of replacing lost tariff revenues. Buansgaard and Keen (2005) find that, after trade liberalisations, 'revenue recovery has been extremely weak in low-income countries (which are those most dependent on trade tax revenues): they have recovered, at best, no more than about 30 cents on each lost dollar. Nor is there much evidence that the presence of a value-added tax has in itself made it easier to cope with the revenue effects of trade liberalisation.'

Offsetting revenue measures. In view of the unmet expenditure needs for government spending on health, education, and infrastructure and the debt burden and structural constraints to increasing government revenues, many SSA countries will need to design the preferential reductions in tariffs on imports from the EU in a way that limits the loss of revenues. The products that SSA governments may need to exclude to maintain government revenues are likely to differ significantly from those that would need to be excluded to protect domestic producers (Stevens and Kennan, 2005). Hence, in deciding on which products to exclude, a strategy of giving priority to protecting fiscal revenues, together with limiting the extent of the exclusions, could provide a healthy counterbalance to the demands of vested interests for continued protection. (For a discussion of additional measures for reducing the distortionary effects of preferential liberalisations see Schiff and Winters, 2003). In addition, as suggested above, the loss of revenues from completely eliminating tariffs on 80–90% of imports could be limited in the medium term by gradually lowering the preferential EU and MFN tariffs on these imports to a revenue tariff of 5% or so and maintaining the revenue tariff at this level for as long as possible while a restructuring of the domestic tax system is carried out and tax administration improved.

To protect their fiscal positions and maintain macroeconomic stability, SSA countries will also need to reform their indirect tax systems so that revenues from the VAT and non-discriminatory excise taxes levied at equal rates on imports and domestic products replace the forgone tariff revenues. Improvements in tax administration could also yield large revenue gains in some countries. Countries that face particularly large revenue losses or that have already successfully implemented a VAT scheme and have little scope for increasing the revenues from it may need to consider strengthening other components of their tax and revenue systems.

Restructuring indirect tax systems and strengthening tax administration are complex legal and administrative undertakings. They require some of the most demanding and time-consuming reforms facing SSA countries. Indirect taxes will also need to be harmonised within regional EPA groups, and variations in revenue impacts within the same EPA group will create additional complications. However, the restructuring of indirect tax systems is necessary in the long term to modernise revenues systems. All countries wishing to integrate into the world trading system will need to implement this reform sooner or later. (Some SSA countries, such as those in SACU and UEMOA, have already embarked on this process in the course of ongoing reform programmes.)

Detailed country-by-country analysis of the revenue implications of preferential tariff reductions and parallel MFN liberalisation will, therefore, be essential for planning complementary reforms in domestic tax reforms. The required strengthening of tax administrations and restructuring of the indirect tax system needs to be started before, the tariff reductions on EU imports are implemented. In addition to having enough time to plan and implement the required reforms, the SSA countries, particularly the least developed ones, may require substantial technical and financial assistance from the EU during the implementation period if elimination of tariffs on imports from the EU is not to undermine their fiscal positions. One particularly useful confidence-building measure would be to provide back-up grant-financing for tariff losses and related revenue shortfalls until the tax reform has been completed, tax administration has improved, and foregone tariff revenues have been securely replaced.

Harnessing EPAs for development: Broad design issues

We see the EPA as a means of unlocking the future, not imprisoning ... ACP countries in the past.

EU Trade Commissioner Mandelson[6]

Determinants of success or failure

The fundamental condition for realising the potential development benefits of the EPAs is to actually use them as instruments for development. Doing so will pose challenges for both the EU and SSA. For the EU, the challenges will be (a) to maintain the development focus of the EPA process in the face of pressures from business and political interests, a difficult task for trade negotiators accustomed to thinking in term of mercantilist commercial advantage and political deals, and (b) to simultaneously address complex development issues in multiple diverse regions and to effectively coordinate trade and development assistance. Because of its central role in the whole EPA process, if the EU cannot rise to these challenges, the EPAs may be abandoned or end up causing more harm than good for SSA, at least in the medium term until the SSA countries are able to implement the necessary complementary reforms on their own.

For SSA countries, the key requirement is commitment to using EPAs to accelerate reforms that are necessary in the long term for integrating their economies globally and regionally. Implementing free trade with the EU will require a number of difficult policy and administrative steps by SSA countries, including undertaking parallel MFN tariff reductions to avoid costly trade diversion and monopoly pricing by EU suppliers, replacing forgone tariff revenues, and liberalising internal trade within and among SSA's regional EPA groups.

Moreover, there are many obstacles to expanding production of tradable goods in Africa in addition to the merchandise trade-related reforms discussed in this paper. The investment and supply response to the merchandise trade-related reforms will be much greater if these reforms are followed by additional reforms in the investment climate. Hence, the readiness of individual countries to use the EPA process to leverage a wide range of investment-climate reforms will be critical in determining the success of EPAs.

Broad EPA design issues

Four design issues are critical to the success of the EPA process: creating effective incentives to reform; allowing enough flexibility to deal with wide variations in regional and country conditions; appropriate phasing and sequencing of a long list of complex policy actions; and designing, if feasible, pro-development provisions concerning trade in services, investment, and competition.

Incentives to reform and aid for trade. Many African countries are reluctant to undertake necessary trade-related reforms, and it is unclear whether the incentives in the current EPA design are sufficient to induce them to do so. In other cases where trade agreements have been used to leverage a wide range of reforms (as in the accession of the Central and Eastern European countries to the EU), the trade agreement with the EU has been perceived by the reforming countries as attractive both economically and politically.

Unfortunately, the EPAs have become quite

controversial; and the perception of the potential gains from EPAs currently appears to be negative in some African countries. For the EPAs to be attractive in political economy terms, they will need to include measures to accelerate growth by diversifying and expanding exports and raising investment levels. The EU will need to include generous treatment of SSA exports in the EPAs by liberalising its restrictive rules of origin, extending full tariff-free, quota-free market access to the non-LDCs in SSA, eliminating agricultural export subsidies and decoupling agricultural production support in products of particular interest to SSA in the Doha round, and in general facilitating exports from SSA in whatever way possible under EPAs. Furthermore, if EPAs are to be credible instruments for leveraging reforms, they will need to be enforced; and a development-friendly approach will thus need to be found for handling enforcement and dispute settlement problems.

Providing attractive levels of aid for trade to support the implementation of the EPAs is also likely to be a critical incentive, particularly for the LDCs. To reverse the current negative perception of EPAs, resources provided as aid for trade will need to be perceived as additional and substantial by the countries entering into EPAs. The additional aid for trade will need to be significantly greater in real terms than the amount needed to finance the transitional costs associated with the EPAs and related reforms and to cover both budgetary assistance and financing of new investment. If the EU were to offer an ambitious programme of additional aid for trade as well as the trade-related benefits noted above, it might tip the balance of political-economy incentives favourably. Careful thought therefore needs to be given to the design of the aid-for-trade package as the negotiations unfurl.

Flexibility in regional and country design. EPAs were originally envisaged as agreements between the EU and customs unions that have common external tariffs. However, the regional EPA negotiating groups in SSA are diverse combinations of customs unions, free trade areas, and independent countries with wide variations in trade policies and commitment to outward-oriented regional integration. Except for SACU, few, if any, are capable in the medium term of reducing internal border barriers or in co-ordinating their external trade regimes to the extent required in a full customs union with revenue pooling and no customs barriers at intra-regional borders. Hence, the EPAs will probably have to permit flexible combinations of customs unions and free trade agreements.

Country conditions within the regional groupings are also diverse. All four regional EPA groups include both LDCs and non-LDCs as well as small economies alongside one or two dominant large ones. Commitment to both external and intra-regional liberalisation differs similarly. The political obstacles to reform (such as civil unrest and strong vested interests) may be so great that some countries, or even sub-regions, may have to fall back for a period of time on the GSP or EBA initiative for access to the EU market until they are ready to implement the EPA-related reforms. Progress in these diverse country circumstances is likely to require that EPAs allow for some differences in the trade regimes and the pace of reform in the same EPA group, at least in the initial phases.

Appropriate timing and sequencing of EPA-related reforms. The current EPA design envisages addressing a wide range of difficult development issues in multiple sectors in 44 countries in four diverse regional groups in a period of 12–20 years. The end-2007 deadline for completing the EPA negotiations is rapidly approaching. Even for countries with substantial institutional capacity, dynamic leadership, and strong political support for reforms, design and implementation of such comprehensive programmes will be a challenge. For countries with serious capacity constraints and lukewarm political support for reform, the list of reforms envisaged is daunting. Hence, a single mega-EPA agreement with a 12–20 year implementation period may prove too demanding to negotiate and implement even for the most committed regions. A series of agreements with careful attention to the timing and sequencing of reforms is probably a more realistic option than a single comprehensive EPA.

The reform process will have to be carefully steered to take advantage of the dynamism provided

by the EPA negotiations and their deadlines while allowing realistic amounts of time for policy design and implementation and avoiding initiatives that would not be sustainable institutionally or politically. With appropriate programme design, the envisaged 12–20 year implementation period appears generally reasonable. However, given the depth of some of the controversies and the need for more preparatory work on some key issues, the end-2007 deadline for completing negotiations may eventually need to be extended for some of them, particularly if trade in services, investment, and competition policy are to be included.

Designing development-friendly provisions concerning trade in services, investment, and competition policy. There are many obstacles to expanding production of goods and services in Africa in addition to the trade-related reforms discussed in this paper. The investment and supply responses to the merchandise-trade reforms will be much greater if these are followed by actions in other areas. It may be possible to address some supply-side and behind-the-border reforms by including trade facilitation, trade in services, investment, and competition policy in the EPA process. Despite the controversy surrounding these 'Singapore issues', this possibility merits serious examination. In-depth analytical work on how to design such measures in a development-friendly way needs to be undertaken with some urgency if they are to be included in the EPAs.

Conclusion: Rewards, risks, and alternatives

The impetus of the EPA process offers the African countries as a group an opportunity to address both internal and external obstacles to global and regional trade integration. This concluding section reviews the potential rewards and risks of EPAs and notes alternative approaches.

Potential rewards of EPAs

Likely situation without EPAs. In many SSA countries the political economy environment for trade liberalisation is difficult because of powerful, well-organised protectionist interests. Political enthusiasm for unilateral liberalisation is limited. SSA countries, hoping for a 'round for free', have not really engaged in the multi-lateral WTO discussions, and the Doha round by itself may not lead to any reductions in applied MFN tariff rates in SSA. The prospects for regional integration efforts in SSA are also uncertain. Thus, in the absence of EPAs, in the medium term progress with reforms is likely to be confined to a handful of countries.

Potential outcome with EPAs. EPAs and the current regional trade areas in SSA may not be optimal arrangements from an economic point of view, but there are strong political forces supporting their continuation. Although controversial, the EPA process has already gathered substantial momentum in both the EU and SSA and is catalysing an active debate over, and some actions on, trade reform and regional integration in SSA. Implementation of EPAs involving liberalisation of both intra-regional and external trade and investment climate reforms may be more feasible to engineer politically than unilateral or intra-regional trade liberalisation by themselves since a quid pro quo, in the form of improved access to the EU market and aid for trade, would be involved. EPAs could thus offer SSA an important opportunity to accelerate trade and growth.

The EPAs could be quite beneficial economically for SSA if they can be used to leverage important policy reforms. The EC hopes that the EPA process can reinforce current reform efforts by strengthening public and private sector reform advocates and deepening the regional integration process. The requirement for SSA countries to liberalise imports from the EU to improve their access to the EU market provides an opportunity for them to integrate into the global economy, strengthen regional integration in Africa, accelerate trade and related reforms under potentially favourable conditions, and lock in these reforms in a way that makes them credible to the rest of the world, investors, and aid donors alike. Moreover, the inclusion of trade in services, investment, competition, and trade facilitation, if feasible, could provide an opportunity to use the leverage of the EPA process and accompanying aid for trade to address a broad range of obstacles

to a strong supply response in trade related sectors. The EPA's negotiating schedules and deadlines create a useful dynamic impetus for global and regional integration in a situation where progress may otherwise be halting: and the technical and financial assistance from the EU could provide more generous support than is often available for countries undertaking trade reforms.

Risks

The EPA process also entails some serious risks for Africa. EPAs could go astray because, despite the EU's good intentions, at critical moments lobbying by politically powerful business interests could lead to commercially advantageous decisions for the EU rather than pro-development ones. Initial negative reactions from the European Commission's trade directorate to liberalisation of the EU's rules of origin and to parallel MFN tariff reductions by African countries are not good omens. The management of a truly development-oriented EPA process effectively combining trade and aid could also prove too complex. Partial preferential liberalisation of imports from the EU under EPAs by itself could be disadvantageous on balance because of the distorted structure of protection and increased anti-export bias that it would create and the likelihood of significant costly revenue losses, trade diversion, monopoly pricing by EU suppliers, and continued inefficiency of import-competing industries. Some SSA countries may not be able to implement the necessary parallel MFN tariff reductions or the required accompanying domestic reforms as a result of lack of political support or limited institutional capacity. These countries may suffer from losses of fiscal revenue, trade diversion, and monopolistic pricing until they make the required reforms. The EPA process could also end up being abandoned, with the acrimony surrounding this outcome poisoning the environment for trade and investment-climate reforms, at least temporarily.

Alternative approaches

The Cotonou Agreement envisages a fairly uniform approach to EPAs with broadly similar agreements to be adopted by four African regions more or less simultaneously. However, as discussed above, because of the diversity of initial conditions, considerable flexibility and selectivity is likely to be needed in the treatment of both the regional EPA groups and the countries within them. Moreover, in order to avoid being limited to the minimum level of progress that is possible in the most difficult subregions, it may be desirable to confine EPAs to those regions and countries that are most committed to the EPA process and can use it effectively to leverage their reform programmes, letting the others fall back on the GSP and EBA initiative for access to the EU market until they are ready to reform. Bilateral FTAs, or other temporary arrangements, with individual non-LDCs may also need to be considered for those that would be most adversely affected by dropping back from Cotonou preferences to GSP.

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7

For Richer or Poorer: Transforming Economic Partnership Agreements between Europe and Africa

Christian Aid

Some NGOs have raised concerns about the Economic Partnership Agreements that the EC is negotiating with the poorest countries... Europe should not be, and is not, seeking to "take" anything from these countries. Our aim is a new framework where neighbours work together to benefit from freer trade, while we offer assistance to integrate them into the world trading system. That is our global 21st-century challenge.

Peter Mandelson, EU Trade Commissioner, the *Guardian*, 1 December, 2004

We are extremely wary of these EPAs because income is going to fall dramatically in a country like Mali. If we sign EPAs and our income drops by 20 or 30%, it seems we are going around in circles. We have a lot of misgivings ... it may lead to revolution.

Amadou Ali Niangadou, Malian MP, Joint Parliamentary Assembly, Brussels, 5 February, 2005

For the first time in history, Europe is negotiating free trade agreements with the countries it once colonised. In return for continued access to European markets, 77 countries in Africa, the Caribbean and Pacific region (ACP) are being asked to open up their markets to products from Europe.

The likely results of these new Economic Partnership Agreements (EPAs) are not hard to imagine. With their diverse range of products and muscle in the marketplace, European producers can outstrip ACP rivals in their domestic markets. European producers have enjoyed decades of subsidies, support and protection from their governments and have built strong, lean, competitive industries.

ACP countries – especially those in Africa, whose problem is not only that they can't sell enough but that they don't produce enough – have not. They stand to lose existing industries and the potential to develop new ones as products from Europe flood their markets.

Through EPAs, Europe is threatening not merely to give with one hand and take with the other. In spite of Commissioner Mandelson's fine words, it is just taking.

Since colonial times, ACP countries have been locked into feeding the European market with raw commodities, and are often locked out when they try to export processed or value-added products. And for more than 20 years, ACP countries have been forced to liberalise their markets to such an extent that many now have economies that are more open than Europe's.

They are already integrated – often harmfully – into the world market. So any new trade agreement between ACP countries and Europe must both help them to improve and diversify what they produce and export, and allow them to protect themselves from imports in the meantime. EPAs in their current form will do neither.

The European Union, on the other hand, stands to gain much by forcing through EPAs. Above all, once the reforms are enacted, Europe will have duty-free access to 77 new markets for the vast majority of its products. Europe's determination to negotiate this was laid bare at a recent meeting between EU and ACP trade negotiators. The ACP representatives were told by a senior Commission official to 'come back in a better mood', when they proposed protecting 30% of their products from tariff elimination under EPAs.

This report, *For Richer or Poorer: Transforming Economic Partnership Agreements between Europe and Africa*, was originally published by Christian Aid in April 2005.

This report calls for EPAs to be stopped in their current form.

It focuses in particular on what African countries want and need from a new trade relationship with the EU, given that 2005 is the year in which the UK government will be pushing its counterparts in the G8 to take action for a strong and prosperous Africa. As EPAs are the framework through which it will shape this relationship, the UK government should take a much greater interest in these negotiations. EPAs may end up achieving the opposite of what the UK government desires in its new deal for Africa.

How EPAs fail on their own terms

> *I intend to ensure that there are no unfair demands for reciprocity in the EU's approach, and no enforced liberalisation until targeted aid programmes have built up local capacities.*
>
> Peter Mandelson, EU Trade Commissioner, *The Independent*, 27 December. 2004

> *I am more convinced that EPAs stand to knock us back. EPAs stand to harm us ... it will only benefit our European partners. The ACP must sit up and look at this issue critically.*
>
> Kwame Osei-Prempeh, Ghanaian MP, Joint Parliamentary Assembly, Brussels, 5 February, 2005

The all-powerful Trade Directorate, which sits at the heart of the European Commission, argues that EPAs are necessary precisely because the way in which ACP countries currently gain access to Europe's markets contravenes World Trade Organisation (WTO) rules.

This is true, but when the new round of WTO trade talks was launched in Doha, Qatar, in November 2001, ACP countries negotiated a 'waiver' with the EU to allow their preferential market access to continue. This waiver is due to expire two years after the end of the Doha round,[1] which means that a way of ensuring continued preferential market access for ACP countries must be found. But in the view of Christian Aid, the organisations with which we work, and many other groups that represent the interests of poor people in African countries, EPAs are not the solution.

Despite the claims of the EU, EPAs are neither development friendly nor, ironically, legally watertight under the WTO's rules. And Commissioner Mandelson's attempt to sugar the pill of **enforced** liberalisation by offering 'assurances' that ACP governments will be allowed up to 25 years to open their markets is further undermining the legality of EPAs.

The WTO rule that governs regional trade agreements – Article 24 of the General Agreement on Tariffs and Trade – is aimed at fostering free trade between countries at a similar level of development. It stipulates that they must liberalise 'substantially all trade' over a limited period of time, usually ten years.[2] In other words, the EU and its Trade Commissioner cannot deliver with any legal certainty on their guarantee of giving ACP countries a long timescale in which to liberalise.

African countries want to negotiate a new trade and aid agreement with the EU, since Europe is still their most important trading partner. They want an agreement that allows them:

- to choose if, when and how they open up their markets to the EU;
- the ability to shape the terms of their access to the EU market; and
- the legal certainty that this market access won't be open to a challenge at the WTO.

Instead, they are being forced into negotiating EPAs by a European Union that appears determined to offer them no alternative means of holding on to their existing access to Europe's markets.

A perilous strategy

> *We fear that our economies will not be able to withstand the pressures associated with liberalisation, as prescribed by the World Trade Organisation. This therefore challenges us all as partners to ensure that the outcome of the ongoing EPA negotiations does not leave ACP countries more vulnerable to the vagaries of globalisation and liberalisation, thus further marginalising their economies.*
>
> President Festus Mogae of Botswana, May 2004

For more than 20 years, trade liberalisation in devel-

oping countries has proved disastrous for poor people. Christian Aid argues that governments in ACP countries now need to be allowed to take a breather. Not only should the push for further liberalisation of their products cease, but because tariffs are already lower on average than those in rich countries, developing countries should be permitted to raise them where necessary.[3] ACP countries must be able to protect their infant industries.

New studies commissioned for this report look at the already disastrous impact of trade liberalisation on poor producers and at the likely effects of a further lowering of tariffs in three African countries.

In Ghana and Senegal, two countries currently involved in EPA negotiations with Europe as part of the Economic Community of West African States (ECOWAS), the enforced lowering of import tariffs on products such as tomato paste and chicken parts and meat has been followed by a deluge of products, sold at cut-throat prices, from Europe. These often undercut locally produced goods, causing factories that add value to local produce to close down. This in turn leads to great hardship in poor, rural communities where people's livelihoods rely on selling surplus food.

In Mozambique liberalisation resulting from EPAs would open up a thriving milling industry to more cheaply produced wheat-flour from Europe, undercutting locally milled flour. This would not only mean job losses in the milling industry, but would also have a knock-on effect among the small but growing number of Mozambican farmers who produce wheat.

These studies show that not only is liberalisation often a harmful policy for poor people, but that locking countries into a pre-determined pattern of liberalisation through EPAs will prevent them developing new industries in the future. This 'capping' of development will not serve to reduce poverty and will leave developing countries dependent on the same narrow range of primary commodities. This is not how now-industrialised countries developed.

Another study looks at the impact that major cuts in EU sugar prices will have on economic development and poverty in Malawi, one of the poorest countries in the world.

Malawi's sugar industry employs tens of thousands of people directly and many more in associated industries. A large share of its income comes from the guaranteed high prices it receives from the sugar it exports to the EU market.

But planned changes to Europe's Common Agricultural Policy (CAP) will see EU sugar prices fall by more than a third, costing the Malawian government and sugar industry at least €4 million. And while sugarbeet farmers in Europe will receive direct aid covering 60% of their revenue loss,[4] Malawian farmers and workers are unlikely to receive such compensation.[5] This sounds like a clear warning of the sort of deal poor countries can expect if EPAs, in their current form, are allowed to go ahead.

It is clear that compensation from the EU for losses in ACP countries as the value of preferences is reduced or they are eroded will not be forthcoming. Christian Aid calls on the EU to make funds available to help cushion the inevitable blow that will fall hardest on the poorest, such as Malawian sugar farmers and workers and their families.

It is clear from these studies that not only is liberalisation already often a harmful policy for poor people, but that using EPAs to lock countries into a pre-determined pattern of liberalisation will deny them opportunities to develop new industries in future. This will scupper their efforts to reduce poverty and transform their economies, and will deny them the opportunity to use protection selectively as they develop, in the same way European countries have been able to do.

Regional development under threat

> *The trade opening or 'market access' part of these agreements are not at their forefront: it comes at the end after regional integration has kick-started growth.*
>
> Peter Mandelson, EU Trade Commissioner, speech to the Civil Society Dialogue Group, 20 January, 2004

EPAs are threatening existing but fragile regional groupings of African countries. They are already undermining the protection of important industries as groups of countries scramble to align their tariffs in readiness for negotiations with the EU.

African countries have long considered regional integration an important development strategy. It is

both a means to overcome the limitations of small markets and an opportunity to pool resources for infrastructure and major production projects. But rather than let African regions decide on the appropriate design and pace of integration, the EU is forcing the issue. Commissioner Mandelson said recently that regional integration was one of the 'most attractive aspects of EPAs' and that the 'EU model has much to offer in that respect'.[6] This externally driven agenda holds several dangers.

The creation of regional markets and the promotion of new regional production to serve them is a key element of African efforts to become more internationally competitive. But regional integration in Africa will certainly not have 'kick-started' growth by the time the EU expects African countries to start opening up their markets to EU imports.

Clearly, regional markets, which first have to overcome very complex political, economic and administrative problems, should be firmly in place and have given rise to new patterns of production before African countries consider opening up to competition from the EU. This is not possible within the European Commission's current timetable. As a result, there is a grave danger that EPAs will force governments to abandon trade policies that will be essential to make the most of new regional opportunities. This will make a nonsense of regional integration.

Government trade negotiators and regional secretariats are already overstretched. An acceleration of the process of economic union, putting further strain on the delicate negotiations over single regional markets, is likely to result in poorly designed regional integration schemes.

If African countries fail to open up their markets to their neighbours before opening up to EU imports, this will cut off any opportunity to develop industries in goods that can be traded regionally. The EU's model of regional integration in Africa could result in trade and its benefits being diverted to the EU, rather than encouraging increased trade and growth within African regions.

EPAs may well divide as much as unite neighbours in Africa. For instance, least-developed countries have little incentive to sign 'free trade' EPAs, because they will continue to benefit from special access to Europe's markets under the Everything But Arms initiative even after the ACP waiver has expired. Each of the four regional groups in Africa with which the EU is negotiating comprise least-developed and developing countries. The onus will be on the countries within each group to deal with their differences, which could lead to further disagreements.

Rewriting EPAs

> *If EPAs carry through, African countries will have to kiss goodbye to their industrialisation efforts.*
>
> Tetteh Hormeku, Africa Trade Network

Christian Aid is part of an international campaign to stop EPAs in their current form. We believe that since Europe's former colonies did not ask to open up their markets to EU imports and since hundreds of campaigning and non-governmental organisations in Africa have said that EPAs in their current form should be stopped, the EU must now listen and act. This report calls on Peter Mandelson to remove the reciprocal market-opening element from the EU's negotiating mandate and leave ACP countries to decide for themselves whether to liberalise.

The resulting one-sided or 'non-reciprocal' trade arrangement could be made WTO-legal if European member states were prepared to instruct the Commission to argue for changes to WTO law. The rules governing regional and preferential trade agreements between developed and developing countries need rewriting. Europe has already promised to support measures to make 'special and differential treatment' for developing countries more effective in the ongoing Doha round of talks. Such changes could be sealed at the WTO ministerial meeting in Hong Kong in December 2005.

On the other hand, if Commissioner Mandelson arrives in Hong Kong with EPAs in his briefcase, the EC could again be heading for a confrontation with developing countries of the kind that led to the collapse of talks in Cancun, Mexico, in 2003.

Christian Aid is calling on the EU to give ACP countries four guarantees:

1. Continued and improved access to EU markets with legal certainty.

2. The right to decide whether, how and when to liberalise their own markets.
3. Finance to help them enhance regional integration and develop their ability to trade and cope with the costs of adjustment caused by trade reforms.
4. Compensation for the loss of revenue caused by preference erosion.

The UK government must use its pivotal role on the international stage during 2005 to influence the outcome of the EPAs debate.

Britain's declared position favours trade that works for poor people and, in its white paper of 2004, the Department of Trade and Industry states that poor countries should not be required to 'pay the price' for access to the markets of rich countries.

Christian Aid challenges the UK government to support this rhetoric with action. It should clearly state that EPAs are not currently compatible with its vision for trade with developing countries. Also, as the UK chairs the G8 and holds the presidency of the EU simultaneously, it should galvanise like-minded European countries to stop EPAs in their current form.

Telling the full story: What is driving changes in the trade relationship between Europe and Africa?

Europe's new trade agenda: Partnership under threat

Since 1976, the European Union's trade, aid and political relationship with African, Caribbean and Pacific (ACP) countries – its former colonies – has been governed by a series of treaties commonly known as the Lomé Conventions. Each five-year convention allowed ACP exporters better access to European markets than any of their competitors in other developed or developing countries. At the same time, ACP countries were allowed to protect their markets from competing EU imports. These provisions recognised that trade between countries at unequal levels of development must be tilted in favour of the less-developed partners if it is to help them generate revenue and grow.

The primary purpose of the Lomé Conventions was to promote economic development in ACP countries through aid and trade preferences.[7] The fourth and last convention was signed in 1996 and expired in 2000, although its provisions continue to govern trade between ACP countries and the EU under a waiver granted at the WTO until December 2007.[8]

The Cotonou Partnership Agreement replaced the fourth Lomé Convention in 2000. Its stated aims are to 'reduce and eventually eradicate poverty consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy'.

Like its predecessor, the Cotonou Partnership Agreement emphasises the need to support the economic development of ACP states. It clearly recognises the right of ACP countries to make their own economic and development decisions.[9] It also states that trade between the EU and ACP should help foster sustainable development and eradicate poverty in ACP countries.[10]

But the EU's interpretation of Cotonou will bring dramatic, historic changes to the way in which the EU trades with its former colonies.

In September 2002, as stipulated in the Cotonou Partnership Agreement, the EU and ACP launched talks to negotiate regional trade agreements – the Economic Partnership Agreements (EPAs) – compatible with WTO rules. The EU is choosing to negotiate under the strict WTO rules that govern free trade agreements between two or more countries. It therefore maintains that EPAs will require ACP countries to open up their markets to 'substantially all' imports from the EU, over a limited time period.

EPAs, therefore, are free trade agreements. So, under the guise of partnership and cloaked in the language of development, European states have chosen to neglect the WTO principle of special and differential treatment for less-developed countries. The European Commission, with the blessing of EU member states, has set itself on the seemingly inexorable path of forcing open the markets of countries immensely poorer than those of Europe.

The mandate which EU member states – including the UK – have given the European Commission

to negotiate free trade agreements with their ex-colonies in Africa; the Caribbean and Pacific shows a radical shift away from their thinking on development and trade of a few decades ago. They no longer seem to recognise that partnership between unequal regions cannot be based on unfettered free trade without undermining the less developed partner.

ACP governments and parliamentarians, along with NGOs and campaigning groups both in ACP countries and Europe, have expressed deep concern about the talks.[11]

According to President Festus Mogae of Botswana, ACP countries stand to lose from the new agreements, especially since they are already struggling with existing trade liberalisation. 'We fear that our economies will not be able to withstand the pressures associated with liberalisation, as prescribed by the World Trade Organisation. This therefore challenges us all as partners to ensure that the outcome of the ongoing EPA negotiations does not leave ACP countries more vulnerable to the vagaries of globalisation and liberalisation, thus further marginalising their economies,' he said.

The source of deepest concern is that EPAs threaten to lock 77 developing countries, 48 of them based in Africa and among the world's poorest, into reciprocal trade agreements whose raison d'être is the mutual elimination of tariffs.

What is driving the EU's new trade agenda?

The European Commission claims that the EU has no interest in opening up ACP markets to its exports through EPA negotiations as the ACP markets in question are so small. Their character as free trade agreements, says the EU, has been determined by the global trade and geopolitical environment; the WTO rules demand that it be this way, and the trigger and timing is the expiry in 2007 of the waiver granted by a majority of WTO members in 2001. The EU says that the terms of EPA negotiations are also determined by legal constraints: the WTO's Article 24 of the General Agreement on Tariffs and Trade (GATT) which stipulates that regional trade agreements must be reciprocal and aimed at eliminating barriers to trade.

The EU's insistence on WTO compatibility can in part be traced back to the 1990s when the EU's trade arrangements with banana-producing former colonies was the source of a bitter trade war with the US. In 1999, the WTO ruled these trade arrangements illegal because the administration of banana imports discriminated between Latin American and ACP producers. The US subsequently sought compensation and imposed bruising tariffs on products from Europe as a sanction to force the EU to comply with the WTO's ruling. The EU has not forgotten the bloody nose it was given.

However, Europe's aggressive interest in the markets of ACP countries should not be discounted. As this report will show, basic EU value-added food products – such as canned tomatoes and frozen chicken parts – are already dominating many African markets. It will also demonstrate that WTO compatibility is a moving target; its rules on regional trade agreements are currently under review as part of the Doha Development Agenda round of world trade talks and could be changed to offer special treatment to developing countries.

The EU can also pursue options outside WTO regional trade agreement rules that would guarantee ACP producers continued access to EU markets, without requiring them to open up their own. One such option would be to improve the EU's existing system of preferential trade arrangements for developing countries – the General System of Preferences.

EPAs as negotiated free trade deals are not inevitable. In Christian Aid's view, they are an unfortunate marriage of the flawed development thinking and new political and trade agendas of the EU.

Trade liberalisation as an instrument for development

The EU bills EPAs as 'instruments for development'.[12] This belief stems from two sets of ideas about how free markets will generate economic development and increase revenue. First, better EU market access will stimulate more investment in export products in ACP countries. Second, competition from imports will force traders, manufacturers and producers in ACP countries to become more productive and competitive.[13]

Since the 1980s, trade liberalisation has been

pushed on developing countries as the policy option most likely to lead to increased growth and poverty reduction. Although trade liberalisation is not always the wrong policy, its imposition on developing countries during the 1980s and 1990s led to well-documented cases of job losses, increased poverty and de-industrialisation.[14] Despite mixed results, hotly contested evidence and the fact that this was not the way that most EU countries themselves developed, EU member states are now condoning the European Commission's pressure on ACP countries to eliminate almost all their protection against EU imports.[15]

EPAs as conceived by the EU will do little to help African countries kick-start production, increase productivity or boost trade in an international system where they already compete on unequal terms. Even the EU's own assessments have concluded that increased competition from European imports could have a devastating impact on emerging industries in all the ACP countries.[16]

In addition, tariff elimination will reduce government revenues, forcing finance ministers to make even more difficult spending choices between different essential public services. According to the World Bank, between ten and 30% of ACP government revenue, aside from aid, is generated by levying tariffs on imports.

A recent IMF study revealed that middle-income countries recovered only US$0.35–0.55 for each US dollar of tax revenue they lost because of trade liberalisation between 1975 and 2000.[17] Low-income countries recovered essentially none.

The process of fiscal reform is difficult and long. The easiest fixes, such as imposing value-added tax, hit the poor hardest. This has important implications for the sequencing of trade liberalisation as part of a development strategy; EPAs currently do not allow the necessary flexibility.

Why preferential trade deals did not work

According to the EU, Lomé trade preferences have failed to bring about economic development in ACP countries; instead they have encouraged the unhealthy dependence of ACP economies on commodity exports. These arguments are borne out by some distressing statistics: ACP exports' overall EU market share has halved since 1975, and what remains is primarily composed of raw materials – 65% in 2002.[18]

But these aggregate statistics hide the fact that trade preferences in many countries have helped specific sectors buck the general trend. For example, overall exports to the EU from Southern African countries declined by 5.4% between 1988 and 1997. But export products that have enjoyed better market access than the EU was offering under its Generalised System of Preferences have expanded by 83%. These include textiles in Zambia and Zimbabwe, furniture in Swaziland, and fish and leather products in Mozambique and Namibia. Exports have expanded in a similar way in Ghana, Mali, Senegal and Kenya.[19] These preferences have played an important role in countering countries' declining earnings from basic agricultural commodity exports, which have fallen by 50% over the past 40 years.

As acknowledged by the WTO's 'wise men' in a report on the future of the international trading system:

> *... we have to accept that access to such treatment is now long established in the WTO and is reasonably regarded as part of the 'acquis' of its developing Members. Moreover, the commercial value to many firms in poor nations, struggling to find a small niche for themselves in a tough global economy, is real. Such firms frequently need some positive discrimination if they are to stand a chance. So, for every importer seeking to cope with the spaghetti bowl of* PTAs [Preferential Trading Arrangements] *there are manufacturers, farmers and traders in developing countries whose best opportunity lies in exploiting a small comparative advantage born of a preference.*[20]

Despite this, the European Commission is proposing to scrap special preferences for ACP countries and replace them with free trade areas in the form of EPAs. This has more to do with the general trajectory of EU trade policy, which views free trade area agreements as an important vehicle for securing increasing spheres of political influence and market advantages for EU exporters over their major Organisation for Economic Cooperation and Development competitors, than with the actual performance of ACP countries in using non-reciprocal

trade preferences. European Commission proposals are based on a very partial analysis of why some countries and regions have been able to effectively exploit non-reciprocal trade preferences while others have failed to do so.

The declining levels of overall imports from ACP countries into the EU demonstrates not that the fundamental principle of granting trade preferences is flawed, but rather that the underlying composition of ACP exports is dominated by poorly performing commodities, that there are shortcomings in the design of preference schemes, and that there has been a failure to increase the productivity of ACP industries and producers.

Withdrawing preferences suits the EU's political interests well. There is a reluctance among new member states to grant preferences based on the old colonial ties of France and Britain. The EU as a whole also believes such schemes reduce ACP countries' interest in seeing tariffs reduced globally in WTO talks, as their advantage will be diminished.

However, although by no means a magic bullet, properly designed preference schemes need not be stumbling blocks to the successful integration of developing countries into the multilateral system. Preferences can help establish systems of non-reciprocal market access for poorer countries based on their level of development, which would allow a more managed process of integration through market opening.

While preferential access to rich countries' markets is not a complete or long-term solution, it defies logic to cut short the difficult task of fostering the sustainable structural development of ACP economies by forcing through premature reciprocal market opening. A better approach to that currently being adopted by the EU through EPAs would be to improve the usefulness of preferences in the immediate term while at the same time helping ACP producers become more productive and competitive.

The onus should be on the rich EU member states to provide assistance to preference-dependent countries, such as those in Africa, to cope with the effects of preference erosion as a result of CAP reforms and multilateral trade negotiations, and to develop their economies so that they can compete for export markets once preferences are eventually eroded or withdrawn. The wholesale liberalisation of imports into the domestic markets of underdeveloped countries has no logical part to play in this process. Until larger regional markets have been built, investment has been mobilised and new production capacity has been developed on a far more competitive basis, it is unrealistic to expect that across-the-board market opening to EU imports would promote the competitiveness of ACP producers and manufacturers.

Politics: The WTO and the regional trade agreement agenda

The EU's push for EPAs is inextricably linked to the WTO's political processes. Whether or not EU exporters are pushing for better access to ACP markets, the political value to the EU of neutralising the potential for opposition to its agenda in the WTO from a large constituency of WTO members – the ACP countries – is considerable.

The WTO operates by a one-country, one-vote consensus. Each country has nominally equal weight, and a coalition of developing countries (called the G90 and including a high proportion of ACP countries) has been pursuing a collective strategy that has enhanced the voice of developing countries. This was clearly demonstrated in 2003 at the WTO's meeting in Cancun where a coalition of developing countries, including some from the ACP, successfully blocked the inclusion of the 'new' or Singapore issues in talks.

The EU was at the fore in seeking agreements on three of these issues – investment, competition and government procurement – and was criticised for its obstinacy in pushing them at the expense of agreement in Cancun. It is no surprise that these same issues are now up for negotiation in EPAs.[21]

But aside from the likely gains the EU will make from ACP countries by including these issues in EPA negotiations, it will also enable them to foster a 'community of interest' with the ACP in future WTO negotiations. It will make an acceptance of issues rejected in Cancun all the more likely in future rounds of world trade talks.

In their open letter of 10 May, 2004, EU Commissioners Pascal Lamy and Franz Fischler told a majority of the countries now negotiating EPAs that

they would not be required to make any concessions on non-agricultural market access (NAMA) as part of the Doha round.[22] It was hoped this offer of a 'round for free' would smooth the way towards reaching a deal. But the promise has proved hollow since these countries are now having to negotiate their tariff levels for NAMA, with respect to imports from the EU, under EPAs. A 'free' round is ultimately likely to prove costly.

Negotiating free trade deals to get better market access than is possible via the slow pace of WTO negotiations is a tried and tested EU strategy. It has been negotiating free trade area agreements with various developing countries and regional groupings since the mid-1990s. These range from Mercosur and Mexico in Latin America, to Algeria, Morocco, Tunisia, Egypt and South Africa in Africa, to some Middle Eastern countries. In many of these agreements, the European Commission has successfully negotiated better market access for EU exports, as well as more rules on investment and intellectual property protection that are more favourable to them than is possible at the WTO.

It is no coincidence, then, that the EU and US have pursued an agenda of 'competitive regionalism' since the collapse of talks at Cancun,[23] seeking to not only promote their own trade interests but also increase their influence at the WTO.

What African countries want from trade with the EU

Despite Europe's new rhetoric of partnership, many people in Africa believe it wants to continue to dictate, as it has since colonial times, the shape and terms of Africa's access to the European market.

Europe's bloodied nose in the banana trade war with the US, the political pressures it faces at the WTO, and its ideological approach to development and trade – and not the needs of African governments – are shaping the choices now facing Africa.

Neither African governments nor their enterprises or citizens have asked to negotiate EPAs on the terms currently offered by the EU. No African government has ever proposed the voluntary opening of its market to EU imports as part of a national development or industrialisation strategy. So why have even the 34 least-developed African countries, whose exporters face no tariffs or quota restrictions in the EU market, signed up to negotiate free trade agreements with the EU?[24]

The short answer is that ACP countries have no option but to negotiate EPAs in order to maintain and possibly improve their most important aid and trade relationship.

African countries, along with Caribbean and Pacific islands, once sat at the pinnacle of the pyramid of special market-access schemes into the EU. Not only have they been knocked off this perch[25] but, with the exception of a few countries,[26] badly designed preferences and inadequate support for industrial development have failed to transform their primary-product-based economies and help them escape the commodity trap.

African countries therefore view regional trade negotiations with the EU as an opportunity to redress some of the flaws in their current, eroding, preference regimes and to get more aid to develop new technologies, improve transport links and kick-start competitive enterprises. In short, they believe they can negotiate a better deal from the EU through formal regional negotiations than by relying on the goodwill of European governments to grant them preference schemes.

For example, the Everything But Arms preference scheme makes it more difficult for products to qualify for free entry into the EU market than the regional Cotonou Agreement. Its terms have been entirely determined by political forces in the EU, and it could be withdrawn at any time without negotiation or notification.[27]

So African governments want:

- **CAP-related supplementary duties on exports removed.** Even though European countries charge zero tariffs on more than 95% of current African exports, some higher value-added products still face very high tariffs. For most ACP countries this is not a product of conventional tariff escalation but rather the result of special supplementary duties charged on agricultural inputs used in value-added food products. For instance, the EU levies no tariffs on raw pineapple exports from Kenya, but up to 27% on canned

pineapples, because of the sugar used in the preservation of the canned fruit. These and other residual tariffs need to be removed.[28]

- **Restrictive rules of origin revised.** Rules of origin mean products only qualify for a zero tariff on entering the EU if exporters can show that most of the constituent parts are also produced in the exporting country or in another African, Caribbean or Pacific state. Aside from the fact that certifying the origin of a product's parts is a cumbersome administrative exercise, which few exporters can afford, many African enterprises rely on cheap imports from Asia and elsewhere to manufacture competitive products. The Commission is reviewing rules of origin as part of the ongoing General System of Preferences review. However, current proposals are not promising and ACP countries have no say in these talks.

- **Punitive non-tariff barriers addressed.** Exporters of agricultural products, which constitute the majority of goods Africa supplies to the EU, have to prove that these products comply with very strict EU food-safety regulations. This prevents many small and medium-sized entrepreneurs from exporting, often not because their products do not comply, but because they cannot afford to have them certified as compliant.

- **Better access for products that compete directly with those produced in the EU.** Where African agricultural exports compete directly with EU products they tend to incur tariffs, albeit at a lower rate than competitors from non-ACP regions. These products are also subject to strict limits on the volume that can be exported under preferential tariffs. For example, Namibia can only export a small quantity of grapes to the EU between November and January at zero tariffs. All African sugar exports to the EU, whether from developing or least-developed countries, continue to face quota restrictions.

- **More development finance.** At present, only about 2% of the European Development Fund (EDF) budget is allocated towards trade, business and agricultural-sector development activities.[29] African governments want additional funds to help them develop legal frameworks, institutions, skills, better electricity supplies and transport, all of which will make their enterprises more competitive. They also want further funds to improve regional institutions, laws and transport links to assist the development of regional markets across Africa.

EPA negotiations between the EU and existing regional groups in Africa may remove some of these barriers. However, the European Commission has told African negotiators that they cannot expect any additional funds to those already committed under the existing five-year EDF. For the slightly improved market access they may get, African countries will be asked to pay dearly by eventually eliminating all tariffs on EU imports. For many of Africa's poorest people, this does not represent a fair deal and contravenes the principles that should underlie an economic partnership agreement.

Is this a real partnership?

Individual EU member states have rhetorically sworn their allegiance to 'making trade work for poor people'. Some have gone as far as to suggest that poor countries should not be forced to 'pay the price' for access to rich countries' markets.[30] It is not unreasonable, then, to suggest that the EU's new trade partnership with Africa should be based on the developmental needs of ACP countries, especially those in Africa.

Agreements should recognise the inequality in economic and political power between Africa and Europe, and the mutually agreed aims, objectives and outcomes should reflect this. But the reluctance or even refusal of European negotiators and politicians to give way to a host of African requests belies the notion of partnership.

Climbing the slippery slope

How can a new trade relationship with the EU boost development in Africa?

If EU politicians and governments listen to Africa and truly grasp the economic, social and political dilemmas facing African countries, they must conclude that the European Commission needs to

Box 1. Come back in a better mood, European official tells ACP ambassadors

At a recent meeting between ACP and EU trade negotiators, one senior EC trade directorate official dismissed ACP ambassadors' requests that they be allowed to exclude at least 30% of products traded with the EU from tariff-elimination commitments.

He told them to come back when they were in a better mood'.[31]

A comparison between the outcomes desired by the ACP and EU respectively from EPA negotiations shows up the failure of the European Commission and its member states to listen to Africa.[32] Some of the African requests outlined below are not even based on their original wish list but are attempts to limit the potential damage of the EU's EPA agenda.

Africa asks the EU ...	**The EU replies ...**
• Open up African markets to EU exports at a very slow pace – at least a five-year moratorium before starting tariff elimination, and then only when African countries reach agreed development indicators. African governments should be able to exclude as much as a quarter of the products they trade with the EU from tariff-elimination commitments.	• The EC disagrees with all these proposals. It says WTO rules will not allow this type of regional trade agreement. This despite the fact that the Cotonou agreement stipulates that the parties should 'collaborate and cooperate closely in the WTO with a view to defending the arrangements reached, in particular with regard to the degree of flexibility available'[33]
• Co-operate in the Doha round to change the rules governing preferential trade agreements. GATT Article 24, for example, needs to incorporate special treatment for developing countries in regional trade agreements with developed countries	• There is enough flexibility in Article 24 already – the EU will not cooperate with the ACP to change the rules governing preferential trade agreements
• Common rules of origin for all African exporters to the EU	• Will negotiate rules of origin with the four regional groupings separately
• Systematically investigate the impact of Common Agricultural Policy reforms on ACP economies, including the shift to direct payments, and include this in EPA negotiations	• Will only investigate the impact of export subsidies on a case-by-case basis
• More resources, in addition to the EDF budget, to help them develop infrastructure and increase productivity – to take advantage of EU market access and cope with competition from EU imports	• No extra resources in addition to what has been budgeted under EDF

change tack. The current course set by the EU under EPAs is unlikely to reward African countries with the extra market access they require without threatening their right to protect their industries as part of an industrial development strategy. Instead, it would force the pace and scope of trade liberalisation, causing major damage to African countries' economies.

But if European member states are prepared to change the direction of EPA negotiations, which are currently sliding down a slippery slope, African countries could receive a huge economic boost. The

EU needs to stop forcing African countries to open up their markets to EU exports and allow African voices to shape the outcome of EPA negotiations. It should increase its financial backing to help African countries transform their economies, and work with them and other concerned countries to change the outdated and inadequate WTO rules that prejudice the outcome of trade negotiations.

Stop forcing trade liberalisation

Poverty will continue to taint the lives of most Africans unless more African industries start producing an increasing number of value-added goods of better quality and at lower cost for their domestic and regional markets. This has never been achieved in a free trade environment and requires appropriate trade policies if it is to be nurtured.

After three decades of 'structurally adjusting' their economies, according to the scriptures handed down from the International Monetary Fund (IMF), many African economies are now far more open and 'integrated' into the global economy than their European counterparts. For example, the UK, France and Germany have more restrictions on trade than Mozambique, Mali and Zambia.[34]

However, rather than liberalisation making them stronger and more productive, their economies – and by implication the majority of their people – have become increasingly vulnerable to uncertain international prices, shrinking or restricted markets and foreign government policies over which they have no control.[35]

Liberalisation damages industries and poor producers

Two new studies from Christian Aid show how the lowering of import tariffs on European exports in Senegal and Ghana have already had a profoundly damaging impact on the producers of first and second stage agricultural products there.

Case study 1: Senegal – tomatoes and poultry

The Ghanaian and Senegalese experiences of gradually opening up their local markets to European imports over the past decade illustrate the dangers of prematurely exposing local producers and industries to cheap imports. These experiences challenge the European Commission's arguments and shows that it is not simply a matter of delaying tariff elimination for a few years, but whether the policy is appropriate at all.

The tomato industry

Prior to 1994, the Senegalese government used high tariffs and quotas selectively to protect and promote domestic industries. In 1994, it started opening up its economy to comply with the conditions of a series of structural adjustment loan agreements with the World Bank and IMF, prompted by its debt crisis. It devalued its currency, the CFA, and gradually reduced tariffs between 1994 and 2001 from an average of 36% to 14%, with the highest tariffs falling from 70% to 42%. The government also eliminated import quotas and licences altogether.

Before it began to liberalise, Senegal had had a thriving tomato industry. With almost limitless sunshine and a superb irrigation system in the Senegal river valley, it became the 23rd largest tomato producer in the world. Producers were able to sell their tomatoes to state-owned tomato-paste factories, which fully supplied the national demand for tomato paste, a key ingredient in traditional Senegalese cuisine. Tomato production was the best paid activity available to rural households in the early 1990s.[36]

But the lowering of tariffs on EU triple-concentrate tomato imports, coupled with the privatisation of Senegal's tomato-paste factories and the withdrawal of government support for farmers, weakened a once-integrated and stable industry. Many farmers no longer had access to the credit necessary to enter the costly business of commercial tomato production, especially in light of increased competition from Europe. By the 1996/97 growing season, local tomato production had fallen to only 20,000 tonnes, from 73,000 tonnes in 1990.

Compared to their Senegalese counterparts, European commercial tomato farmers have easy access to credit and qualified labour. This means they can produce tomatoes more cheaply for the European processing industry. In addition, EU member

states paid out $300 million in export subsidies to their tomato processors in 1997 alone.

This created yet another problem for the Senegalese farmers that had managed to continue growing tomatoes. The next link in their local marketing chain – the tomato-paste factories – stopped buying their tomatoes. These factories found it cheaper to import triple concentrate tomato paste from Italian processors and transform it into double-concentrate for the local market, than buy and process local fresh tomatoes.

As a result, the prices they paid to local tomato farmers fell from CFA50 (five pence) to about CFA25 a kilo during this time,[37] and imports of European tomato paste soared from 221 tonnes in 1993/94 to 4,600 tonnes only three years later.

The poultry industry

The Senegalese poultry sector plays a very important social and economic role. It employs around 10,000 people, and has an annual turnover of about CFA25 billion. It used to be a stable sector with a well-integrated local production chain[38] – from raising breeding chicks to slaughtering mature chickens for the growing market. Chicken consumption increased from 1.5kg of chicken per person per year in 1990 to 2.5 kg in 1997.

This growing urban demand led to the development of semi-industrial poultry farms and supply industries around major cities. By 2000, these farms were already producing around a third of the country's total poultry meat, with smaller traditional farms supplying the remaining two-thirds.[39]

All this changed in 2000, when the government lowered tariffs on imported chicken parts from 60% to 20%. This decision was made to align Senegalese import tariffs with the common external tariff agreed, under the influence of the World Bank,[40] by its fellow members of the West African Economic and Monetary Union (WAEMU). It led to an 11-fold increase in the volume of chicken meat imported into Senegal between 1999 and 2003.[41]

Three-quarters of this meat came from the EU – principally Holland and Belgium – mostly in the form of frozen chicken parts, which sell for as little as half the price of the local equivalent. This was in part because of a general expansion of EU poultry meat exports – up from 400,000 to one million tonnes between 1992 and 1999 – resulting from the reform of the EU cereals sector.

Cereal farmers in Europe are able to undercut their Senegalese competitors largely because of the direct payments they receive from the European taxpayer. As a result of these subsidies, the EU producer price for wheat, fodder and barley, which make up about half of the ingredients in poultry feed, dropped by around 50% between 1990 and 2002.

This has led to the price of poultry feed in Europe falling by almost a third. Given that poultry feed makes up 70% of the cost of poultry production, this has made EU exports more price competitive.[42]

Changing consumption patterns have led to the emergence of a new trade in the parts of the chicken that are not consumed in Europe. This has contributed to the exponential rise of exports of chicken parts to Senegal, from 1,787 tonnes in 2000 to 9,312 tonnes in 2003. These cheap imports have depressed chicken prices in Senegal.

As a result, local chicken production has dropped by a third, leading to around 2,000 job losses and the closure of seven out of every ten chicken farms in Senegal.[43] This has destroyed the livelihoods of many small farmers and has put almost all industrial producers out of business. Their most important market outlet – the local hotel industry – now sources around 90% of its chicken from Europe in the form of frozen chicken parts.

The collapse of the chicken industry has also cost many of Senegal's maize farmers their livelihoods. Locally grown surplus maize is mostly used for chicken feed, although production has never been sufficient to supply the entire poultry industry. But the collapse of commercial chicken farms as a result of European imports of frozen chicken parts has cost maize producers and their families around CFA7 billion in lost sales.[44]

At the same time, imports of subsidised cereal meal and pellets from the EU have risen almost four-fold since 1993.[45] Given the competition local chicken producers are facing from cut-price chicken parts imported from Europe, they are highly unlikely to source more expensive locally grown cereals

should they decide to rebuild their businesses in the future. This will jeopardise the government's plans to encourage increased cereal production and enhance food security.

What about the future?

Despite the damage inflicted by a succession of structural adjustment programmes during the 1990s, Senegal has a relatively well-developed industrial sector compared to its neighbours. It still has much to lose.

Two-thirds of Senegal's manufacturing output, half of which is concentrated in the agro-processing industry, is sold on the domestic market. Most value is added to agricultural products through the transformation of locally grown peanuts into oil; locally grown and imported cereals into food products and animal feed; imported sugar into various consumer products, such as fizzy drinks; locally grown tomatoes into paste; and imported milk powder into milk products.

Private enterprises undertake most of this processing. Therefore, any future developments that reduce local demand for these processed agricultural products – such as the elimination of import tariffs under EPAs – will reverse current efforts to industrialise.

Already, EU exports of wheat flour, chicken parts, flour-based foods, potatoes, onions and various other food products have expanded massively over the past ten years, and now amount to around one-fifth of EU exports to Senegal.[46]

The experience of producers and enterprises that cultivate, market and transform tomatoes and poultry has shown how much damage a premature reduction in tariff protection can cause. It also illustrates the threat that agro-processing and agricultural sectors in other African countries will face when they are no longer protected from EU imports, especially those benefiting from public subsidies, against which they cannot hope to compete.

African countries using selective trade protection

Today, some African countries are beginning to employ selective trade restrictions to protect and promote what they view as sensitive or strategic industries or agricultural sectors. Developing such industries is part of their attempt to break out of their dependence on raw commodities. It is a strategy aimed at developing self-sustaining and integrated national and regional economies that provide secure income-earning opportunities for their populations.

In Mozambique, the government has levied restrictions on sugar imports to encourage investment in local sugar refineries that produce sugar for the local market. And in Ghana, the government has recently announced the ambitious Rural Enterprises Development Programme, which involves financing new rural industries while raising tariffs on imports of potentially competitive products.[47]

A realistic first step to industrialisation for most African countries, with the majority of their populations still at least connected to if not based in rural areas, is to set up and support factories and companies that add value to basic agricultural products by processing, packaging or completely transforming them. This can create secure outlets for small and medium-sized farmers (see the Ghana case study below); secure, high-quality jobs for factory or company workers; and demand for intermediate products, such as packaging or added ingredients.

But to get such companies off the ground, aid-dependent African countries face a constant battle with their main creditors, the IMF and World Bank.

In Mozambique, the World Bank and IMF have in the past tried to remove the government's restrictions on cashew exports and sugar imports respectively. In 2003, the IMF insisted that the Ghanaian government ignore an act of parliament designed to increase tariffs on chicken imports threatening the local industry.

Influential policymakers within the IMF and World Bank, supported by their main shareholders, the G7 countries (including the UK, France, Germany and Italy from the EU), are opposed to any trade intervention to promote industrial or agricultural development.

But their views and policy prescriptions are based on a mix of questionable political, theoretical and empirical assumptions.[48]

Case study 2: Ghana – tomatoes and poultry production

In Ghana, imports of prepared and preserved tomatoes and poultry meat from the EU pose a major threat to the development of local value-added food and agricultural production. These cut-price, highly subsidised products are entering Ghana's domestic market in already substantial and ever-growing quantities.[49] Between 1993 and 2003 there was a staggering 628% increase in processed tomato imports and a 144% rise in the already high level of poultry meat imports.

The tomato industry

The influx of tomato paste from Europe is of particular concern because local processing can provide a safety valve for the fresh tomato market when there is a glut – the excess can be canned or made into concentrate to save it from perishing. This is of great importance to Ghana's large number of poor tomato farmers who, in spite of a lack of firm links into the processing and marketing chain, still grow tomatoes.[50]

The 27,000 tonnes of prepared EU tomatoes that entered Ghana in 2003 at a cost of €25 million in lost foreign exchange overtook the market for locally processed tomatoes and further depressed the expansion of the domestic tomato-processing industry. The absence of ready and secure markets discourages farmers from producing at full capacity, resulting in very low average tomato yields.[51] This in turn precludes the build up of a strong and sustainable supply base of fresh tomatoes, which is necessary for the development of a local processing industry.

Because the local processing industry is nearly non-existent, tomato paste from the EU is dominating the domestic market.[52] Shifting consumer tastes in favour of imported tomato paste, filled with additives, is also capping the potential market for local produce.[53]

In spite of the proliferation of, and increasing predilection for, imported tomato paste in the country's markets, the Ghanaian Ministry of Food and Agriculture is attempting to kick-start domestic tomato processing.[54] The ministry has identified two policy measures it will need to introduce to help the infant tomato-processing industry take off – tariff protection and production support. Donors are happy to allow production support, but the government recognises that introducing tariff protection will require great 'diplomacy' on its part.[55]

A protected industry can improve its efficiency and competitiveness only if the supply of fresh tomatoes is increased. Giving farmers support in the form of fertilisers and affordable credit can boost yields. In addition, investment can repair ageing irrigation systems, such as those in the north of the country that were built using British aid money in the 1970s, and ensure a consistent year-round supply of tomatoes.

The poultry industry

Ghana imports more than 30% of total EU frozen chicken exports to west Africa. With the reduction of tariffs under structural adjustment programmes and the West African Economic and Monetary Union (WAEMU) common external tariff, west Africa has seen an eight-fold increase in EU chicken imports, which are likely to increase even further.[56]

Recent surveys show that local consumers are dissatisfied with the quality of the imported meat, which they regard as tasteless and fatty. In some cases, this meat is even reported to be unfit for human consumption.[57] However, most Ghanaians eat imported meat because it is significantly cheaper than locally produced and processed chicken. Locally grown broilers are sold at 28,000 cedis (£1.60) per kilo, whereas poultry imported from the EU costs only 16,000 cedis (92p) per kilo, less than the local cost of production.

The livelihoods of some 1,000 registered and many more unregistered small-scale poultry farmers are now under threat, and already there are signs that the industry is collapsing.[58] Faced with inadequate government support and difficulties in accessing loans, small-scale farmers are grappling with very high production costs, especially for feed (some ingredients of which are imported).[59]

In spite of the current stagnation, there is potential for an indigenous poultry industry in Ghana.[60] But it is difficult to envisage one unless the Ghanaian government is able to raise appropriate tariffs on imports of EU poultry meat. Although this is theo-

retically possible without breaching WTO rules, it has been forbidden by the IMF.[61] The National Poultry Farmers' Association estimates that tariffs would need to be in the region of 80%, four times their current level, to allow local producers and processors to compete fairly with EU imports.[62]

According to the Ministry of Food and Agriculture, increased government revenue from higher import taxes could be used to subsidise chicken farmers and support the overall development of the poultry industry.

What about the future?

A boost in local tomato processing and poultry meat production will increase significantly Ghana's overall economic activity, given the size and importance of these two sectors.[63] At present, only 13% of the country's agricultural produce is processed inside Ghana. However, the presence of cheap EU imports is depressing local production and processing, and jeopardising the future development of the processing industry.

To unlock the growth potential of both the poultry and tomato industries, Ghanaian producers and enterprises need properly designed and well-targeted trade policies – including increases in import tariffs – as part of a national agricultural and industrial development strategy. Although this would be permissible under WTO rules, a contractual agreement between the EU and Ghana to eliminate 'substantially all' tariffs and other barriers on EU imports threatens to scupper any such prospect.[64]

Liberalisation capping development

Tariff elimination under EPAs not only risks destroying much of Africa's existing agricultural and agro-processing industry, and the livelihoods of millions of workers and producers with it, but will also damage the prospects for future industrial development.

If tariff elimination on 'substantially all' EU imports goes ahead, African entrepreneurs will be unlikely to develop value-added industries requiring advanced technologies – such as certain types of food processing – that will face competition from similar EU exports in their national or regional markets. Even as things stand, most existing private enterprises in Africa cannot compete with the capital and know-how of their European counterparts to produce goods for which there is an existing or even potential future demand in their own or regional markets.[65]

African entrepreneurs that wish to add value to locally grown agricultural products and sell them to consumers and companies nationally or regionally will need conditions under which they can produce competitively and reach these markets. They will therefore require massive investment in Africa's trading infrastructure.

They will also need protection from imports, especially products that are sold below the cost of local production as a result of the public subsidies they receive. Many European agro-processors will still be receiving such subsidies in 20 years' time. Even though these subsidies will not be linked to the level of output, and are therefore not considered to be distorting prices, direct payments to farmers still allow them to sell at lower prices than they would be able to otherwise.[66]

This competition will increase if African governments agree to eliminate their tariffs on EU exports. The marketing advantages that European brands such as Nestlé already enjoy in African markets, combined with cheaper prices, will prevent African countries developing industries in the future that add value to locally or regionally grown cereals.[67]

A third new study from Christian Aid shows how the opening up of Mozambique's markets to products from Europe under EPAs threatens to 'cap' the development of the country's industries.

Case study 3: Mozambique – the future of the milling industry

Under EPAs, imports of wheat flour from the EU would undermine Mozambique's thriving milling industry and destroy future prospects for development in the country's value-added wheat sector. This capping of development is one of the most profoundly worrying aspects of an EPA that demands reciprocal market opening.

The milling industry in Mozambique has real

potential for development. The country doesn't produce much wheat but has successfully developed a domestic milling industry by processing and adding 20% value to imported wheat.[68]

Milling is one of the few manufacturing activities left in a country where traditionally large employers, such as the textile and clothing sector, are collapsing.[69] In Mozambican terms it is a big and dynamic industry, accounting for around one-fifth of the country's manufacturing output and employing more than 3,000 people.[70] It also stimulates economic activities such packaging and distribution, and the production of bread, pasta, pastry and biscuits.

The industry has developed as a result of a conscious government policy. Tariffs on the industry's main input – imported wheat – have been kept as low as 2.5% to keep its costs down. Tariff-free wheat imports are now made available to larger Mozambican mills by the National Institute of Cereals, which is considering extending such provision to medium- and small-scale milling companies. However, a 25% tariff is levied on imported wheat flour to protect the output of the mills. Mozambique has selectively used liberalisation and protection to help promote the industry.

The positive and dynamic growth of wheat mills and the expanding wheat-flour market in Mozambique have prompted the government and private investors to protect the industry from outside competition and provide new investment capital. A new milling plant is under construction in Beira, not far from Rotanda, the only area in Mozambique that grows wheat and has the potential to expand its wheat production. A secure market outlet would encourage local families to increase their wheat production, providing them with a secure livelihood.[71]

However, Christian Aid's research shows that if the proposed EPA liberalises trade in wheat flour, the milling industry in Mozambique will face a significant set-back. If import tariffs on flour are removed, wheat flour from Holland and Belgium will enter Mozambique at a price significantly lower than that of locally milled flour.[72] Given that the market for wheat flour in Mozambique is relatively small, even limited amounts of imported flour will create major disruption in the domestic market.[73]

According to an EU-funded study investigating the potential impact of an EPA between Mozambique and the EU, wheat-based cereal milling and bakery is a 'dynamic' industry and will be damaged if the government eliminates tariffs on EU imports.[74]

Premature exposure to increased competition will cap the development of this young, yet potentially strong, industry. And any contraction in the industry could prove catastrophic for its workers. Profit margins in milling are not high and are very sensitive to increased competition.

Higher tariffs on processed agricultural imports from the EU – at an average of 23%, tariffs are double the rate imposed on unprocessed agricultural imports – have to date helped industries in Southern Africa, such as wheat-milling, to develop. In some countries, tariff rates are much higher than this 23% average. They are 30% in Mozambique, 67% in Botswana and 42% in Zimbabwe.[75] Eliminating these tariffs on EU exports in a bilateral contractual agreement will not only threaten existing agro-processing industries, but **also lock them into their current low-value-added patterns of production.**

Without such industries, most African economies' reliance on commodity exports will be compounded. According to the United Nations Conference on Trade and Development (UNCTAD), there is a clear link between dependence on exports of primary commodities and the incidence of extreme poverty.

The millions of households who make a living from cultivating these products have, with some exceptions, seen no significant increase in their incomes, life expectancy, health or education. In fact, many have seen their incomes dry up as a result of the long-term downward trend in real commodity prices since the 1960s, or sudden international price crashes. Real commodity prices of least-developed country exports alone declined by more than 30% between 1986 and 1999.[76]

Commodity sectors offer people little prospect of breaking out of poverty. Since 1999, international cotton prices have dropped one-third, almost halving the prices received by Mozambican cotton growers. According to one of the thousands of women who try to make a living from cotton, 'Many of us

grow cotton although it doesn't yield us anything, but we are forced to continue. The problem is that there are no other jobs for women. If there were ... women would certainly ... not cultivate cotton.'[77]

In most African countries, the bulk of the population – often 60 to 70% – is only just surviving by growing and sometimes selling their own food, hawking low-value goods, or selling their labour piecemeal and cheaply.

Countries that have successfully broken – or are breaking – out of this kind of dependency and survival economy, such as Mauritius (one of a few African countries), South Korea and Taiwan, have done so partly through careful industrial and agricultural development planning. Trade restrictions were an integral component of these strategies.[78] African governments should be allowed to use such restrictions as part of their efforts to encourage development and reduce poverty. This will be impossible if they enter into a contractual agreement with the EU to eliminate all existing tariffs and other barriers on EU imports.

The UN-appointed Zedillo Commission, reporting to the 2002 Monterrey Conference on Financing for Development, captured the growing unease surrounding this potential denial of previously successful policies. It noted that: 'However misguided the old model of blanket protection intended to nurture import-substitute industries, *it would be a mistake to go to the other extreme and deny developing countries the opportunity of actively nurturing the development of an industrial sector.*'[79]

Peter Mandelson, the new European Trade Commissioner, and his bureaucrats have been at pains to emphasise that African countries will be able to negotiate much longer transition periods before they are required to eliminate tariffs, and exclude 'sensitive' products from their free trade agreement with the EU. They normally cite the South African government as an example. It was able to exclude 14% of products imported from the EU from any tariff-elimination commitments in its bilateral trade agreement with the EU.

In principle, therefore, the Mozambican government should be able to exclude its milling industry from any future trade liberalisation commitments in its EPA. But even if it is allowed to do so[80] such an approach still ignores the dynamic nature of development. Such exclusions can only be based on an assessment of existing production and trading patterns. It is very difficult to predict which products will be in demand in ten or 20 years' time. If more competitive and productive EU enterprises are already given free access to African markets, African entrepreneurs will not be able to respond to domestic or regional market opportunities.

Support home-grown regional integration

The EU is failing to acknowledge that building regional markets and competitive regional industries in Africa is a complicated process. It will take much longer than the arbitrary trade liberalisation schedules envisaged under EPAs. Fast-tracking common external tariffs among groups of African countries and forcing them to open up to EU imports prematurely would deny many producers and manufacturers vital national and regional markets.

For many decades African governments have tried to cooperate more closely to develop regional transport and communication links; coordinate their economic development and environmental strategies; and reduce trade barriers among their often-artificial neighbouring national borders.

It is widely acknowledged that such strategies, if successfully implemented, could create sufficiently large markets to encourage local and foreign entrepreneurs to invest in economic activities that require large-scale production to be competitive.[81]

But until now, regional schemes in Africa have been mostly unsuccessful in creating larger and more integrated markets. This is because most political leaders have not actively promoted the idea for fear of losing their power to make national policies; hence regional co-ordinating institutions have remained under-funded and without clout.

In addition, many African enterprises produce or export more or less the same products as each other, so they are more interested in access to industrialised countries' markets than those of their neighbours. Moreover, the difference in economic size between larger economies, such as South Africa, Kenya and Nigeria, and their neighbours has meant that smaller economies in Africa have often been wary of integration. They fear that the larger

economies will reap most of the investment and income from market integration.

These realities have resulted in many regional schemes repeatedly failing to take off or making only very slow progress. Uganda, Tanzania and Kenya, for example, have tried unsuccessfully since the 1960s to create a regional market. In their latest attempt they have announced plans to create a common external tariff by 2009.

The member countries of the Southern African Development Community (SADC) initially joined together to fight apartheid in South Africa through economic sanctions. But they worked for 15 years on developing transport and communication links among themselves, as well as joint environmental and industrial development strategies, before deciding in 1996 to negotiate a regional free trade agreement. They now plan to have a common external tariff in place by 2010.

Even Europe's experience of regional integration has been one of selective regional trade liberalisation, which began among the coal and steel industries in the 1950s. Only in 1967 did member states establish a common external tariff – nine years after they had first agreed to form a customs union in the 1958 Treaty of Rome.

Despite their own experience and that built up from their long-standing support of African regional groupings,[82] EU member states are now using EPAs to push African groups into aligning their tariffs and other trade barriers at a much faster rate than they would do without external pressure. The destruction of the chicken industry in Senegal after the government reduced tariffs on imported chicken as part of aligning its tariffs with the West African Economic and Monetary Union (WAEMU) common external tariff in 2000 (see the Senegal case study), illustrates the dangers of rapid regional integration.

EPAs may repeat this kind of mistake many times over.

Technically, African regional groupings can only agree to eliminate their tariffs on EU imports if they are signed up to a common external tariff among themselves. For instance, eight members of the Economic Community of West African States (ECOWAS) have not yet signed up to the WAEMU common external tariff, which is much lower than their existing tariffs. They are now accelerating their efforts to align their own tariff regimes with the common external tariff so they can meet the 2007 deadline for finalising EPA negotiations.

Similar discussions are underway in the SADC grouping. Its plans to establish a common external tariff by 2010 are partly motivated by the need to have one in place before they can agree to a schedule to eliminate tariffs on EU imports under EPAs.

The very integrity of two long-standing Southern African regional groupings, the Common Market of Eastern and Southern Africa (COMESA) and SADC, is under threat because governments that are members of both groupings now have to choose under which one they will negotiate a new trade deal with the EU.

In all fairness, countries that presently belong to several regional groupings would eventually have had to choose which one to align to – at least as far as reducing their trade barriers is concerned – with or without pressures from EPA negotiations. Governments are already finding it difficult to divide their political attention among several negotiating forums and it will be impossible for them to adhere to more than one common external tariff.

But the speed and nature of these choices are difficult political and economic decisions. They need to be based on a careful assessment of which regional arrangement will best serve a country's poverty-reduction and development goals. Such decisions should not be influenced by the artificial deadlines imposed by the European Commission and EU member states. Even the World Bank has cautioned developing countries to consider carefully whether new agreements, particularly with developed countries, are helpful on top of existing regional integration schemes.[83]

It is highly unlikely that African regional groupings will have built robust regional markets and mobilised sufficient investment to develop competitive regional production by the time EPAs will require them to open up to EU imports – within the next ten years, according to WTO rules. Competition from cheaper EU imports to neighbouring markets will therefore undermine any government efforts to attract domestic or foreign investment in sectors that could serve these markets.

The situation in Southern Africa provides a warning of what may happen as Europe forces the pace of regional alignment. The EU already has a free trade agreement with South Africa which requires it to dismantle tariffs on imports from Europe from 2005 onwards. Neighbouring countries that are members of the Southern African Customs Union (SACU) fear that this will have a devastating impact on their industries. For example, many Southern African firms producing cloth, pasta and biscuits (Botswana); refrigerators (Swaziland); televisions (Lesotho); and wheat flour and meat (Namibia) for the South African market fear that they will not be able to compete with duty-free EU imports once the South African government starts dismantling tariffs.

EPAs between the EU and other African regions pose a similar risk to regional trade and development integration.[84]

Let Africa shape the outcome of negotiations

One of the reasons the EU is now actively promoting reciprocal free trade agreements with African countries is its belief that the old system of preferences failed to increase and diversify trade and production in Africa.[85] But what it does not acknowledge is that Africans have never been actively involved in shaping the trade preferences granted under the various Lomé Conventions. No negotiations took place – their scope and terms were entirely decided by EU member states in the context of their donor-recipient relationship with their former colonies.

African entrepreneurs, exporters and governments may be able to improve their access to EU markets through EPAs if they are allowed to shape the structure, format, terms and schedule of negotiations. But the reality suggests that it is still business as usual. The European Commission has shaped the negotiations in such a way as to prevent the voices of African governments, parliaments, enterprises, farmers and poor communities influencing their outcome.

The EU first proposed and initiated EPA negotiations amid much scepticism and reluctance from African, Caribbean and Pacific countries.[86] A very rapid phase one of negotiations, pushed by a Commission unwilling to negotiate with the ACP countries as a single group, did not allow enough time to develop an overall ACP–EU legally binding framework to guide the conduct of the regional EPAs.

The ECOWAS member states were the first to enter into regional negotiations hoping their haste would get them a better deal. Despite the rush, it took them and the European Commission 14 months to develop and agree on the 'road map' for regional negotiations because of serious initial disagreements. The Commission refused to offer additional funding to help develop the productive capacity of ECOWAS states, insisting that this should be paid for out of existing EU aid funds.

ECOWAS member states also asked to be allowed to deepen their regional integration prior to eliminating tariffs on EU imports. The Commission refused this request.[87] As a compromise, it agreed that negotiations on tariff elimination would not start before September 2006.

Negotiations have now been structured in a remarkably similar way in all four African regions (ECOWAS, SADC, WAEMU and COMESA), which are at very different stages of regional integration, creating the impression that they were derived from a common EU source.[88]

African governments are aware that they are at a disadvantage in these negotiations. They are entirely dependent on EU generosity to pay for good-quality – **independent** – sector-level studies to help them make decisions and formulate positions.[89] They need to fully understand the potential impact that import-tax revenue losses, tariff dismantling or new rules of origin will have on poverty, women, the spread of HIV/AIDS, and different industries and economic sectors, in each country, and across each region.

Many of the existing studies are not particularly useful to African negotiators. They tend to draw conclusions from econometric models only and do not investigate thoroughly, as Christian Aid's partner organisation the Integrated Social Development Centre (ISODEC) has done in Ghana, how different products and sectors will be affected if tariffs are eliminated on all EU imports.[90] Very few governments have yet commissioned these studies, and

most of them are undertaken by European consultants, sidelining African researchers.[91]

African governments also do not have enough qualified bureaucrats to manage EPA negotiations in addition to very important ongoing regional and WTO trade negotiations.

The Cotonou Partnership Agreement entitles a wide range of civic organisations in Europe and Africa to participate in EPA talks. In reality, very few groups that will be affected by the new trade deal are playing any meaningful part in negotiations.

In most African countries, senior bureaucrats make national trade-policy decisions without any meaningful contribution from parliaments, enterprises, development organisations or farmers' associations. The needs and interests of small- and medium-sized businesses, small-scale farmers, and poor communities are therefore not represented.

Governments were supposed to have set up national negotiating forums to bring together government representatives, unions, farmers, businesses and other affected groups to discuss their needs and interests. This was meant to inform the positions of governments in the regional trade negotiating forums, and the positions of ambassadors and ministers who negotiate directly with the European Commission.

However, national consultations are taking place only sporadically or not at all in many countries. This is leaving most of those who will be affected by the outcome of negotiations as mere bystanders in the process. Regional secretariats and ambassadors are continuing to hold discussions with the European Commission without the kind of information that could have been gathered from national consultation processes.[92]

According to Richard Kamidza from the Southern and Eastern African Trade, Information and Negotiations Institute (SEATINI): 'The process now seems to be firmly under the direction of the COMESA secretariat and ambassadors in Brussels, with government officials and the private sector to some extent guessing what to do. Other non-state actors – civil society, media and MPs – are still restricted to the periphery of engagement'.[93]

This should concern the UK government in particular, which has recognised the need for the active involvement of all stakeholders in national trade policymaking and has invested considerable resources in programmes to encourage this process in least developed countries.[94] The behaviour of the Commission is threatening to undermine these efforts.

Left in the hands of mandated technocrats and technical committees in the European Commission and African regional secretariats, the negotiating process so far lacks legitimacy, transparency, accountability and broader democratic representation. The EC has also eroded the credibility of this process by using its leverage as a donor to shape the outcome.

If EPAs are to address the development needs of African countries, more African voices need to shape their outcome. This will require:

- bureaucrats on both sides to transfer ownership of the process to national governments and stakeholders;
- more impartial and accessible financial and technical assistance from the EU that will enable both national governments and civic bodies to engage in the negotiations;
- negotiations to be conducted in an open, transparent and inclusive way, with details, including the outcome of impact studies, brought into the public domain as a matter of routine;
- the pace of negotiations to be set by African negotiators' level of preparedness and their corresponding ability to make informed decisions; and
- that national impact assessments ask the right questions, take account of national development objectives and inform each step of the negotiations.

Increase development finance

A major reason even least-developed African countries want to be at the negotiating table is because they believe EPAs will provide much-needed development assistance to help boost their productivity and enhance their trade performance, so that their enterprises can take advantage of more open EU

markets.[95] The EU has reinforced this hope by pledging to fully integrate EPAs with its existing development funds for Africa – disbursed through the European Development Fund (EDF) for ACP countries – and allocate adequate resources for this purpose.[96]

However, disbursements through the EDF are extremely slow and cumbersome – it often takes up to 13 years to fully disburse a five-year programme. What is even more discouraging is that only 1.8% of the latest EDF budget is earmarked for trade development activities. Given the scale of social needs in African countries, this amount can only be increased by allocating additional funds to the budget.

Aware of the limitations and inadequacies of the EDF, African countries have called upon their European counterparts to commit 'additional resources' to the EPA process – a request that has thus far fallen on deaf ears.

During phase one of the EPA negotiations and in subsequent regional negotiations, the European Commission Trade Directorate constantly reiterated that resources for the next five years (2005–10) of the EDF have already been allocated and that it only has a mandate to negotiate trade issues and not financial packages.

This is a disingenuous position. European Union member states will undermine their own stated commitment to reduce poverty in Africa if they force tariff elimination on African countries without increasing the level of aid they contribute to the EDF in the coming five years.

The erosion of special preferences for some of Africa's traditional commodity exports to the EU is another reason why African governments want increased development finance from European member states.

Many African countries rely on special preferences for their beef, sugar and banana exports to the EU, which generate a major share of their foreign exchange income and domestic economic activity. These protocol agreements, which have been in place since 1975, will now be replaced by whatever market-access terms African governments manage to negotiate under their respective regional trade deals with the EU.

This may mean the end of the large and predictable quotas under which African countries are able to export these products at zero tariffs to the EU market, which would severely damage the beef and sugar industries in particular. Additional development finance would help governments to encourage these industries to become more productive by supporting skills-training programmes and improving infrastructure; fostering the development of other economic sectors; and dealing with the short- and medium-term social and economic fall-out of industry closures.[97]

Since 1975 a number of African countries have been benefiting from the very high internal EU prices they have received for an agreed quota of sugar exports to the EU under the Sugar Protocol. This has enabled their sugar industries to attract foreign and domestic investment, allowing them to consolidate, expand and modernise. The sugar industry fulfils a multifunctional role in these countries and through its links to other sectors of the economy is a major pillar of economic development.

However, recent reforms in the EU sugar regime will see EU prices drop by up to 37%. This will not only hit the foreign exchange coffers of governments. If sugar enterprises are unable to make up the lost income in the short-term, it will put the livelihoods of hundreds of thousands of people – involved in all stages of growing, processing and selling sugar – at risk.

The abrupt and unaccommodating way in which the EU is ending its long-standing commitments under the Sugar Protocol is a worrying harbinger of its approach to EPAs.[108] It is signalling its intent to shift from a clear system of preferences for its former colonies to free trade agreements that offer neither proper financial assistance nor respect the right of ACP countries to make their own economic decisions.

More legal security for African exporters

It would be wrong to conclude from the controversy surrounding EPAs that entering into trade arrangements with the EU will necessarily be bad for the African countries of the ACP. On the contrary, even least-developed countries hope to use the negotiations to improve the terms of their access to European markets. However, their priorities are very

Box 2. Case study 4: Malawi – the future of the sugar industry

Sugar is not just another cash crop in Malawi. It is a vital industry delivering a wide range of direct and indirect benefits to the Malawian economy and its people.

Three out of every five Malawians live below the poverty line and the government depends on foreign donor funding for about 80% of its annual budget.[98] Sugar exports earn the country MK1.1 billion (US$1 = MK18,600) in foreign exchange, constitute 5% of its gross domestic product and contribute MK908 million to central and local government coffers from income and corporate taxes.

The sugar industry employs 13,000 people directly, and another 15,000 through subcontracting.[99] It has stimulated other parts of the local economy; Malawian companies producing products used in sugar processing, and those using sugar in their products depend on the industry as source of income and raw materials. These companies, in turn, employ even more Malawians.[100]

Under the terms of the Sugar Protocol, Malawian exporters can supply the EU market with 20,000 tonnes of sugar a year at zero duties and prices that are about a third higher than the world price. Guaranteed market access and high prices have drawn private investors to the sugar industry, bringing with them much-needed capital and technological know-how.

Illovo Sugar Group, the main investor and shareholder of SUCOMA, Malawi's largest sugar producer, has improved sugar production, as well as conditions for its workers and the surrounding communities.[101] Sugar estates are situated in rural areas where poverty is high and basic services and transport are lacking. SUCOMA provides housing, water and electricity to its employees and their families. It also provides them and surrounding communities with free healthcare and schooling.

The proposed EU sugar-price reforms will damage the economy and could exacerbate poverty. Lower prices for the 20,000 tonnes of sugar exported under the Sugar Protocol will cost the country €4 million in export earnings. This will reduce SUCOMA's profits and government revenues from sugar taxes. Lower earnings may force the company to retrench workers, cut services and lower the prices it pays smallholder farmers growing sugar under contract. This would be disastrous for communities in the Chikwawa and Nkhotakota districts, where sugar is the mainstay of the local economy.

EU member states have not yet come up with any measures to mitigate these short and medium-term effects of lower sugar prices.

A true spirit of partnership would see the EU treat sugar producers and exporters in countries such as Malawi in the same way as sugar-beet farmers in Europe. European member states are likely to refund 60% of the income sugar-beet farmers stand to lose as a result of lower prices, through direct aid payments.[102] But they are not prepared to consider similar compensation for ACP sugar growers and exporters.[103]

Sugar-producing ACP countries, especially least-developed countries such as Malawi, are deeply concerned about the proposed phasing out of the special EU market access and high prices they used to enjoy.[104] Estimating that the proposed price cuts will cost their countries about $333 million a year, least-developed countries that are members of the Sugar Protocol have asked for better-managed market access over an extended transition period in conjunction with a more modest and gradual reduction in price.[105]

European trade officials, however, have dismissed their arguments as alarmist, ignoring the findings of existing in-depth, country-specific impact assessments. The EU is backing out of its initial proposal to provide 'accompanying measures' to support ACP countries to diversify out of sugar, find new markets for sugar exports and become more productive sugar producers. Member states are not prepared to pay ACP producers compensation.[106] They are only prepared to respond to 'specific requests' for assistance, based on 'actual needs' in the Sugar Protocol countries.[107]

different to those currently being set by the EU. A true economic partnership agreement, which addresses Africa's development needs and priorities, would give African countries:

- legal security for continued and better access into EU markets;
- flexibility and the right to decide how and when to liberalise their own markets;
- sufficient and timely financial assistance to help regional integration, and improve their ability to cope with the costs of adjustment caused by trade reforms; and
- compensation for the loss of revenue caused by preference erosion.

There are several options open to the EU and ACP countries that could help them negotiate such agreements. One option is to make regional trade schemes between developed and developing countries more flexible. Another is to improve the way preferential trade schemes for developing countries are designed and enforced at the WTO.

Changing WTO rules on regional trade

> *The developed countries do not expect reciprocity to commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing countries, i.e. the developed countries do not expect developing countries, in the context of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs.*
>
> Article 5, 1979 decision or 'enabling clause' of GATT

The 'special and differential treatment' (SDT) of developing countries, which allows them to implement agreements more slowly or benefit from exemptions, is a founding principle of the WTO. It recognises:

- the need to discriminate in favour of poor countries, whose industries will suffer in competition with their more advanced counterparts, but who could benefit from increased access to the markets of developed countries;
- the difficulties rapid liberalisation presents developing countries – given their inability both to manage and cope with adjustments; and
- the need to give developing countries the flexibility to adopt their own development strategies, including enhancing their capacity to take advantage of international trade.

Although SDT has been problematic – mostly because current provisions are not sufficiently far-reaching, and are vaguely defined and difficult to enforce – its principles are fundamental to trading arrangements between developed and developing countries.[109] In 2001, the Doha Development Agenda committed to clarifying SDT and making it effective.[110]

However, EPAs are not being negotiated under SDT principles but under the strict rules that govern regional trade agreements at the WTO (GATT Article 24). These rules were conceived before trade agreements between rich and poor countries were contemplated, and therefore contain no provision for special treatment for poor countries entering into such deals. They stipulate that all signatories to a regional trade agreement must liberalise 'substantially all trade' over a limited period of time – usually ten years.[111]

In its public statements, the European Commission says it appreciates the importance of special treatment in EPAs. At the same time, it insists that it is compelled to negotiate these unique agreements under strict WTO rules to ensure they adhere to WTO law. The vague provisions of WTO rules governing regional trade, the Commission claims, gives it the 'wriggle room' needed to reconcile this apparent contradiction and offer the ACP countries 'asymmetric' market access, with a longer period over which to reciprocate with a lower level of liberalisation. They cite earlier trade agreements that have strayed from the accepted interpretation of current rules in this manner to support their position.[112]

There are several disadvantages to this approach for ACP countries.

First, it falls far short of giving them enforceable rights to balance their development needs and trade commitments. That means they will not be able to raise tariffs on EU products to protect their indus-

tries. Rather, everything will depend on the outcome of the EPA negotiations. Their experience of negotiations to date shows that the European Commission is unlikely to agree to their requests to exclude entire sectors or large percentages of their products from tariff elimination (see Box 1 on partnership).

ACP countries will also need to decide in advance which areas of their economy will need protecting in the future. This requires them to predict development. If the predictions prove inaccurate, too bad; EPAs will have locked them into the wrong course of action.

Second, this asymmetrical approach is flawed because it does not offer the legal certainty the Commission claims. Asymmetrical EPAs will still be open to challenge if they do not conform to the accepted interpretation of WTO rules on regional trade agreements. As current talks attempt to interpret more clearly and strictly enforce these rules, they are likely to become more rather than less constraining. As their number and scope increase, so does the likelihood of disputes. In the absence of legal certainty, the local economy is less likely to receive domestic public or private investment.

Under the Doha Development Agenda there is a clear opportunity to address the lack of provision for special treatment under Article 24 of GATT.[113] The ACP countries have put together a proposal to improve the deal they could get under the rules of regional trade agreements.[114] But so far, the Commission has been dismissive of their efforts to incorporate the principle of more flexibility into Article 24.

Fixed deadlines for trade liberalisation, argues the Commission, are useful to 'lock in' the process of trade reform within countries. In turn, they will provide a stable environment to encourage investors. However, this approach is politically flawed. High-handed external interference is no way to guarantee a country's genuine commitment to reform. Rather, there is evidence that governments will commit to reforms only if they view them to be in their best economic or political interest.

This approach also assumes that the progress of development will always be linear rather than unpredictable, a bit like taking two steps forward and one step backward. Liberalisation will not always play a positive role in this process. Indeed as this report indicates, premature liberalisation often has a detrimental effect on a country's economy and people and thus provides a disincentive to investors that outweighs any incentives derived from countries being 'locked in' to reforms.

Investor surveys show that formal investment agreements, special investment incentives and free trade agreements are low down the list of factors that influence foreign investors' decisions about where to invest.[115] And experience in industrialised and high-income developing countries shows that only economies with already capable and well-functioning local enterprises receive the kind of foreign investment that brings industrial growth.[116]

Regional trade agreements, therefore, must include the principle that developing countries should not be forced to open their markets to developed countries according to arbitrary timescales and market shares. Instead, if developing countries are keen to enter into a regional trade agreement with developed countries, they should be able to choose when and how they want to open their markets based on a set of agreed development benchmarks.[117]

Improving preferential market access

As well as reforming the WTO rules governing regional trade agreements, there is a need to change the way the WTO views preferential access to rich countries' markets. Preferential treatment should give developing-country exporters, including those from Africa, guaranteed and legally secure access to the EU market, without requiring them to open up their markets in return.

Besides the Cotonou preferences, which EPAs are supposed to replace, the EU operates two other preferential schemes – its Generalised System of Preferences applying to all developing countries, and the Everything but Arms initiative which applies to just least-developed countries and offers free access to the EU for all their products except sugar, bananas and rice.[118] The WTO 'enabling clause' allows developed countries to grant different sets of developing countries better access to their markets as long as the criteria for granting preferences to some and not others are 'objective and transparent'.

It is therefore possible for the EU to design a preference scheme that would offer Cotonou-equivalent levels of market access to countries at similar levels of development to the ACP and with similar development needs, without exposing their weaker member states to competition with larger developing countries. But to make this happen, EU member states will need to muster the political will to defend such an agreement at the WTO. They will need to instruct the European Commission to pursue this matter in its WTO discussions on their behalf. And they will need to take this into account in their current review of the EU's General System of Preferences and the provisions of the Everything But Arms agreement.

The EU's conclusions on the poor track record of its preference schemes are politically self-serving and miss the target. In order to make such schemes truly useful, their design needs to be improved.

Under current WTO rules, these schemes are unilaterally devised by 'grantor' (developed) countries and are not legally binding. Preferences under these schemes can be withdrawn or modified at the whim of the grantor or because of challenges by third parties at the WTO. For example, the EU's preference scheme granted to countries, such as Afghanistan, that are attempting to diversify away from their dependence on growing illegal narcotics was recently and successfully challenged by India as being discriminatory.

This lack of legal certainty further undermines the usefulness of preferences and acts as a disincentive to public and private investment. There are options that would give recipient countries legal certainty – including renegotiating the provisions of the enabling clause under the Doha talks on S&DT.[119]

The unilateral design of preference schemes is a major reason why they have failed to increase trade flows between developed and developing countries. They are primarily designed to protect rich countries' farmers or industries, rather than promote developing-country exports.

The number of 'missed' preferences – that is, when exporters have chosen to forgo available preferences – demonstrates that there are factors that prevent African exporters exploiting the opportunity to enter EU markets on favourable terms.[120]

Particularly onerous to small producers are the 'rules of origin' that products need to comply with to qualify for preferential access. These rules are designed to ensure that more advanced developing countries do not 'free-ride' on preferences awarded to less-developed nations. However, they have in fact penalised exporters and producers in poor countries that cannot process goods sufficiently and have to source most of the constituent parts of what they export from outside their own country and therefore do not qualify for special market access. This does not correspond to modern supply-chain realities where producers source parts and disperse processing across a wide range of countries. Current rules of origin, therefore, do not benefit producers in countries wishing to diversify away from commodity production and become more integrated in global supply chains.

Overcoming these problems would go some way to enabling ACP countries to use preferences as a transitional strategy to develop their economies and the international competitiveness of their industries, just as more developed countries did in the past.

Non-reciprocal or preferential market-access schemes can only ever be one element of promoting development through trade. They will become less and less useful as global tariffs are reduced under successive rounds of trade negotiations. However, preferences are still a critical lifeline for many developing countries, and in the right circumstances can be a useful tool for their development.

At the very least, the dismantling of preference regimes should not be undertaken rapidly or without making effective compensation available to help poor countries cope with the resulting income losses and develop new industries.

Recommendations

It is clear from this report that there is not a strong legal case for requiring reciprocal market access commitments from ACP countries. At least two WTO-compatible options are available that would allow trading arrangements that are desirable to African governments.

Neither is there a strong pro-development case

for linking reciprocal market-access commitments from ACP countries to the 'trade and development' aspects of EPAs – which are assisting regional integration, overcoming the problems of preferences and supporting the growth of ACP economies.

After careful analysis, Christian Aid believes EU interests and objectives are playing too great a role in shaping the outcome of current EPA negotiations. As a result, African countries – among them some of the world's poorest – are now in a defensive position. They have no option but to negotiate their market opening in return for maintaining or, they hope, improving, arguably their most important aid and trade relationship.

EPAs are history-making agreements. For the first time in the long development relationship between the EU and its former colonies, the less-developed partner will have to make trade commitments to its more developed partner. As this report has shown, this will in all likelihood undermine African countries' development efforts. It will destroy existing industries and put a cap on the emergence of new, basic processing and manufacturing businesses.

Recommendations to EU member states and the Commission

For reasons outlined, EPAs in their current form must be stopped. As a matter of the highest priority – since EPA negotiations have already begun – the EU must seek a new deal for African countries that guarantees them:

- legal security for continued and improved access to EU markets;
- flexibility and the right to decide whether, how and when to liberalise their own markets; and
- sufficient and timely financial assistance to help promote regional integration, their capacity to trade, and their ability to cope with the costs of adjustment caused by trade reforms and the erosion of preferences.

Finally, the EU's trading relationship and negotiations with ACP countries should support rather than seek to drive local development strategies, especially efforts to create larger regional markets.

If EPAs are truly to be tools for development, the European Commission must:

- push for the inclusion of special and differential treatment for developing countries in WTO rules governing regional trade agreements. This must go beyond prolonged transition periods and asymmetry, and leave open the possibility for non-reciprocity. Market opening in developing countries must be linked to development benchmarks and should not be undertaken unless it will contribute to poverty reduction;[121]
- improve its own Generalised System of Preferences as well as WTO rules governing preferential trade schemes. Preference schemes must deliver market access that corresponds to the export interests of developing countries. They must also provide legal certainty so that they can be used with confidence to stimulate investment, develop economic capacity and increase international competitiveness; and
- try to persuade EU member states to provide additional financial assistance as part of their economic partnership agreement with African, Caribbean and Pacific countries, beyond their commitments in the next five-year European Development Fund. This must be targeted at increasing the capacity of ACP enterprises and producers to trade and compete internationally and providing compensation for the loss of preferences.

Above all, these measures must be entirely independent of whether or not and when ACP countries decide to open up their markets to EU imports. If trade liberalisation is a good policy for ACP countries, they will choose it and the EU must respect their choices.

Recommendations to the UK government

In 2005, the UK government is in a unique position to influence the outcome of the debate surrounding EPAs. The UK government's stated position favours trade that works for poor people and, in its White Paper of 2004, the Department of Trade and Indus-

try stated that poor countries should not be required to 'pay the price' for access to the markets of rich countries.

The UK government must follow through on its rhetoric and:

- Use the political opportunities of 2005 (setting the Africa agenda for the G8 meeting, presiding over the EU and participating in the five-year review of the Millennium Development Goals and the sixth WTO ministerial meeting) to push for a visible change of direction in the EU negotiating position and the EPA process to ensure that development rather than mercantilist trade interests guide the economic partnership with Africa.
- Hold the European Commission to account for its positions and conduct in EPA negotiations with Africa. This could involve setting up a group of like-minded European member states to influence the rest and put pressure on the European Commission to argue for the inclusion of effective special and differential treatment in WTO rules that govern trade relations between developed and developing countries.

Endnotes

1. The Doha round of trade talks was originally scheduled to finish at the ministerial meeting in Hong Kong in December 2005, but because of the collapse of talks at the Cancun meeting and subsequent wrangling and delays, this timetable now seems unlikely to be met. The ACP waiver may well, therefore, last longer than was expected, although ACP countries clearly cannot rely on this.
2. WTO understanding on interpretation of Article 24 of GATT, 1994.
3. See *Taking Liberties*, Christian Aid, 2004.
4. 'EU sugar regime overhaul: too radical for some, too weak for others', published on 15 July. 2004, see www.eu ractiv.com/ Article?tcmuri=tcm:29-128646-16&type=News
5. At a meeting of the ACP Ministers Responsible for Sugar with the EU Agriculture Council on 24 January, 2005, Trade Commissioner Mandelson emphasised the centrality of EPAs and expressed the idea that the Sugar Protocol would be integrated into the EPAs in a way that ensures full compatibility with WTO rules on regional trade agreements. However, the ACP position is that the Sugar Protocol, because of its legal status, cannot be integrated into the EPAs and, moreover, any negotiations that involve the Sugar Protocol should be on an all-ACP basis and not subsumed by the EPA negotiations.
6. At International Development Select Committee hearing, 7 February, 2005.
7. The Convention also provided schemes to compensate the commodity-dependent ACP countries for sudden and large drops in international commodity prices.
8. This waiver allowed the EU and ACP to retain the preferential trade agreement made in the Lomé Convention, even though it was technically illegal under the WTO rules on regional trade agreements. The waiver was granted for a period of two years beyond the conclusion of the Doha round. So the December 2007 date is based on an assumption that the Doha round will be concluded with the Hong Kong ministerial at the end of 2005. This timetable seems unlikely to be met, and earliest the Doha round is likely to be concluded is the end of 2006.
9. Article 4, Cotonou Agreement 2000, states 'The ACP states shall determine the development principles, strategies and models of their economies in all sovereignty'.
10. According to Article 34: 'Economic and trade cooperation shall aim at fostering the sustainable and gradual integration of the ACP into the world economy, with due regard for their political choice and development priorities, thereby promoting their sustainable development and contributing to poverty eradication in the ACP countries.'
11. See 'Why EPAs Need a Rethink', Christian Aid briefing, 2004, www.epawatch.net
12. European Commission (undated). 'Economic Partnership Agreements: Means and Objectives'.
13. Karl Falkenberg, EU Director for Trade, commented in January 2005 at a meeting of African trade ministers and European Commission staff in Dar Es Salaam that 'There are forces of inertia in each of the African economies – competition is needed. Reciprocity [opening up to EU exports] is supportive of ... development'.
14. 'The policy roots of economic crisis, poverty and inequality', *Structural Adjustment Participatory Review Initiative*, Zed Books, London 2004.
15. *What works? Trade, Policy and Development*, Christian Aid, 2003. Taking Liberties, Christian Aid, 2004.
16. Sustainability Impact Assessment of Trade Negotiations of the EU–ACP Economic Partnership Agreements, Mid-Term Working Draft, October 2003.
17. *Tax revenue and (or) trade liberalization*, Baunsgaard and Keen, September 2004, draft report, IMF Fiscal Affairs Department.
18. European Commission (undated), *Economic Partnership Agreements: Means and Objectives*. Since the start of the first Lomé Convention, the ACP's overall share of the EU market has more than halved.
19. Rob Davies and Kaire Mbuende, 'Beyond the rhetoric of economic partnership agreements: issues to be addressed in EU-ACP negotiations', March 2002.
20. *The Future of the WTO: Addressing institutional challenges in the new millennium*, report by the Consultative Board to the Director-General Supachal Panitchpakdi, WTO, January 2005.
21. For details of what the EU wants to negotiate with ACP countries see 'Why EPAs Need a Rethink', Christian Aid briefing, 2004, www.epawatch.net
22. Developing countries, apart from least-developed countries, are also required to bind at twice their current tariff levels under current NAMA proposals – this deprives these countries of the opportunity to raise these tariffs to useful levels should this become desirable as part of their industrial policy. For this reason, many have criticised the 'round for free' offer on its own terms, as disguising increased market opening commitments from developing countries.
23. UNCTAD, *Swimming in the Spaghetti Bowl: Challenges for developing countries under the new regionalism*, 2004.
24. The EU's Everything But Arms scheme, which is a legal prefer

ence scheme registered under the GATT enabling clause, gives duty-free and quota-free access to ALL existing and potential exports of ALL least-developed countries. All raw sugar, rum and banana exports, however, still face restriction, which will only be phased out by 2009.

25. The EU's expanding web of free trade areas with developing countries, new preferential trade schemes such as the Everything But Arms agreement, and the overall reduction of EU tariffs after each round of multilateral trade negotiations have gradually reduced the advantages African exporters used to have in the European market.
26. African countries such as Namibia, Zimbabwe and Mauritius, which enjoyed a significant margin of preference over other suppliers, were able to diversify their economies based on the special market access they enjoyed over competing suppliers of beef, sugar, textiles and clothing.
27. Most African least-developed countries still prefer to trade with the EU under the Cotonou agreement rather than the Everything But Arms agreement, as the former places far fewer restrictions on the products that qualify for free entry into the EU market.
28. See IDS and Bureau Européen de Recherche, 'EU Agricultural and Fisheries Market Access for Developing and Transition Countries', Sussex, February 2000.
29. European Research Office, 'The ACP guidelines and the EU negotiating mandates: a comparison and commentary', Brussels, 2002. ACP Sustainable Economic Development Department, 'ACP-EU negotiations of EPAs, areas of convergence and divergence', 28 September 2003.
30. UK government, *Making globalisation work for good*, 2000. See *Taking Liberties*, Christian Aid, 2004.
31. This remark was made at a negotiating meeting of the ACP–EU Working Group on Market Access in 2005, and relayed to Christian Aid by a senior official at the Brussels-based ACP Secretariat.
32. ACP Secretariat, 'ACP–EU negotiations of economic partnership agreements: areas of convergence and divergence', Brussels, September 2003.
33. Article 37.8, idem.
34. Based on the 2002 IMF Trade Restrictiveness Index, quoted in Rigged Rules and Double Standards, Oxfam, 2002.
35. *Taking Liberties*, Christian Aid, 2004.
36. For evidence see research presented at an UNCTAD workshop on 'Improving Market Access. Conditions to Promote Export Diversification in Developing Countries', New York, January 2002, cited in Demba Moussa Dembele, *Debt and Destruction in Senegal*, World Development Movement, London, November 2003, *Le Senegal: dans la tourmente des importations agro-alimentanes*, Groupe de Recherche pour une Stratégie Economique Alternative, Brussels 2005 (mimeo), commissioned by Christian Aid.
37. Andrew Pendleton (Christian Aid), interview with Senegalese chicken farmers, January 2003.
38. Although many industrial producers rely on overseas supplies of chicken feed and breeding chicks.
39. Total poultry meat production in Senegal amounted to 24,000 tonnes: 8,000 tonnes produced by the industrial sector, 16,000 tonnes by the small-scale sector.
40. See Benedicte Hermelin, *La politique agricole de l'UEMOA: aspects institutionnels et politiques*, April 2003. Written for FAO Agricultural Policy Support Service, Policy Assistance Division. Also, Farmer organisations of the WAEMU (UEMOA) member countries believe that the common external tariff (CET) has been set at too low a level, and is damaging to their agricultural sectors. The CET was decided before the WAEMU Common Agricultural Policy was put in place, and farmers were not at all involved in the process of deciding at what level to set the tariff. See Bibiane Mbaye Gahamanyi, *State of the EPA negotiations between West Africa and the European Community*, ENDA, Dakar, February 2005, upcoming in ACP–EU Civil Society Information Network newsletter.
41. Chicken meat imports went from 1,137 tonnes in 1999 to 11,950 tonnes in 2003. According to the Poultry Association of Senegal, this figure was closer to 14,000 in 2003, quoted in RADI-Christian Aid framework document *Trade Justice Campaign in Senegal*, 2004.
42. Paul Goodison, European Research Office, *Analysis of EU agricultural and food product exports to Senegal*, September 2004, research commissioned by Christian Aid.
43. Production in the industrial sector alone dropped from 7,007 tonnes in 1999, to 5,982 tonnes in 2003, according to Momar Ndao National President of the Consumer Association of Senegal, quoted in Denis Horman, 'Le Senegal dans la tourmente des Importations agroalimentaires'.
44. Denis Horman, 'Le Senegal dans la tourmente des importations agroalimentataires', Brussels, November 2004, research commissioned by Christian Aid.
45. EUROSTAT figures, 1993–2003, compiled by European Research Office for Christian Aid, 2004.
46. European Research Office calculations using the EUROSTAT database show that imports of wheat flour have increased 74-fold; foods prepared with flour 23-fold; poultry meat seven-fold; and potatoes and onions more than three-fold since 1993. EU exports of food and agricultural products represented 22% of total EU exports to Senegal in 2003, up from an average of 19% for the previous three years.
47. For more detail see Christian Aid, *Taking Liberties*, 2004. The Ghananian programme – especially the trade component – may still be shot down by the World Bank.
48. They assume that developing country governments will prioritise the interests of well-organised protected industry, that trade openness has led to economic growth and increased competitiveness in most countries, and that markets are perfect. None of these assumptions are based on the real experiences of African countries.
49. In 2004, EU tomato processors received €319.3 million in production aid, while poultry producers benefited from lower cereal prices, the result of the shift from price support to direct aid under the CAP reform (unit costs have declined by 25% since the onset of cereal sector reform, given that animal feed in 2002 made up 70% of the cost of poultry production). European Research Office, 'EU imports into Africa 1993–2003', commissioned by Christian Aid, October 2004.
50. By providing an outlet for surplus tomatoes at peak times of the year, the local tomato-processing industry absorbs production gluts, mitigates post-harvest losses and sustains producer prices for fresh tomatoes.
51. In a recent questionnaire, farmers point to the lack of local processing plants and storage facilities as main obstacles for selling their produce at remunerative prices throughout the year. Data from the Statistics, Research and Information Directorate of the Ministry of Food and Agriculture in Ghana reveals that average tomato yield in rain-fed conditions in 2003 was only 7.5 metric tonnes per hectare, 50% below the achievable yield of 15 metric tonnes.
52. 90% of the tomato paste presently consumed in Ghana is imported from the EU. There is only one large-scale processing plant currently operational, in the town of Wenchi, which

exploits only 10% of its production capacity. Due to competition from EU produce, the local processor is struggling to keep production costs low and is therefore unable to pay contracted farmers high enough prices to secure sufficient and uninterrupted supply of raw materials (ISODEC research).

53. A recent survey by Christian Aid partner ISODEC shows that imported brands of tomato paste, such as Salsa and Gino, are preferred because of their strong red colour and sweet taste (due to the high content of additives and carbohydrates, which Ghanaian consumers are not aware of). Local tomato paste on the contrary is fresh, and free of additives but perceived as sour.
54. The Ministry of Agriculture has distributed 60 master processing machines to tomato-producing areas countrywide, each with the capacity to process 200kg of tomatoes per hour. In conjunction with the Food and Agriculture Organisation it is setting up a Processing Promotion Centre for technical support and a tomato processing factory in Techiman. Production is expected to start in June and with a production capacity of two tonnes per hour will be the second-largest processor after the plant in Wenchi. Information obtained from an interview with a senior agriculture officer at the Agricultural Engineering Service Department, December 2004.
55. The term 'diplomatic' refers to the difficulties that the government faces in its attempts thus far to apply tariffs in order to protect local industries. See *Struggling to be heard*, Christian Aid, 2003, and *Taking Liberties*, Christian Aid, 2004.
56. West Africa is becoming an increasingly important market for EU exports of fresh, chilled or frozen poultry meat and edible offal. In 2002, the region accounted for 8% of total EU chicken-part exports, almost eight times higher than in 1996. EU consumption of chicken meat is set to rise by 9% and since the trade with Ghana consists of poultry parts that are a by-product of consumption of the prime cuts in the EU, the availability of poultry parts for exports will increase by 9%. Paul Goodison, European Research Centre, *Analysis of EU agricultural and food product exports to Ghana*, September 2004, research commissioned by Christian Aid.
57. 85% of exported poultry meat from the EU tested unfit for human consumption as it is highly infected with salmonella and other dangerous microbes, according to *Importation massive et incontrolee des poulets congeles en Afrique: le cas du Cameroun*, a report jointly published by Service d' Appui aux Initiatives Locales de Development, and the Citizens Association for the Defense of Collective, 2004.
58. Afarwa Farm in Tema, Ghana, reports having to slaughter 10,000 day-old chicks a week and Pomadze Poultry Enterprise Ltd, one of the leading local hatcheries, collapsed. Production in the remaining 11 hatcheries is currently using an average of 38% of total production capacity.
59. Because feed alone forms 70–80% of the total cost of production, local producers cannot increase their price competitiveness through expanding production in a cost-efficient way, which can only be done if access to cheaper fodder is available or feed inputs are provided by the government.
60. See GAWU DHS, CIECA, ABEID, GRAPAD, *New ACP-EU trade arrangements: new barriers to eradicating poverty?*, Eurostep, Brussels, March 2004; UK DFID and government of Ghana, *Ghana Trade Policy Project – Assessment of the Competitiveness of Local Agriculture and Industrial Protection*, March 2002.
61. The Ghanaian Minister of Finance included in the 2003–04 budget an increase in the tariff on poultry meat from 20 to 45%, but under threats from the IMF to withhold future loan disbursements the new tariff line was not applied in practice, although it remained in the statute books. See *Struggling to be heard*, Christian Aid, 2003 and *Taking Liberties*, Christian Aid, 2004.
62. It is important to note that this 80% tariff is well within the rates allowed under the WTO. Ghana's bound agricultural tariff is at 125%, to be reduced to 99% over a ten-year period.
63. See *The National Farmers' Day In Perspective*, GNA, 11 May 2003.www.ghanaweb.com/GhanaHomePage/features/artikel.php?ID=46124
64. Ministry of Food and Agriculture warns about the lack of an entrenched legislative framework, through which trade and agricultural policies can be directed. This is reflected in *ad hoc* and inconsistent policies that weaken the ability of stakeholders to make long-term plans and commitments. Policies are also changed when it is considered politically expedient to do so, such as in the recent example of the attempted and failed increase of the import tariff on poultry. A legislative framework is essential in order for policies to be carried out effectively.
65. Companies in Africa face a range of obstacles such as small market outlets, lack of information, technical skill shortages, absence of suppliers, and poor support institutions.
66. This can be seen in the impact which the rolling out of the new CAP instruments in new EU member states is having on production. The latest European Commission 'Prospects for EU Agricultural Markets' survey shows the following estimated expansion of cereal production in EU member states between 2002 and 2011: 12.8% for wheat, 12% for soft wheat, 6.1% for maize, 15.4% for pig meat production and 37.2% for poultry meat production. If the rolling out of EU CAP programmes to new member states were genuinely non-distorting then such dramatic increases in production would not take place.
67. For an in-depth analysis of cereal price trends in Europe and the impact of lower EU cereal prices on the poultry, pig meat, flour and processed food and drinks industry and exports, see Technical Centre for Agricultural and Rural Cooperation, ACP–EU, Cereals executive brief, August 2004.
68. Mozambique produces only 100 tonnes of wheat a year and consumes more than 200,000 tonnes. Consumption demand is met through commercial imports from the EU, USA and South Africa, as well as through donations sold at world market prices to the domestic milling industry.
69. Exclusive of Mozal (the big aluminium plant in Mozambique) food, beverages and tobacco production accounts for 75–80% of the total value of industrial output, 19% of which is attributed to the milling industry and its production of wheat flour. Instituto Nacional de Estatisrica, Mocambique, *Statistical Yearbook, Anuario Estatistico*, 2003.
70. The industry accounted for 19% of the total value of Mozambique's industrial output in 2003 and had a 13% annual growth between 2002 and 2003. It encompassed 781 mills in 2003, and employed a total of 3,229 people in 2002. The three biggest mills involved in the production of wheat flour accounted for 30% of the total workforce within the milling sector.
71. The construction of the plant will be finished in April 2005. The total project cost is $4.95 million, for which the World Bank provided an investment guarantee facility of $2.5 million.
72. In 2003, imported wheat flour from the EU was less than one tonne but just ten years earlier, prior to the development of Mozambique's domestic milling capacity, these imports were as high as 32,245 tonnes. Source: European Research Centre, *Scoping study*, commissioned by Christian Aid, 2004. 'It is possible to get flour from Holland and Belgium at a cost including freight (CIF) price cheaper than the CIF price of imported, high quality hard wheat from the USA that is utilized in the largest cereal milling plants in Mozambique', National Assessment Study of an EPA between Mozambique and the EU, NAS. Carlos

Nuno Castel-Branco, Michael Davenport, Leonardo Iacovone, José Sulemane, Main Report, Final Version 03, 31 August 2004, p. 72.

73. The EU has lost major markets in the Middle East as local mills have been set up according to local tastes and demands. This has led to a 40% downsizing in milling capacities in France, similarly in Italy, thus prompting EU producers to fall back on African, particularly West African, markets. One day's supply from a Rotterdam mill is virtually the national demand in Mozambique for a whole year, therefore even one shipload could severely disrupt the local market – particularly since the EU has just re-inforced export refunds for wheat exports of two million tonnes to help clear the market in the face of a large crop production. Paul Goodison, European Research Centre, *Recent trends in the EU milling industry*, February 2005.
74. Ibid. This report was commissioned by the Mozambican Ministry of Industry and Trade to assess the possible impacts of the establishment of an EPA with the European Union. The study was undertaken by Carlos Nuno Castel-Branco, DPhil, (team leader and development economist), José Sulemane, DPhil, (macro-economist, fiscal analyst), Michael Davenport, DPhil (trade specialist) and Leonardo Iacovone, MSc (trade specialist).
75. Economic Commission for Africa, 2004 Trade and Regional Intergration Division of the World Bank, 'Economic and Welfare Impacts of the EU-Africa Economic Partnership Agreement'.
76. According to the 2002 *Least Developed Country Report* published by UNCTAD, the traditional commodities of LDCs 'are concentrated in sectors within which world demand is either slower than average or declining'.
77. Quoted from research commissioned by the Economic Justice Network of FOCCISA and Christian Aid, *Women and cotton production in Mozambique*, November 2004, soon to be published.
78. Most East Asian economies used infant industry protection, export subsidies and targets, credit allocation and direction, and local content rules to build their industrial base. Amsden, *Asia's next giant*, Oxford University Press, 1989; Joseph Stiglitz, 'Some lessons from the East Asian Miracle', *The World Bank Research Observer*, 1996; Robert Wade, *Governing the market*, Princeton University Press, 1990; L Westphal, *Technology strategies for economic development in a fast changing global economy*, Economics of Innovation and New Technology, 2002; World Bank, *The East Asian miracle*, Oxford University Press, 1993; Sanjaya Lall, *Reinventing industrial strategy: The role of government policy in building industrial competitiveness*, TIPS, Johannesburg, June 2004.
79. Zedillo Commission, Executive Summary, 2001, pp. 9–10.
80. It took the South African government four years of hard and dedicated negotiating, thorough research and good coordination with industries and labour unions, to get a more favourable trade deal with the EU. This amount of time, institutional development and resources are not available to the Mozambican government.
81. Jaime de Melo and Arvind Panagariya, MP, eds, *New dimensions in regional integration*, Cambridge University Press, 1993; Maurice Schiff and Alan Winters [SW], *Regional integration and development*, World Bank and Oxford University Press, 2003; Manuel de Ia Rocha, 'The Cotonou Agreement and its implications for the regional trade agenda in eastern and southern Africa', World Bank Policy Research Working Paper, June 2003.
82. The European Union has been a valuable development partner for many African regional groupings almost since their inception. The European Commission and bilateral EU donors have for many years supported regional integration schemes in Africa, mostly through making funds available for regional transport and communications, as well as other development programmes and the operating costs of regional secretariats.
83. *Global Economic Prospects*, World Bank 2005.
84. Keith Jefferies, Botswana Institute of Development Policy, 'EU-SA Trade Development and Cooperation Agreement: options for industry restructuring', paper for workshop in EU-SA TDCA Agreement, Gaborone, Botswana, July 1999.
85. 'Information Note to the College from Commissioners Lamy and Nielson on Progress in EPA negotiations', European Commission, Brussels, 21 October 2004.
86. Ambassador Vijay S. Makhan, Assistant Secretary General of the OAU, 'The EU has effectively used its trump card of being the provider of development finance for ACP cooperation to secure acceptance of its negotiating position', *Africa Agenda*, Vol.3, No.3, 2000.
87. A five-point roadmap for ECOWAS was already adopted at the trade and finance ministers' meeting in Accra in November 2003. However, after prolonged discussions and under EC pressure the roadmap had to be amended at a Ministers' meeting in August 2004.
88. 'Negotiating economic partnership agreements between African sub-regions and the EU', note prepared for the African Trade ministerial meeting organised by the African Union in Kigali, 24-28 May, 2004. See www.acp-eu-trade.org/documents/ILEAP%2014-05 04%20Paper%20for%20Kigali%20on%20%20EPA.pdf
89. For instance, at the Regional Negotiating Forum I, II, Ill of East and Southern Africa (ESA) held in April, July and October 2004.
90. UNECA has developed impact assessments that are not sector-specific and dynamic but based on welfare estimates from economic models. The Project and Management Unit established by the ACP Secretariat and the EC is supposed to facilitate studies aimed at helping trade negotiators formulate their negotiating position. However these studies funded by the EC are available exclusively to national governments and not non-state actors who are part of the national negotiating forum.
91. Richard Kamidza 'Non-state actors' participation in the ESA configuration', Southern & Eastern African Trade Information and Negotiation Institute, 2004, www.seatini.org
92. Observations of the Southern & Eastern African Trade Information and Negotiation Institute (SEATINI), currently the only civic body participating at regional level in the ESA–EU negotiations. See 'Non-state actors participation in ESA' at www.seatini.org/publications/articles/2004/esa-epa.htm
93. Richard Kamidza 'Non-state actors' participation in the ESA configuration', SEATINI, 2004, www.seatini.org
94. The Integrated Framework for Trade-Related Technical assistance to Least Developed Countries inaugurated by six multilateral institutions (IMF, ITC, UNCTAD, UNDP, World Bank and the WTO) and to which DFID is a contributing donor.
95. Peter Aoga, *EcoNewsAfrica*, 'Development support from the EU is one of the most important motivating factors for ESA countries to negotiate an EPA, especially for those classified as LDC', reporting from the second Regional Negotiating Forum of ESA held in July 2004 in Uganda. Views expressed during unstructured interviews with various African ambassadors and trade officials at their respective permanent missions in Brussels, October 2004.
96. Directives for the negotiations of Economic Partnership Agreements with ACP countries and region, 9930/02 Annex I, DG E II, section on Complementarities, p 14.
97. Rob Davies and Kaire Mbuende, op.cit.
98. World Bank, *African Development Indicators*, 2004.

99. *Malawi Economic Report 2003*, Ministry of Economic Planning and Development; SUCOMA Annual Financial Statements, 2004.
100. The sugar industry is an important supplier of inputs to the beverage, biscuits and confectionery industries and other downstream economic activities, such as trading and transportation. At the same time the industry itself is a significant consumer of electricity, postal, telephone and bank services and other upstream business activities supported by its operations.
101. According to its 2004 annual report, SUCOMA carried out comprehensive rehabilitation and capacity expansion programmes for its two mills at Nchalo and Dwangwa. In addition, the company adopted improved farming methods and other agricultural practices with the objective of improving productivity and quality of production. SUCOMA annual financial statements, 2004.
102. The 60% compensation is not the end of the story. EU producers will also pay a lower levy on their sugar produce as the price for this produce becomes lower. With EU prices nearly 200 euros lower, the levy paid by farmers will be about €16 per tonne less, which translates in an effective compensation of farmers of 68%. http://www.euractiv.com/Article?tcmuri=tcm:29-128646-16&type=News
103. At a meeting of the ACP Ministers responsible for sugar with the EU Agriculture Council on 24 January, 2005 Trade Commissioner Mandelson emphasised the centrality of EPAs and expressed the idea that the Sugar Protocol would be integrated into the EPAs in a way that ensures full compatibility with WTO rules on regional trade agreements. However, the ACP position is that the Sugar Protocol, because it is already a WTO-legal agreement, cannot be integrated into the EPAs and moreover, any negotiations that involve the Sugar Protocol should be on an all-ACP basis and not subsumed by regional EPA negotiations.
104. Officials from the affected countries have expressed their concerns on numerous occasions. See: the ACP submission on the EC communication of 14 July, 2004 concerning the reform of the EU sugar regime. www.acpsec.org/InternalSheet.aspx?ArticleFileName=2004/sugardeclaration en.html&sessLang=1 and the 6 October 2004 press release following the ACP workshop on sugar reformwww.acpsugar.org/finalacppressrelease 2.doc as well as statements made by the LDC ministerial spokesperson at the EU Agriculture Council Meeting with the ACP ministers responsible for sugar, 24 January 2005, Justus Lipsius Building, Brussels, see www.acpsugar.org/24ldcspokesman.doc
105. The request was put forward by an LDC ministerial spokesperson at the EU Agriculture Council Meeting with the ACP Ministers responsible for sugar, 24 January, 2005, Justus Lipsius Building, Brussels. See speech at www.acpsugar.org/24ldcspokesman.doc See also LDC proposal regarding the adaptation of the EBA initiative in relation to sugar at www.sugartraders.co.uk/proposal0304.pdf
106. The EC committed itself to 'supporting the process of adaptation in the countries affected by EU sugar-sector reform' in response to oral questions submitted in the context of the ACP–EU Joint Parliamentary Assembly meeting in the Hague in November 2004. Two months later, ACP and LDC Ministers were presented with the EC's 'action plan' (at a meeting held on 24 January 2005 in Justus Lipsius Building, Brussels). Claiming to be setting out plans for countries that will suffer as a result of the sugar price cuts, this action plan does not offer compensation, only to respond to 'specific requests' on the basis of 'the actual needs of the countries concerned'.
107. While the EC has committed the EU to providing funds for ACP sugar restructuring through the EU budget, no financial provision has been made for this support in the 2005 EU annual budget. So 2006 would be the first year in which such funds would become available. However, as it takes a considerable amount of time to set up the administrative arrangements for European-based management of these funds, unless alternative provision is made in parallel with the budget debate it is likely to be mid-to-late 2007 before such funds actually become available in ACP countries.
108. However, lessons learned from the reform of the Banana Protocol and consequent financing of various adjustment programmes show that a genuine commitment in the country to undergo economic diversification is paramount to its success. 'Beyond EU Sugar Reform: Financing Diversification in ACP Sugar Exporting Countries', Trade Hot Topics, Commonwealth, Issue 39, see www.thecommonwealth.org/shared asp files/uploadedfiles/{CE4AE9A2-1164-4111-A678-B433EC42E1D5} trade%20hot%20topics%2039.pdf
109. J. Stiglitz, *An agenda for the development round of trade negotiations in the aftermath of Cancun*, Commonwealth Secretariat, 2004.
110. Paragraph 44, Doha Ministeral Declaration, WTO, 2001.
111. WTO understanding on interpretation of Article XXIV of GATT, 1994.
112. EC, *Economic Partnership Agreements: Means and Objectives*. Undated. Cites South Africa's agreement to liberalise 86% of EU originating imports over 12 years.
113. Paragraph 29, Doha Ministerial Declaration, WTO, 2001.
114. WTO, ACP submission on regional trade agreements call for flexibility in meeting 'substantially all trade' requirements and that the transition period be consistent with 'trade, development and financial situation' and not less than 18 years, April 2004.
115. UNCTAD, *World Investment Report*, 1998 and 2002.
116. Ibid.
117. Such an approach is entirely consistent with the principles of SDT and the rules of the WTO. A successful challenge to the EU's system of preferences by India established in WTO case law that it is possible to differentiate treatment of developing countries based on objective and transparent criteria. Systems for identifying such criteria and to manage graduation out of special treatment as they progressively develop, already exist and could be developed further at the WTO. The idea of EPA benchmarks has been explored by some ACP member states and researched by African academics. Tekere and Goodison, 'Rethinking the negotiations: linking poverty eradication and free trade', Harare and Brussels, 1999.
118. Sugar, bananas and rice exports will only enjoy free access to the EU market from 2009 onwards.
119. See also Page & Kleen, *Special and Differential Treatment of Developing Countries in the World Trade Organization*, (ODI 2001), which suggests that introducing a system of notification of schemes to the WTO, so that these could be subject to the WTO's enforcement mechanisms, as well as clarifying through legal judgement the obligations on transparency and non-discrimination.
120. UNCTAD, *Improving Market Access for LDCs*, 2001.
121. Such benchmarks are already contained in the ACP countries' proposal for a so-called EPA-lite, which will place emphasis on building regional markets and developing production capacity to serve enlarged regional markets *prior* to the establishment of any substantive tariff elimination commitments *vis-à-vis* the EU. A special and differential treatment clause in Article 24 should make this possible.

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8

Preference-dependent Economies in the Doha Round: Impacts and Options

Roman Grynberg and Sacha Silva

Introduction

Since their emergence in the late 1960s, preferential market access schemes for developing countries have significantly impacted global trade and investment decisions in both developed and developing countries. Barriers to global free trade create distortions, and distortions create both costs and benefits. The benefits of trade preferences have accrued not only to the markets that they protect, but also to a small but significant number of developing countries whose economies have become dependent on preferential access.

When these preferences are eroded, the balance of winners and losers is reversed. Commitments from both the previous Uruguay Round and the ongoing Doha Round negotiations threaten to reduce the value of preferential access in the short, medium and longer term. Preference-dependent economies unable to compete in a liberalised market may see significant losses in production, revenue and employment. Given the combination of high poverty levels, small domestic markets, and vulnerable export sectors in many of these economies, many are unlikely to be able to finance the necessary adjustment by themselves. The scale of the shock implies that preference-dependent economies may incur net losses from multilateral liberalisation.

The launch of the Doha Round of trade negotiations has been predicated on the assumption that developing countries' needs would be explicitly incorporated into the negotiating agenda, and any agreements reached would reflect the true costs and benefits of integrating developing countries into the global trading system. Net losses from multilateral liberalisation may lead to further marginalisation of preference-dependent economies and has led to scepticism over the net benefit of agreeing to subsequent reductions in global trade barriers.

This paper aims to assess both the impact of multilateral liberalisation on preference-dependent economies and policy options to assist them. First we outline the theoretical approach of this chapter. Then potential losses from preference erosion are estimated. We consider these losses in the development and Doha context, and outline a policy framework to assist preference-dependent economies in adjusting to multilateral liberalisation.

A typology of economic loss

Economic loss is by nature a multi-layered phenomenon. The losses that interest economists and academics may differ substantially from those which preoccupy policymakers and governments. Yet any estimation is significantly constrained by the limitations of economic forecasting. To complicate matters, the so-called 'Quad' countries (European Union, United States, Canada and Japan) currently administer a large number of overlapping preferential regimes, all with different numbers of beneficiaries, numbers of commodities covered, and values of the concessions provided. Furthermore, there is significant disagreement over models, methodologies and estimates. These caveats will be discussed below.

Any estimate will be highly sensitive to initial assumptions. Yet a sufficiently rich representation of the *status quo* compared with a range of probable outcomes can allow an appreciation of future resource needs. This paper will focus on two types of loss which can be reasonably estimated *a priori*: 'incentive loss' (quota rents) and 'competitive loss' (revenues).

Quota rent/income transfers

In sensitive Quad sectors, several instruments act to provide a price cushion above world price for

domestic producers: (a) high tariffs; (b) quantitative restrictions on imports (quotas); and (c) producer support measures such as export subsidies and price support. These instruments result in a price premium in the domestic market, which can be partially or wholly captured by preferred producers. The profits derived from trading goods subject to quotas (and therefore artificially scarce) are known as quota rents.

Since quota rents represent returns in excess of those provided by the market in the absence of quotas, they also represent income transfers from consumers or government treasuries to quota beneficiaries.[1] This income transfer can be conceptualised as the tariff revenue foregone by donor countries to producers in exporting countries. Any country given preferential access to a highly protected market can gain a price premium over the normal rate of return that is required to encourage investment in the domestic economy, thus generating a powerful incentive to allocate resources to that sector (Brenton and Ikezuki, 2004a).[2] Where such allocation would occur in the absence of preferences, then the removal of the quota rent incentive may have little economic impact. However, where quota rents have been concentrating resources in uncompetitive sectors, a loss in income transfer may reduce the investment incentive for that country or that sector. This is the first aspect of economic 'loss'.

Revenues

Reductions in protection (quota abolition, tariff reduction, etc.) often enhance market access for competitive suppliers. If these suppliers respond rationally to that enhanced access (and are not restrained by new protection) there will undoubtedly be changes in relative prices, supply patterns and export revenues. High-cost producers who lose market share to more competitive suppliers may potentially suffer losses in output, employment and export revenues. These losses are often several orders of magnitude larger than the initial losses in quota rents. These losses can in turn negatively affect internal and external balances where the sector in question is a primary source of foreign exchange. This is the second aspect of economic 'loss'.

Models, scenarios and methodological caveats

Tables 1 and 2 show that for most products traded on world markets, standard tariff rates are relatively low, yet a simple average hides a wide dispersion where many products have very high tariff rates (so-called 'tariff peak' products). This paper will focus on preferences in agriculture (sugar, bananas, beef) and textiles and clothing as these products have some of the most lucrative preferential margins for preferred exporters.

Table 1. Effective ad-valorem tariff equivalents on bilateral trade flows

	Exporters			
Importers	**Least developed countries**	**Other low-income countries**	**Middle-income countries**	**All developing countries**
		Total trade		
Canada	6.7	5.4	4.4	4.4
European Union	2.8	7.0	10.3	7.2
Japan	4.9	6.4	4.5	4.7
United States	13.6	6.2	3.6	4.5
Other OECD	8.7	13.1	10.4	10.2
		Trade in agriculture		
Canada	3.4	18.7	16.3	17.5
European Union	7.6	13.4	24.8	20.0
Japan	29.1	16.3	21.2	21.9
United States	28.1	9.5	13	12.7
Other OECD	19.6	28.0	35.4	32.5

Source: IMF and World Bank (2002)

Table 2. Import-weighted tariffs in the US and EU (%)

	EU	US
Textiles	9.1	11.2
Clothing	11.9	13.3
Other Manufactures	3.6	2.8

Source: IMF and World Bank (2002)

A crucial modelling decision involves choosing between a partial equilibrium versus a general equilibrium framework. Generally, inter-sectoral linkages (such as cross-price elasticities) are ignored in the former, whereas they are explicitly included in the latter. The partial equilibrium setting focuses on particular sectors, without accounting for price and resource allocation changes elsewhere in the economy. The computable general equilibrium (CGE) framework allows the modelling of inter-sectoral reallocation of resources associated with changes in model variables, and the effects on the input–output structure of the economy. However, the onerous data requirements of CGE modelling means that country specificity is limited to a small number of large economies for which reliable data is publicly available.

Agriculture

For the agricultural sector, this paper uses UNCTAD's Agriculture Trade Policy Simulation Model (ATPSM); a deterministic, comparative static, partial equilibrium model. As such it is limited to the agricultural sector yet contains data for a large number of countries.[3] The calculation of quota rents considers the tariff rate quotas (TRQs) for agricultural goods introduced in the Uruguay Round Agreement on Agriculture (URAA). The three instruments of a TRQ are the in-quota rate (the preferential tariff paid by beneficiary producers), the out-quota rate (for imports exceeding the quota), and the actual level of the quota itself (see Figure 1).[4]

Three different scenarios are modelled:

- **Ambitious:** A complete elimination of export subsidies and domestic support and an across-the-board reduction in bound MFN tariffs with a 'Swiss' coefficient of 25. The Swiss formula is designed to eliminate tariff peaks and tariff escalation by making proportionately higher cuts for higher tariff levels.[5]
- **Harbinson:** The 'Chairman's Text'[6] proposal tabled in February 2003 calls for a complex formula to reduce bound tariff rates according to developed/developing country status (for developed countries the middle range is between 15 and 90 per cent with the lower and upper bounds lying on either side; for developing countries the middle range is 20 to 120 per cent).
- **Conservative:** A Uruguay Round-type outcome with developed countries implementing 36 per cent reductions in out-quota tariffs, 45% cuts in export subsidies, and 55% cuts in domestic support. Developing countries implement two-thirds of these reductions and the least developing countries implement none.

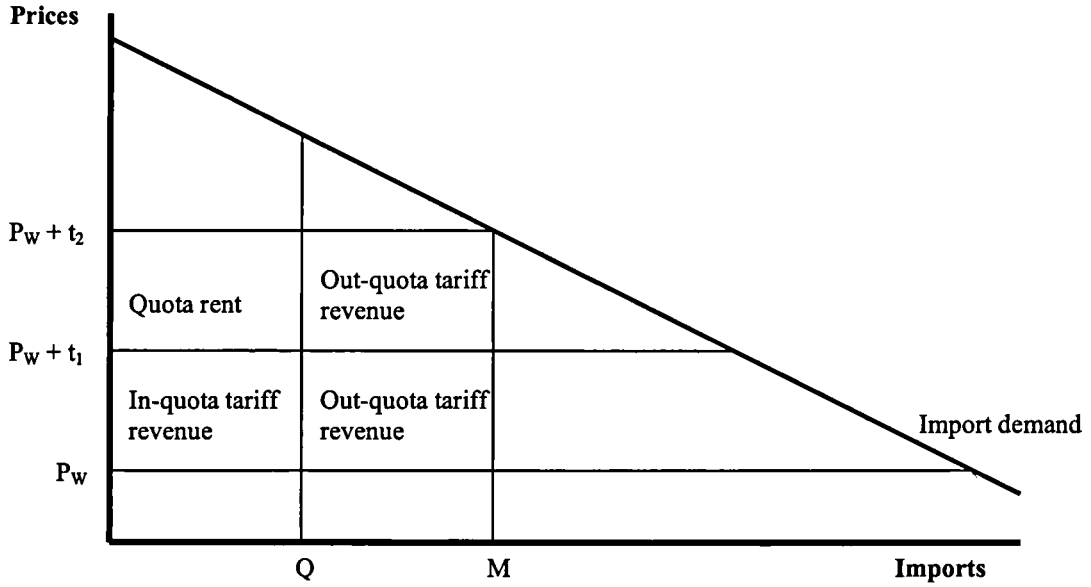
Textiles and clothing

In textiles and clothing, this chapter summarises a number of findings which use the Global Trade Analysis Project (GTAP)[7] model; a comparative static, global general equilibrium model based on neoclassical theory. To determine price premiums for individual exporting countries in various importing markets, import demand curves need to be derived reflecting the 'Armington' assumption of heterogeneous goods distinguished by country of origin. Given the detailed country-level data required, the GTAP model includes only a limited number of developing-country exporters.

It is important to note that the textile/clothing (T&C) quotas do not rely on two-tariff TRQs and that the T&C sector lacks the dominating factor of domestic support measures such as export subsidies, which further depress world prices. Thus determining price premiums in the various markets is not as straightforward as calculating the price effects of in- and out-quota tariffs as in agriculture. In the existing literature, the quota rents arising from the MFA have been conceptualised as an export tax equivalent (ETE):

> *The presence of a quota of a certain size provides no clear indication as to whether exports are being restricted by a large or a small amount.* MFA *quotas*

Figure 1. Quota Rents with binding out-quota tariff



Source: Vanzetti and Graham (2002)

are administered by exporters, and hence the value of the scarce quotas accrues to those exporters who hold the quotas. In order to export apparel or textile goods subject to quota, exporters must either buy quotas for these goods, or pass up the opportunity of selling quotas they already hold. For many purposes, it is useful to think of an export quota as being effectively the same as an export tax in its restrictive impact on exports. The price of a quota per unit of exports is then equivalent in its impact to an export tax of the same magnitude. If we divide the quota price by the value of the good in the absence of quotas, we obtain a measure of the quota rent in proportion to the value of the export (Khaturia et al., 2001).[8]

The ETE indicates the quota premium as a percentage of the unit value of exports excluding the premium, i.e. the value of the quota divided by the price received by a producer who does not own the quota license. The estimates of Agreement on Textiles and Clothing (ATC) quota rents (and hence of the corresponding export tax equivalent rates) are based on estimates by Francois and Spinanger (2000) included in the GTAP database. The scenarios themselves vary by study. Most studies model the ATC quota phase-out in addition to a steep reduction in tariffs in textiles and clothing.

Caveats

The question of whether preferred exporters capture the full value of preferences – and how multilateral liberalisation may or may not impact supply decisions in rent-based industries – is subject to several theoretical caveats.

First, there is the question of whether underused preferential arrangements generate significant transfers to preferred exporters. The use of preferential schemes varies and can be significantly less than 100%. In the agricultural context, for example, rent generation depends on which of the three TRQ instruments (quota levels and in-/out-quota rates) is considered binding (formulation from Vanzetti and Graham. 2002).[9] Ideally, the import quota fill rate (i.e. reflecting use) should determine the domestic price. If the quota is unfilled, domestic prices should be determined by in-quota tariffs, and prices should be high only if the quota is filled or overfilled. However, in practice there is an intermediate case: quotas are unfilled but domestic prices are high in the relevant importing market. Thus ATPSM assumes that quotas are filled, either explicitly (i.e. global quotas do not exceed imports) or through administrative constraints. This implies that in the model the applied tariff or out-of-quota tariffs, rather than the in-quota tariff, drives the domestic

prices. This further implies that changes in in-quota tariffs do not have price and quantity effects, as these instruments are not binding. (They do, however, change the distribution of rents.)

Second, quota rents are in theory distributed between the different economic agents in the supply chain – exporters, processors, taxpayers, consumers and governments. Much depends on the relative bargaining power (and market position) of the various agents. If a small number of potential supplying countries receive the preference – especially if importers cannot switch imports between preferred states, or do not wish to in order to maintain high domestic prices – then a higher share of the quota rents accrues to beneficiary exporters (Stevens and Kennan, 2003).[10] If there is considerable rent-seeking activities or inefficient quota administration, then a share may accrue to governments. The form in which quota shares are allotted – whether through auction, or on the basis of historical trade flows – further affects the distribution of quota rents.

Estimated losses in the agricultural sector

Income transfers

The ATPSM model yields substantial annual losses in income transfers for preferred exporters of the three major preferential goods – sugar, bananas and beef (Table 3). In the 'Ambitious' scenario, losses total US$402 million. For sugar producers, the estimated annual losses range from $172 million to $288 million; for banana producers, the estimated annual losses range from $8 million to $35 million; and for beef producers, the estimated annual losses range from $0.41 million to $78 million.[11] Total welfare losses total $318 million among the most dependent economies.[12] The aggregate losses of income transfers and welfare in the 'Harbinson' and 'Conservative' scenarios are, respectively, 75% and 47% of the 'Ambitious' scenario.

By way of comparison, several studies have estimated income transfer losses in the sugar sector. Milner et al (2003) considers a 'Current WTO Case' scenario (reduction of EU subsidised exports according to Uruguay Round commitments) and a 'Full OECD Liberalisation' scenario (removal of all OECD export subsidies and protection of domestic production). Milner's high-case total annual loss of income transfer ($297 million) is broadly comparable to the ATPSM high-case scenario ($288 million).

Export revenues

A staff paper of the Commission of the European Communities (CEC, 2003) concludes that the range of annual export revenue losses lies within the €150–350 million range. LMC International (2004) considers the costs of sugar production in ACP countries relative to feasible price movements in the EU market.[13] The LMC study concludes that under a 'Price Cut' scenario[14] sugar production will disappear entirely in several ACP countries. The resulting losses in annual export revenues (Table 4) are estimated at €719 million, with only five countries earning above €15 million annually.

Estimated losses in the textiles and clothing sector

Income transfers

Table 5 lists a number of countries for whom the quota rent/income transfer in the T&C sector is a substantial proportion of merchandise export revenues. The annual income transfer of $1.32 billion is nearly three times that of the agriculture case, reflecting the relatively higher value of trade flows in T&C. The list is considerably shorter than the agricultural list. This is primarily due to its focus on quota rents deemed at risk of being phased out, partially or wholly, over the medium term. In Table 5, this is denoted in the final two columns as TBA (To Be Abolished). The list of T&C preference-dependent economies includes significant ATC suppliers such as Bangladesh, Sri Lanka, Pakistan and Mauritius.[15] Several African countries such as Lesotho and Madagascar are also excluded as (a) they were not previously subject to ATC quotas; (b) they are both eligible for the EU's Everything But Arms (EBA) agreement; and (c) they are eligible for liberal global sourcing rules of origin under the African Growth and Opportunity Act (AGOA).

When the ATC textile and clothing quotas are dismantled, the quota rents listed in Table 5 will disappear completely. For the major T&C preference-

Table 3. Changes in annual income transfers and welfare – 'Ambitious' scenario (all figures in US$ unless otherwise stated)

	Change in income transfer					Change in welfare
	Total	of which: beef	of which: bananas	of which: sugar	As % of value of agricultural exports	
Fiji	−72,423,863	−146	144	−72,423,862	−46.8	−62,962,159
Mauritius	−97,656,428	−4	156	−97,656,580	−39.6	−87,952,867
Congo	−5,012,265	0	3,388	−5,015,652	−33.3	−5,422,350
Botswana	−40,950,190	−40,939,747	−758	−9,684	−29.2	−31,668,836
St. Lucia	−5,857,891	0	−5,857,891	0	−23.0	−5,729,651
Guyana	−33,810,466	16,720	943	−33,828,128	−22.3	−29,802,679
Namibia	−36,472,346	−36,472,346	0	0	−21.8	−22,193,902
Barbados	−12,548,562	−61	0	−12,548,501	−21.6	−11,606,598
Jamaica	−43,041,144	0	−4,112,577	−38,928,567	−17.8	−40,677,038
Belize	−18,582,235	−6,051	−3,314,849	−15,261,334	−17.1	−16,033,295
Dominica	−2,146,916	0	−2,146,916	0	−13.1	−2,052,398
St. Vincent	−2,980,128	0	−2,980,128	0	−10.9	−2,916,459
Swaziland	−6,837,898	−829,433	−46,727	−5,961,737	−4.8	19,972,082
Suriname	−2,220,770	0	−2,220,770	0	−4.6	−2,476,196
Cameroon	−10,116,363	−1,270	−10,106,860	−8,234	−2.8	−9,783,160
Mozambique	−818,426	0	2,164	−820,590	−2.1	−2,592,029
Dominican Rep.	−10,663,246	0	−4,219,969	−6,443,277	−2.0	−4,764,241
Total/Average	−402,139,137	−78,232,338	−35,000,650	−288,906,146	−18.4%	−318,661,777

Source: ATPSM database simulations

Table 4. Impact of 'Price Cut' scenario on ACP sugar industry

	Change in production (%)	Change in export earnings (millions €)
Barbados	−100	−32
Belize	−100	−35
Congo, Rep	0	−8
Cote d'Ivoire	−100	−13
Fiji	0	−61
Guyana	0	−33
Jamaica	−100	−73
Madagascar	−100	−12
Malawi	−19	−12
Mauritius	−100	−291
St Kitts	−100	−11
Swaziland	−20	−47
Trinidad	−100	−30
United Republic of Tanzania	−3	−16
Zambia	−14	−14
Zimbabwe	−28	−31
Average/Total	−55	−719

Source: LMC International (2004); Figures assume no changes in cost structure

dependent economies who will not have compensating duty-free access to the EU or US markets under another preferential regime, the total annual losses in income transfers total approximately $1.32 billion.

scarce as most studies aim to report results at regional or global aggregates; a limited number of these countries are included as separate regions in GTAP. The results for studies on Bangladesh, Sri Lanka and Pakistan are summarised in Table 7.

Table 5. Annual quota rents (million US$) as percentage of merchandise exports (MXR, M US$)

	Annual quota rents	Total (MXR)	Quota rents (% of MXR)	Market access	
				US	EU
Cambodia	78	1,295	6.03	TBA	EBA
Bangladesh	480	5,495	8.74	TBA	EBA
Pakistan	467	9,170	5.10	TBA	TBA
Sri Lanka	218	4,327	5.04	TBA	TBA
Mauritius	76	1,448	5.22	AGOA	EBA
Total	1,319	21,735			

Source: Secretariat estimates based on GTAP studies.
TBA = Quota access to be abolished

Export revenues

After multiple extensions of the MFA, there have been a number of phases in which successive tranches of imports have been integrated into WTO norms. The ultimate impact of the MFA phase-out has been foreshadowed by competitive supply shifts leading up to the 2005 deadline. The Phase III experience is summarised in Table 6. The results show growing supplier concentration in China and India, largely at the expense of preference-dependent suppliers in South and South-East Asia.

The vast majority of the post-ATC studies have been undertaken using the GTAP model. Data for T&C preference-dependent economies is often

Bangladesh: Many studies conclude that Bangladesh is not sufficiently competitive to maintain its share in a quota-free market after 2004. Mlachila and Yang (2004) find the largest estimated losses in the GTAP studies.[16] In their baseline 'central elasticities' scenario,[17] losses in export revenues of –17.7% in the clothing sector and –4.7% in the textiles sector, translating to respectively $1.9 billion and $100 million in 1997 prices. Using recent export revenue data from the ITC,[18] these percentages translate into losses of $892 million in the clothing sector and $20 million in the textiles sector.

Losses in gross domestic product (GDP) (–2.3%) and employment (–4.5%) are also quite consider-

Table 6. Selected countries' exports of textiles and clothing to the United States and EU (Products liberalised in Phase III of ATC, percentage changes Jan–Sept 2001 vs Jan–Sept 2003)

	Exports to the US			Exports to the EU	
Origin	Change in value (US$)	Change in volume	Origin	Change in value (€)	Change in volume
China	193.6	652.6	China	90.8	377.1
Pakistan	13.2	27.7	India	–12.5	–9.5
India	12.2	1.8	Sri Lanka	–21.6	–0.6
Cambodia	–43.2	–31.1	Bangladesh	–41.2	–8.4
Bangladesh	–43.6	–41.9	Thailand	–44.8	–26.9
Sri Lanka	–57.9	–64.5	Vietnam	–49	6.6

Source: IMF (2004)

able. The authors also report a 'higher elasticities' scenario (double the central elasticities), with a near-doubling of the corresponding losses. Lips et al. (2003) find smaller output changes (–11% in clothing, and an increase of 1% in textiles) in both a base case (ATC elimination) and a WTO scenario (ATC elimination plus reduction in T&C tariffs), although welfare losses are substantial (up to $425 million in the WTO scenario). Spinanger (2003) finds much milder effects (–7.9% in clothing, +15% in textiles) with a negligible effect on GDP.

Sri Lanka: The GTAP studies on Sri Lanka provide a fairly mixed picture. Francois and Spinanger (2001) use GTAP to model the elimination of Chinese ATC quotas on T&C, and find negligible effects on textiles but a strong (–6.5%) impact on clothing which, assuming recent export revenue data from the ITC, translate into losses of $162 million. The authors also finds a correspondingly sharp fall (–$452 million in 1995 prices) in welfare. Lips et al (2003) find negligible output changes (–2.4% in clothing, and an increase of 12.7% in textiles) with welfare losses of –$228 million in their base case scenario; results are much more favourable for the WTO scenario.

Pakistan: Martin et al (2004) use GTAP to model the effects on Pakistan of abolition of ATC quotas on itself and its major competitors. Although the authors estimate high efficiency gains for Pakistan, they determine that the losses in quota rents for Pakistan outweigh the efficiency gains and produce a net welfare loss of $280 million, with a 15.7% increase in textile exports offset by a 17% decrease in clothing exports. Again, using recent export revenue data from the ITC, these percentages translate into a loss of $374 million in the clothing sector.

Preference erosion: Implications for development and the WTO

To summarise the findings presented above, the total annual loss of income transfers is estimated at $1.72 billion in agriculture, textiles and clothing. In agriculture, the potential annual losses in income transfers equal $402 million, with welfare losses of $318 million among the most dependent economies. In the T&C sector, losses of quota rents are estimated at $1.32 billion. Adding quantity adjustments, estimates for losses of export revenues are approximately $300 million above the income transfer losses in each sector.

These losses must be placed in a wider context. First, there is the development impact of an exogenous shock to what is in many cases a primary foreign exchange earning sector. Second, there is the potential for increased marginalisation of preference-dependent economies in the global trading system and increased scepticism of the benefits on multilateral liberalisation.

Implications for development

The degree to which individual states embrace globalism, encourage free trade and investment and

Table 7. Change in major economic aggregates for studies on South Asian T&C sector

	Clothing exports	Textile exports	GDP	Employment	Welare (M US$)
Bangladesh					
Mlachila and Yang (2004)	–17.7%	–4.7%	–2.3%	–4.5%	...
Lips et al. (2003)	–11.3%	1.0%	...	...	–401 to –425
Spinanger (2003)	–7.9%	15.5%	–.014%	...	...
Sri Lanka					
Francois and Spinanger (2001)	–6.55%	–0.62%	...	...	–452
Lips et al (2003)	–2.4%	12.7%	...	...	–228
Pakistan					
Francois and Spinanger (2001)	–17.0%	15.7%	...	...	–280

Ellipses (...) indicate estimates unavailable

explore lucrative niches in the market is highly sensitive to the country's specific economic endowments and capacities. The ability to identify new long-term high-growth sectors, and efficiently reallocate factors of production to minimise adjustment costs, can be severely hampered by the combination of handicaps[19] facing many preference-dependent economies:

- **High number of small, poor and vulnerable states:** Almost any list of preference-dependent economies includes a disproportionate number of small and poor states. Countries are considered small if they account for less than 0.05% of the world's imports of goods and services and poor or low-income if their per capita GDP measured in PPP terms lies below $4,630. Table 8 lists a number of small and poor countries where significant economic activity derives from preferential market access. The same table also indicates that according to the UN's Economic Vulnerability Index (EVI), all but one is considered 'vulnerable' (EVI>31) and two-thirds are considered 'highly vulnerable' (EVI>36).

- **Lack of economies of scale:** The relative lack of economies of scale substantially influences the structure of the economy. Most economies are able to have a wide variety of different-sized firms. When economies are small, either the economy becomes very specialised (thus becoming highly vulnerable to demand swings) or the average size of the enterprise remains small (thus costs remain high). The economy cannot both diversify and achieve lower costs.

- **No large consumer market:** Given the prohibitive cost of offering a wide variety of goods for consumers in small and poor economies, the economy is unlikely to attract significant levels of investment (either domestic or foreign). Fixed costs are likely to be large relative to the scale of investments. When demand is low, firms are forced to remain at a small scale, with subsequent inefficiencies in the rate at which inputs can be transformed into outputs.

- **Net food imports:** A number of small and poor preference-dependent economies, most notably island states where arable land is highly constrained, are net importers of agricultural products. The reduction in trade measures such as export subsidies and domestic support may lead to substantial increases in heretofore artificially depressed world prices and increases in food import bills. Most studies estimate a rise in food prices of between 4 and 8%, although some simulations of a full elimination of trade-distorting subsidies arrive at a price impact of up to 20% for major food staples (Matoo and Subramaniam, 2004 and Tokarick, 2003).[20]

- **High operating costs:** Winters and Martins (2004) found that in many small economies everyday transportation and infrastructure costs – such as airfreight, utilities, fuel, and air travel – are often prohibitive relative to larger economies. In potentially lucrative sectors such as electronic assembly, clothing and hotels/tourism, the cost inflation factors for small and micro economies can range from 6.2 to 57% (Winters and Martins, 2004).[21] As these cost premia often cannot be passed onto consumers, the only way that most firms can export is if one of the factors of production accepts lower returns than it would in the case of a larger economy. As many small and poor preference-dependent economies exhibit high levels of risk and correspondingly prohibitive risk-adjusted interest rates, investment rates in these economies are often below those required for economic sustainability (Hughes and Brewster, 2002).[22]

The combination of the above factors implies two unfavourable outcomes for preference-dependent economies. First, preference erosion may lead to further economic instability and marginalisation in global trade. The narrow resource base and excess trading costs in many preference-dependent economies means that the set of goods that will be traded internationally will be relatively smaller than a larger economy. In practice, many high-cost countries lack 'operational' comparative advantage; that is, there is no good or service which they can export because their transaction costs or real production costs are too high to permit any trade on a commercial basis. Taking world prices as given and subtract-

Table 8. Selected small, poor and vulnerable preference-dependent economies (2000)

	Imports of goods and services		Per capita GDP (US$)	WTO member	EVI score
	(billion US$)	(world share)			
Suriname	0.72	0.01%	n.a.	Yes	44.28
Lesotho	0.76	0.01%	2320	Yes	53.11
Guyana	0.79	0.01%	4560	Yes	51.41
Fiji	1.03	0.01%	4730	Yes	37.39
Swaziland	1.10	0.01%	4330	Yes	35.02
Haiti	1.32	0.02%	1920	Yes	45.61
Congo (Rep.)	1.40	0.02%	950	Yes	46.90
Madagascar	1.47	0.02%	810	Yes	26.75
Mozambique	1.53	0.02%	1000	Yes	37.36
Zimbabwe	1.96	0.02%	2450	Yes	40.94
Cambodia	2.01	0.03%	1760	AP[1]	61.00
Tanzania	2.10	0.03%	510	Yes	36.23
Cameroon	2.38	0.03%	1640	Yes	31.59
Cote D'Ivoire	3.50	0.04%	1550	Yes	32.81
Jamaica	4.33	0.05%	3590	Yes	31.18

Source: Mattoo and Subramaniam (2004) and Grynberg and Remy (2004)

ing the minimum costs of trading, there is little or nothing left for value added and (in some cases) subsistence. In the absence of trade preferences or non-trade flows of foreign exchange, the country may be disconnected from the world economy (Winter and Martins, 2004).[23] Furthermore, reliance on a narrow export base implies an increased vulnerability to large swings in terms-of-trade when world prices fluctuate. Such imported instability can destabilise an economy, particularly when imports are important inputs into the manufacturing sector.

Second, the production and revenue losses in vulnerable developing economies may lead to strong negative impacts on employment and poverty levels. The textiles and clothing sectors in Sri Lanka and Bangladesh are forecast to shed jobs following the MFA phase-out. In Bangladesh, the T&C industry plays a key role in employment and in the provision of income to the poor, directly employing about 1.8 million people, or about 40% of manufacturing sector employment, 90% of whom are women. Mlachila and Yang's (2004) GTAP results for Bangladesh show a 4.5–7.7% decrease in overall employment. The UNDP's often-quoted estimate of 500,000 to 1 million job losses in Bangladesh is broadly in line with these GTAP results. Employment losses on this scale could have significant economy-wide impacts as the industry supports indirectly about 10–15 million people (Mlachila and Yang, 2004).[24]

In agriculture most studies have focused on the sugar industry. Employment in the sugar industry is dominated by rural-based unskilled labour, particularly of family-based self-employment on small-scale farms. Consequently, it is this labour group that is greatly impacted in the event of a loss of sugar trade preferences (Levantis et al., 2002).[25] LMC International (2004), under the 'Price Cut' scenario, finds a 51% drop in field employment levels and a 33% drop in factory employment levels.[26] Levantis et al. (2002), using a general equilibrium model of the Fijian economy (FIJIGEM), find decreases in total unskilled rural employment in Fiji ranging between 5–6%.

Implications for the multilateral trading system

With the accession of a large number of new developing country members, the two-tiered approach in the WTO was abandoned to create a symmetry of obligations among WTO members.[27] Since the conclusion of the Uruguay Round and the advent of the

Single Undertaking, many preference-dependent economies have become increasingly vocal in articulating their interests in the multilateral trade negotiations.

The loss of preferences on the scale estimated earlier, combined with the economic handicaps described above, implies that the interest of many preference-dependent economies are only imperfectly aligned with the broader liberalisation agenda of the multilateral trading system. First, many small and poor preference-dependent economies lack sufficient market size to be attractive to the larger WTO members. The cornerstone of WTO negotiations – reciprocal bargaining yielding mutually beneficial market access – is immediately put into question as many of these countries are structurally disadvantaged in reciprocal negotiations. Secondly, preference-dependent economies face a combination of falling consumer surplus from rising food import bills, falling government tariff revenue from MFN tariff reductions, and falling producer surplus from the erosion of trade preference-based income transfers. These economies are struggling to allocate scarce resources to implement past agreements, let alone take on the fiscal burdens of new commitments. Several new preferential schemes have been tabled (such as the EU's EBA and the US AGOA), however the potential positive impact of these schemes have been greatly curtailed by the political economy surrounding their design.[28]

Such an overwhelmingly negative outcome, irrespective of the wider context of rising average global welfare, threatens further marginalisation of preference-dependent economies and the fragile consensus surrounding the need for subsequent reductions in global trade barriers.

Assisting preference-dependent economies: A proposed framework

When a country is hit by a negative shock, it must decide both the appropriate mix of adjustment to the impact of the shock and the appropriate use of external or domestic financing. The financing–adjustment mix will ultimately depend on the nature of the shock and its direct and indirect economic effects. A *country must ultimately adjust to a permanent shock*. However, where the short- to medium-term impact of the shock may be significant relative to the economy's capacity to adjust, an immediate adjustment may not be feasible or desirable, and financing to smooth the adjustment path to the new equilibrium may be warranted.[29]

For preference-dependent economies facing large-scale erosion of income transfers in their major export markets, financing must be focused on encouraging private and public sector investments in new higher growth industries, and on rationalising existing preferential sectors to maintain international competitiveness. This section addresses a number of deficiencies in the existing financial architecture for preference-dependent economies, and lists a number of essential principles that future instruments should account for.

Appropriate lending terms

Both the instruments used (e.g. loans and risk-sharing instruments) and the lending terms (i.e. interest rates and maturities) should reflect the need to increase investment in high-cost economies and ensure sustainable debt burdens. Preference erosion, unlike a commodity price shock or a natural disaster, is a permanent rather than transitory shock. An instrument whose primary focus is on smoothing temporary consumption or relieving short-term balance-of-payments pressures may be inappropriate for the preference-erosion setting, where the compensating efficiency gains may only occur after a protracted period of adjustment and resource allocation. Such a period may easily outlast the disbursement cycle and increase country risk far above the terms provided by existing arrangements. If the economy is already heavily indebted, contracting new loans (even on a highly concessional basis) may easily aggravate borderline debt burdens and turn a smooth adjustment into a twin export-sector/balance-sheet crisis. Table 9 shows a number of preference-dependent economies whose debt indicators are already high compared to the policy-dependent debt indicator thresholds (indicated in brackets).[30] Determining debt dynamics *ex ante* is a difficult task. Yet the Guyanese example yields some insight. In 2002, Guyana's total external debt stood at

Table 9. Debt indicators in selected preference-dependent economies

	Debt/ Exports (100,200,300)	Debt/GDP (30/45/60)	Debt service/ exports (15,25,35)
Guyana	200.92	219.49	23.0
Mauritius	59.32	39.74	8.24
Congo	209.36	234.68	0.98
Jamaica	119.6	75.28	18.39
Belize	161.96	109.58	36.48
St. Lucia	113.96	67.29	7.2
Dominica	147.87	94.96	7.94
St. Vincent	118.38	60.15	7.58
Zimbabwe	n/a	42.29	n/a
Mozambique	362.78	135.24	5.95
Average	181.39	98.06	12.86

Source: World Bank Global Development Finance Online Database (http://publications.worldbank.org), accessed August 2004

$1.459 billion. Of this total, $196 million is incoming IDA lending, nearly matched by $154 million in outgoing debt-service payments. Despite substantial debt forgiveness under the HIPC initiative, Guyana's debt profile remains well above its 'safe' thresholds.[31] When one considers that its estimated income-transfer losses in agriculture amount to between $36 million to $66 million *annually*, it is clear that contracting further lending even at IDA terms[32] on this scale – at a time of potentially falling output in the very sectors from which external debt would be potentially repaid – could easily lead to even more unsustainable debt dynamics. Similarly, increased lending under the IMF TIM mechanism would in principle increase access to PRGF funds. However, despite a below-inflation interest rate of 0.5%, PRGF repayments begin after only five-and-a-half years, with full repayment due at the end of ten years.

A hypothetical lending facility could determine the grant element through a standardised approach implying loans on IDA terms for IBRD borrowers, and 'IDA plus' (largely grants) for IDA borrowers, or through a country-specific approach using the enhanced debt sustainability analysis (DSA) framework recently proposed by the IMF and World Bank.

Focus on diversification

Where production in preferential sectors is potentially uncompetitive, diversification into non-traditional export sectors should be a long-term objective. Most instruments have tended to focus on protecting public sector balance sheets and mitigating economy-wide fluctuations, rather than focusing resources on areas of potential future growth. As such, financing was directed to central bank international reserves and to provide budgetary support for the government ministry overseeing the relevant sector. However, there is ample evidence (see Razzaque et al., 2003; IMF, 2003; and Hubbard et al., 2000)[33] that financing channelled in this manner was used primarily as compensation payments to affected sectors. This tying of aid to the recovery of ailing sectors was prone to the fallacy of composition argument, as it encouraged further dependence on weak sectors and led to distortions in the private sector (ibid.).[34]

The case of EU bananas is instructive. An analysis of the effectiveness of EC SSA assistance (Hubbard et al., 2000)[35] concluded that allocating funds on the basis of a 'competitiveness gap' into declining sectors resulted in a waste of EU resources. While in certain countries financing was effective in upgrading productivity, the low share of SFA funds spent on diversification (12% in 1999) was flagged as a possible factor in the low levels of growth in banana-producing countries, despite the substantial inflows of external financing. The recent increase in the diversification share (up to 64% in 2002) points to an increasing realisation by preference-dependent economies of the need to finance diversification activities.

Promotion of the private sector

To maximise sustainable, broad-based growth, financing for the private sector should be a priority. Many of the impacted sectors were dominated by large state-run enterprises. As such the benefits of compensatory financing were often concentrated in a small number of inefficient producers. While such large enterprises can be engines of export dynamism, there is substantial evidence pointing to the crucial role of the private sector in generating

flexible, broad-based growth and poverty reduction. Clearly, the public sector has a vital role in providing complementary investments where private investment is not forthcoming. Yet given the competitive demands of exporting to increasingly liberalised markets, the private sector must be a lead engine.

Intervention in the private sector has become a *sina qua non* for recent multilateral efforts to encourage broad-based growth in developing countries. These efforts, spearheaded by agencies such as the World Bank Group's International Finance Corporation (IFC), are still in their infancy. The current projected IFC funding for its operations stands at $1.3 billion worldwide, of which $614 million is financial assistance to firms through the domestic financial sector and $431 million for financial markets investments. Despite substantial donor commitments, lending to the private sector from sources such as the IFC is currently small relative to the potential need arising from preference erosion.

Another important consideration is the form that such intervention takes. Most multilateral lending to the private sector is on-lent through local intermediaries with upward interest rate adjustments for both country and institutional risk on top of the lenders' own cost of funds. In many preference-dependent economies the resulting risk premium, although mitigated by the multilaterals' investment-grade rating, often puts the cost of funds out of reach of most firms. This is most notable in the initial 'transformative' stage where the wider economy is suffering a systemic shock from preference erosion yet the capital needs are greatest.

Ideally, a financing instrument would provide a private sector window to facilitate investment start-up, expansion, restructuring or rehabilitation through local-currency loans (either indirectly through domestic commercial banks or directly from the lender). The loans could be augmented by discrete, finite matching grants disbursed directly to the firm for 'transformative' service or capital goods expenditures (such as factory re-tooling or outside consultants). Such an approach would recognise the hurdles to investment in preference-dependent economies without introducing distortions into the domestic financial sector.

Adequate scale

The aggregate scale of financing should reflect the magnitude of the annual losses and the long-term nature of adjustment. Despite the significant donor resources flowing into developing countries, the multiple donor and country objectives often means that resources allocated for export diversification fall short of needs. In many IDA-eligible countries this may reflect the multilaterals' focus on poverty reduction programmes and macroeconomic structural adjustment rather than export diversification *per se*. Only in the banana sector have bilateral or multilateral external flows (€45 million from the EU under the Special Framework for Assistance) been commensurate to the estimated losses, however the absolute amount spent on diversification activities has only recently exceeded 50%.

Furthermore, several preference-dependent economies are already constrained by the high level of their pre-existing commitments to multilateral lenders. Guyana, for example, is eligible for concessional lending through both the IMF and the World Bank. Its existing three-year PRGF loan of US$75 million already absorbs 63% of its IMF quota. Guyana's IDA-13 allocation is up to $26 million for the three-year IDA-13 period, of which $4 million consists of a Public Sector Technical Assistance Credit and the remaining amount for two Poverty Reduction Support Credits. A matter of concern is that even in Guyana, which among preference-dependent economies has a relatively long-standing relationship with the international donor community, the resource needs for adjustment relative to those currently allocated are significant.

Determining the total nominal financing needs requires a prior assumption of adjustment timescales. Assuming (a) a fourteen- to twenty-year adjustment period (including an initial ten-year gradual implementation period of WTO commitments where losses of income transfers are assumed to be negligible) and (b) the $1.72 billion annual income transfer loss estimated earlier, total nominal financing needs for preference-dependent economies range between $6.88 billion and $17.2 billion. In textiles and clothing, the ten-year implementation period will conclude in 2005. In agriculture,

the (assumed) ten-year implementation period will begin at the conclusion of the Doha negotiations. Applying a hypothetical 3% discount rate and adjusting for the two different implementation scenarios, the NPV of total financing needs ranges from $6 billion to $13.8 billion.

Flexible, forward-looking investment incentives

To ensure that diversification begins before a shift in relative prices occurs, financing should be disbursed as soon as reasonable *ex ante* estimates of economic losses are available. A major flaw in the existing financing architecture for preference-dependent economies is the misalignment between allocation and needs. In the balance between *ex ante* preventative versus ex-post mitigating actions, many instruments opted overwhelmingly for the latter.[36] Instruments such as STABEX disbursed funds for loss of export earnings relative to a trend, and entailed significant administrative costs (such as detailed statistical analysis) to justify disbursements. The resulting frequent delays in delivering supplementary financing implied that disbursements tended to be pro-cyclical, rather than responding counter-cyclically to adverse shocks.[37]

Preference erosion differs from traditional commodity price shocks in that its occurrence, if not its approximate impact, is foreseeable. However, the preventative 'cure' – export diversification – is difficult to anticipate. Diversification must begin *before* a shift in relative prices occurs, ensuring that new investment comes to fruition as the preference erosion shock hits the wider economy. Moreover, prejudging sector-specific outcomes in a changing, liberalised market when export diversification is led by private sector agents may be unworkable and undesirable. Yet the establishment of clear financial incentives in the years ahead of the preference erosion shock may yield high returns on expenditures relative to the costs of mitigating the negative impact after the fact.

It must be reiterated that loss of income transfers is an imperfect proxy for future adjustment needs. Adjustment varies in practice according to a number of variables whose precise relationship remains a subject of debate. Ideally, a 'first-best' instrument would foresee the scale and timing country-specific adjustment needs and disburse funds accordingly. Given the limitations of economic modelling, this is a difficult (if not impossible) task. The data requirements for more precise modelling excludes many small and poor countries which comprise the majority of preference-dependent economies. If external assistance is to be truly forward-looking, then a 'second-best' instrument could pass on the foregone income transfer – over a reasonable adjustment horizon for these economies – as investment financing for producers in non-traditional sectors.

Conclusions: Moving beyond the 'spaghetti bowl'

Although the costs of preference erosion are often highly concentrated, the timing and sources of external assistance have been *ad hoc*. This has resulted in preference-dependent economies facing a 'spaghetti bowl' (to paraphrase Jagdish Bhagwati), burdened by multiple and often conflicting donor-specific priorities, country strategies, asymmetric bilateral negotiations and donor/loan-specific disbursements which are often 'too little, too late'. In such an environment countries with limited administrative capacities will find it difficult to effectively marshal resources to mitigate the impact of preference erosion.

The multilateral negotiating context introduces even greater uncertainty for preference-dependent countries. As the history of recent trade rounds confirms, outcomes are often shaped by ever-changing political economy considerations rather than concrete analysis. New preferential regimes are often established as soon as old schemes are phased out. Although financing has been provided for such terms-of-trade shocks, the analytical process by which the funds are established and disbursed is often less than transparent.

A more consistent, clear and transparent framework could yield several benefits. An analytical and objective assessment of the impact of preference erosion will allow donors and beneficiaries to assess the costs and benefits of preferential schemes into future trading rounds. A forward-looking framework

would provide greater 'buy-in' from preference-dependent economies, as their preventative efforts to encourage investment in non-preferential sectors would be visibly backed both politically and financially. Most importantly, a harmonised framework can effectively channel donor resources to create diversified, sustainable export sectors in preference-dependent economies.

Endnotes

1. This paper will use the two terms interchangeably.
2. Brenton and Ikezuki (2004a).
3. The present version of the model covers 160 individual countries plus one region (the European Union) and 36 commodities. Volume data are from 2000 (also the base year) and are compiled from FAO supply utilization accounts. The price data are also from FAO. Parameters on elasticities and feedshares are from FAO's World Food Model. Bilateral trade flow data are from UNCTAD's Comtrade database. These are used to allocate global quotas to individual countries. The UNCTAD TRAINS database is the source of information on applied tariffs.
4. To accommodate heterogeneous goods with one price, ATPSM estimates composite tariffs to determine the domestic consumption and production price.
5. The 'Swiss Formula' takes the following structure: T1 = (T0/c)/(T0+c) where T1 is the new tariff rate, T0 is the initial tariff rate, and c is the reduction coefficient.
6. WTO (2003).
7. See Hertel and Tsigas (1997).
8. Khaturia et al (2001).
9. This formulation is from Vanzetti and Graham (2002).
10. Stevens and Kennan (2003).
11. The lower figure is likely due to the substantial 'water' in the beef tariff and the fact that the Conservative scenario applies to bound rates only.
12. Welfare in ATPSM has three components. The first, producer surplus, is the aggregate difference between price and marginal cost plus any quota rent received on exports. The second, consumer surplus, is the aggregate different between marginal valuation and price. The third, net government revenue, only relates to revenue from import tariffs, including both within quota and out-of-quota tariffs, and expenditure on export subsidies and domestic support.
13. In estimating production costs, the LMC study assumes that sugar producers either (a) maintain their current industry structure, or (b) restructure their operations in accordance with existing national sector restructuring plans. The study then models the supply responses of each country under the range of price cuts implied by each scenario, the average selling price in each market, and by extension changes in industry revenue and export earnings.
14. Under this scenario, the EU market price for sugar is cut by 38%, which is comparable to recent EU proposals for sugar sector reform.
15. This classification excludes a number of countries whose preferential access derives from regional initiatives such as the Caribbean Basin Economic Recovery Act and EU-EBA. This excludes many countries such as Haiti, Honduras, El Salvador, and the Dominican Republic, for whom T&C exports are more than 50% of total exports. Although Mauritius is AGOA/EBA-eligible, it is included as it was subject to binding ATC quotas until 2000 and the offsetting impact of AGOA may be substantially limited due to its more restrictive rules of origin under AGOA. As Mauritius is not included in the GTAP database, it exhibits similarly low utilization rates as Sri Lanka, so its quota rents have been estimated on the basis of the same quota wedges. Similarly, the quota wedges for Cambodia have been estimated using estimates for Vietnam in 1997.
16. The losses in the EU market are surprising considering that Bangladesh, much like Mauritius, has preferential access to the EU market under EBA. However such access will be highly limited by rules of origin requirements, and estimate that less than half of Bangladesh's exports actually receive duty-free treatment under EBA. (Mlachila and Yang 2004)
17. Assuming constant nominal wages and medium levels of elasticities.
18. See http://www.intracen.org
19. This list is a combination of factors from Josling (1998), Winters and Martins (2004) and UNCTAD (2002).
20. Matoo and Subramaniam (2004) and Stephen Tokarick, 2003, 'Measuring the Impact of Distortions in Agricultural Trade in Partial and General Equilibrium,' IMF Working Paper 03/110
21. Winters and Martins (2004).
22. Hughes and Brewster (2002).
23. Winter and Martins (2004).
24. Mlachila and Yang (2004).
25. Levantis et al (2002).
26. The LMC estimates are based on calculations of the number of workers that will be employed in the field and factory sectors are based on the average number of factory workers per mill, and the average number of field workers per hectare.
27. Much of the theoretical framework of this section is summarised from Mattoo and Subramaniam (2004).
28. See UNCTAD (2003a), UNCTAD (2003b), Brenton and Ikezuki (2004a) and Brenton and Ikezuki (2004b) for an analysis of these initiatives.
29. A more detailed analysis can be found in IMF (2003).
30. See the IMF's paper on 'Debt Sustainability .in Low-Income Countries – Proposal for an Operational Framework and Policy Implications' (International Monetary Fund, Washington, February 2003) for a more detailed summary of these policy-dependent thresholds.
31. Guyana has had six separate rounds of Paris Club debt treatments, all of which remain active (i.e. not fully repaid) and of which the last two have been within the HIPC framework.
32. IDA loans have a typical maturity of 20, 35 or 40 years with a ten-year grace period. IDA loans have no interest charge but typically carry a service charge.
33. See Razzaque et al (2003), IMF (2003) and Hubbard et al (2000).
34. See Razzaque et al (2003), IMF (2003) and Hubbard et al (2000).
35. Hubbard et al 2000
36. Again, this subject is explored in greater detail in Razzaque et al (2003) and IMF (2003).
37. Of 311 STABEX disbursements analyzed over the period 1975–1995, 60 per cent occurred in periods of increasing government revenues (IMF, 2003).

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9

GSP Reform: A Longer Term Strategy (with Special Reference to the ACP)

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Introduction

Evolving the GSP

The European Commission has put forward broad proposals for a new Generalised System of Preferences (GSP) to cover the period from 2006 to 2015, but has issued a detailed draft Regulation – COM (2004) 699 final of 20 October, 2004 (CEC 2004b) – only for the period 1 July, 2005 to 31 December, 2008. Comment upon this draft Regulation needs to take account not only of changes that should be implemented immediately, but also of the longer term possibilities for evolving the GSP regime.

What role can the GSP play over the medium term in rationalising the EU's multi-layered and partly conflicting trade policies? What contribution can it make to the development of the 'alternative arrangements' that the EU has promised to make available to those African, Caribbean and Pacific (ACP) countries unwilling to enter into Economic Partnership Agreements (EPAs)?

These are the questions raised in this chapter. Neither the Commission's July 2004 Communication to the Council (CEC 2004a) nor the draft Regulation provides any clear guidance. This is unsatisfactory given that the current exercise is intended to be a major review. Moreover, it may accidentally foreclose on options that later appear to be desirable.

The focus of this chapter

The particular focus of this chapter is on the possibilities for the GSP to become an acceptable alternative successor regime to the Cotonou Trade Agreement for those ACP states for which it is undesirable or unfeasible to join EPAs. The reasons for this are twofold.

First, of course, the Cotonou Agreement commits the EU to 'assess the situation' of non-least-developed ACP states that decide 'they are not in a position' to enter EPAs in order 'to provide these countries with a new framework for trade which is equivalent to their situation and in conformity with WTO rules' (Article 37:6). Originally scheduled for 2004, this is now to be done in 2006. There are no other known developments in EU trade policy between now and the end of 2006 that could provide a plausible peg for a generalised alternative that is WTO compatible. It may prove possible to create individualised arrangements for odd countries falling outside the EPA network, but this would worsen one of the current features of EU trade policy that an evolution of the GSP would counter. This is the high degree of diversity between different trade instruments. This provides the link to the second reason to focus on the ACP. The EU has literally dozens of agreements with developing countries, which often overlap. As explained below, this differentiation has been a source of controversy in the WTO, most recently with the dispute over the anti-narcotics tranche of the GSP brought by India. The Appellate Body ruling on the India case has provided an opportunity to move forward. It has confirmed that differentiation within the GSP is possible provided that it is related to objective and internationally accepted differences in circumstance. The GSP+ is designed to take advantage of this ruling. The effective integration of the ACP countries in the GSP would represent the largest possible additional step in the direction of creating a single, coherent framework for trade preferences.

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The bulk of the chapter is divided into two parts. Part A reviews what is in the GSP reform proposal as described in the draft Regulation (updated to include changes where these are known). Part B takes the proposed new GSP as its starting point and assesses the additional changes that would be required to make it an acceptable alternative to EPAs. As it now appears to be too late for these changes to be incorporated into the present review they should be a target for achievement between now and the end of 2007.

Part A: The New GSP

The *status quo*

The place of the GSP – and its link to the ACP

The EU's GSP is the broadest element of its preferential trade policy. Because it applies to almost all developing countries, the GSP provides a 'safety net': no developing country (other than the richest and most competitive) is offered less favourable access to the European market than that provided under the GSP.

Because of this, though, the GSP is not always the most favourable of the EU's import regimes. Lower tariffs are often paid by parties to the EU's older preferential trade accords – not only the Cotonou Agreement, but also the more recent free trade agreements (FTAs), such as those with Mediterranean countries, South Africa and Chile. Kenya, for example, would pay tariffs of up to 10.1% on its sales of fresh/chilled peas if they were imported into the EU under the GSP but it does not do so because they are imported instead under the Cotonou Agreement and enter duty free.

In broad terms the EU's trade partners fall into three categories:

1. the most preferred – 38% – that benefit from a trade agreement that is superior to the Standard GSP[1] (including, but extending well beyond, the ACP);
2. the middle group – 27% – that are party to the Standard GSP but to no other regime (mainly South and East Asia, the Middle East and parts of Latin America);
3. the least preferred (mainly industrialised countries) – 35% – that trade on the so-called 'most favoured nation' (MFN) terms.

Of the three groups, the middle one accounts for the smallest share of EU imports. It is favoured by the EU in cases where a beneficiary country competes with members of the third group, but disfavoured when competition is with a member of the first.

The term 'standard' is used in the description of the group's access to the EU because the GSP does not provide equal treatment to all developing countries. There are special, more favourable, tranches not only for the least-developed countries (LDCs), but also for those fighting illicit narcotics and those with favourable social and environmental policies. These states fall into the 'most preferred' group.

It is this differentiated nature of EU trade policy towards developing countries that has underlain a number of disputes taken to the WTO over the past decade. The most recent of these, with India, has contributed directly to some of the reforms in the current Commission proposal.

The GSP affects the ACP in two ways. Any change to the GSP, therefore, is of potential commercial importance if it alters either of these two effects. They are:

- to establish the market access terms potentially available to the ACP's competitors in the EU and, hence, the size of the ACP's margin of preference over them; and
- to set the 'safety net' for the future access to the European market of any ACP state that declines to enter into an EPA and is not able to negotiate any other alternative trade arrangement with the EU.

The current GSP

What was new

Now over 30 years old, the GSP has been reviewed and adapted several times, most recently in 2001.[2] Although described as a mid-term review of the ten-year regime 1994–2005, it made radical changes. It greatly simplified the old system under which covered items (see Box 1) fell into four categories

Box 1. A GSP lexicon

The term **covered imports** includes imports of all items included in the GSP that originate in a beneficiary country, regardless of whether that country has been graduated out of the sector concerned. **Eligible imports** are limited to products for which the originating country has not been graduated.

Preferential imports are products for which GSP treatment has been actually claimed.

The EU's total imports from a country include, in addition, all the products for which there are no GSP preferences. At present almost one-tenth of products to which duty applies in the Common Customs Tariff are not covered by the GSP.

according to their sensitivity and the applicable GSP tariff was 85, 70, 35 or 0% respectively of the MFN tariff. There are now only two categories for covered items. Tariff duties on those classified as non-sensitive are entirely suspended.[3] For those classified as sensitive:

- the simple *ad valorem* GSP tariff is 3.5 percentage points lower than the MFN rate for all goods except clothing and textiles (Chapters 50 to 63) – for which the reduction is 20%;
- specific duties are reduced by 30%[4] unless in combination with an *ad valorem* duty, in which case the specific duty is not reduced; and
- duties are totally suspended where the application of the GSP reduction formula results in *ad valorem* duties of 1% or less or in specific duties of €2 or less.

The new regime also incorporated the 'Everything but Arms' (EBA) scheme proposed in 2000. This extended a pre-existing special tranche of the GSP for LDCs that already offered duty-free access for all industrial goods but not for all agricultural ones.

What was retained

Three of the features of previous GSPs that were retained are:

- special, additional tariff cuts (most resulting in duty-free access) for states fighting narcotics (Andean and Central American states plus, for the first time, Pakistan);
- further tariff reductions, generally of 5 percentage points (in addition to the 3.5 percentage point Standard GSP reduction) on some items for countries meeting the requirements for inclusion in special incentive regimes for the protection of labour rights and the environment; and
- a graduation mechanism that made some states ineligible for GSP tariffs on specified products if they fell foul of criteria related to share of preferential imports, development index and export-specialisation index.

In 2002 India complained to the WTO that the anti-narcotics arrangement contravened the EU's multilateral obligations. The WTO Appellate Body found in India's favour in April 2004 (WTO 2004a) and subsequent arbitration (WTO 2004b) has requested the EU to amend its trade policy by 1 July, 2005.

The new GSP

Broad features

In its July Communication the Commission seeks to deal with the criticisms that have been levelled at the GSP and with the WTO ruling. Like its predecessor, the GSP regime it proposes will last for ten years (from 2006 to 2015) but with a mid-term review. The Commission's draft Regulation covers only the first period to 2008 – and it also brings forward by six months the proposed start date to July 2005 in order to comply with the WTO ruling; this starting point has subsequently been brought forward even further, notionally to assist the countries worst affected by the Indian Ocean tsunami.

Among the key reform objectives foreseen in the July Communication are to make the GSP:

- stable, predictable, objective and simple;
- targeted on the countries that most need it, such as the LDCs and the most vulnerable developing

countries (small economies, land-locked countries, small island states, and low-income countries) as well as the countries that would need preferences most after the Multifibre Arrangement (MFA) textile-quota system comes to an end in December 2004; and

- supportive of regional co-operation between developing countries.

Further, argues the July Communication, the GSP must strike the right balance between development through trade and through industrialisation via origin rules that reflect the balance but are less strict than at present. It should assist countries to attain a level of competitiveness that could make them self-supporting economically and full partners in international trade.

This can be done by maintaining and improving the Community offer. The accession to the Community of ten new Member States has already improved substantially the value of the GSP, but the July Communication also considers extending the GSP to cover new products and to reclassify others from the sensitive to the non-sensitive category. Preferential margins are to be at least maintained.

One way for the GSP to focus on the countries most in need is via graduation. The July Communication argues that certain beneficiaries should be graduated for the groups of products in which they are most competitive. Given the high level of competitiveness, there is no further justification for a continuation of preferential tariff treatment.

Weighing up the changes

The July Communication presented a balance of changes, such as limiting preferences to the most competitive states whilst extending and deepening preferences to the remainder. But it did not provide the details needed by observers to weigh up the partly offsetting reforms and to determine whether or not the 'balance' was to their liking.

The draft Regulation has provided these details for the first period of implementation, but not for the second. Table 1 lists the main areas of change proposed in the July Communication and summarises the relevant changes in the draft Regulation. The following three sections then review the details.

There are two areas of major uncertainty. These affect not only achievement of the objective of improved stability and predictability but also assessment of the new GSP's likely impact. One concerns the number of countries that will apply for the special incentives and meet the EU's criteria. Whilst Table 1 recognises the potential importance of GSP+ for the countries identified in the July Communication for targeting, most other developing countries would also be eligible. Wide usage of special incentives could transform the GSP's impact (see later); modest take-up could reduce its trade effects. There is also a question mark over whether the regime would survive a WTO challenge.

The other uncertainty is over what will happen in the 2009–15 period. Neither the July Communication nor the draft Regulation specifies in sufficient detail, for example, how the graduation mechanism will be applied. As the 2001 reform demonstrates, 'mid-term reviews' can be substantial. Hence, while the outlook to 2008 is stable and predictable, any exporters requiring an investment payback period of over three years may view the regime as very unpredictable.

Moreover, the ACP states will find no guidance in the draft Regulation on the likely impact of not joining EPAs. Part B returns to this issue.

Graduation

The graduation formula in the new GSP will replace that in the old one (see Box 2). So there will be winners (countries that are reintegrated into the GSP) as well as losers (countries that are graduated anew). And, of course, for some countries there will be no major change: they are currently graduated and will remain graduated.[5]

Winners and losers to 2008

The draft Regulation indicates which countries will be graduated for which sections on the first application of a new formula (see Table 2). Graduation from a section applies to any country which accounts, on average over three consecutive years, for more than 15% (or 12.5% for Section XI, textiles and clothing)

Table 1. The objectives of GSP reform

Objective (as stated in July Communication)[a]	Extent of change (in draft Regulation)[b]
Improved stability and predictability	• Standard GSP is both stable and predictable to 2008 • Incidence of special incentives unclear • Substantial uncertainty post 2008
Improved objectivity	• The criteria for graduation have been changed, but are neither more nor less objective than the criteria replaced • Criteria for special incentives more objective than before
Simplification	Number of regimes reduced
Targeted on:	
LDCs	No change
Small economies	Potential availability of GSP+[c]
Land-locked countries	Potential availability of GSP+[c]
Small island states	Potential availability of GSP+[c]
Low-income states	Potential availability of GSP+[c] (but not for India, which is excluded *a priori*)
MFA-affected	Potential availability of GSP+[c]
Rules of origin change:	
Form	No change
Substance	No change
Procedures	No change
Extending product coverage	243 new items (of which 151 are fish/fisheries)[d]
Reclassification of sensitive items	None

Notes:
[a]CEC (2004a).
[b]CEC (2004b).
[c]All countries have been eligible for the special labour and environmental incentives incorporated into the GSP in the1990s, but the margin of preference under the proposed GSP+ is more substantial, and the product coverage broader.
[d]General Secretariat of the Council 2004. Four of the items on the list (two in HS 190420 and two in 210610) do not, however, appear in Annex II to the draft Regulation, and 27 are covered only under GSP+.

Box 2. Types of graduation

'Old graduation' is what applies at present through the application of the formula in the current GSP Regulation linking market share, level of development and specialisation. Countries that fall foul are graduated out for a variable range of products: in some cases a single Harmonised System (HS) chapter; in others, two or more chapters. For example, Brazil is graduated out of, among others, GSP Sector VI, which is Chapter 9 of the HS (coffee, tea, etc.) while China is graduated out of, among others, for Sector XXVII, which covers all of Chapters 74–83 plus eight 6- or 8-digit items within HS 7202 plus 7217, 7223, and 7323–7326.

The second is **exclusion**. A country which is otherwise eligible for the GSP is simply excluded for some products. Unlike 'old graduation' this is not related to any stated criterion and hence will not be reversed if the criterion no longer applies. South Africa, for example, is simply excluded from the GSP for iron and steel and Greenland is excluded for fisheries.

Third, there is **'new graduation'**. This is the application in future of the formula that has been proposed by the Commission and which is the central concern of this study.

Table 2. The effects of the new graduation formula

HS		Brief description	Change from *status quo*		Remain graduated[a]
Section	*Chapter*		*Graduated for the first time*	*Reintegrated*[b]	
1	2	3	4	5	6
I	1–5	Live animals; animal products	–	Argentina, Brazil, China, Thailand, Uruguay	–
II	6–14	Vegetable products	–	Brazil, Chile, China, Costa Rica, Ukraine	–
III	15	Animal or vegetable fats and oils and their cleavage products	–	Philippines	Indonesia, Malaysia
IV	16–24	Prepared foodstuffs; beverages; tobacco	–	Mexico, Thailand	Brazil
V	25–27	Mineral products	Algeria	Kuwait, Libya, Russia, Saudi Arabia	–
VI	28–38	Products of the chemical or allied industries	–	Belarus, Chile, Mexico, Russia, Ukraine	China (HS 28–38 excl. 31)
VII	39–40	Plastics and rubber and articles thereof	–	Malaysia, Thailand	China
VIII	41–43	Raw hides and skins, leather, furskins and articles thereof	–	Argentina, Brazil, India, Pakistan, Thailand	China (HS 42–3)
IX	44–46	Wood and articles thereof	China	Malaysia	Brazil, Indonesia
X	47–49	Pulp of wood or of other fibrous cellulosic material	China	Brazil	–
XI	50–63	Textiles and textile articles	–	India, Macao, Mauritius, Pakistan	China (HS 61–3)
XII	64–67	Footwear, headgear, umbrellas etc.	–	Brazil, Indonesia, Thailand	China
XIII	68–70	Articles of stone, plaster, cement, asbestos, mica or similar	–	Mexico	China
XIV	71	Precious or semi-precious stones; precious metals and articles thereof	China, India	Brunei	Thailand
XV	72–83	Base metals and articles thereof	Russia	Brazil, Mexico	China
XVI	84–85	Machinery and mechanical appliances; electrical equipment	–	Malaysia, Thailand	China
XVII	86–89	Vehicles, aircraft, vessels and associated equipment	Thailand, South Africa, China	–	–
XVIII	90–92	Precision instruments; clocks; musical instruments	–	–	China
XX	94–96	Miscellaneous manufactured articles	–	–	China

Note: [a]Countries shown in this column may not currently be graduated from as broad a range of items as they will be under the draft Regulation. This is because the 33 sectors from which countries may currently be graduated are reduced in the draft Regulation to the 21 HS sections. In most cases, therefore, the HS sections are broader than the current sectors. Where this is the case for countries in this column, the HS Chapters from which they are currently graduated are shown in brackets.
[b]For the reason given in (a), countries shown in this column are not necessarily graduated for all items in the relevant HS section.
Source: CEC 2004b, and information received subsequently.

of the total value of covered imports within that section. Table 2 lists them and shows how the new regime will compare with the *status quo*.

The absolute 'losers' (countries not currently graduated that will be under the new regime) are listed in Column 4. There are not very many of them. Only six of the 19 Harmonised System (HS) sections[6] would see any countries graduated out for the first time. China is graduated out of four sections which, between them, cover all wood and pulp, plus jewellery and vehicles. India is graduated out for jewellery, Algeria for mineral products and Russia for base metals. The section that sees the greatest 'first-time graduation' is vehicles. No fewer than three significant sources of EU imports (Thailand, South Africa and China) are graduated out.

There are significantly more 'winners' (countries currently subject to old graduation that will not be caught by new graduation). Listed in Column 5 of Table 2, they include three of the countries most affected by the tsunami. The revenue these countries will gain as a result of paying GSP rather than MFN tariffs is equivalent to between one-fifth and one-third of 1% of their exports to the EU.

Brazil and Thailand regain their rights to the GSP on the largest number of products – in six sections apiece. Mexico does so on four, Malaysia on three and Argentina, Chile, China, India, Pakistan, Russia and Ukraine on two apiece.

China remains graduated out for ten sectors, three of which do not overlap exactly with the product scope of its old graduation.[7] Brazil and Indonesia remain graduated on two sections (which correspond exactly with their old graduation), whilst Malaysia and Thailand remain graduated out in just one.

What happens in 2008?

The draft Regulation lists all the graduations that will be implemented before 2008, but what about after? Presumably the graduation exercise will be repeated (or else countries will begin to exceed the import share thresholds yet not be graduated). But against which imports will the share be calculated? The answer is of potential importance to the ACP. Clearly, graduation affects ACP exporters' competitive position by altering the terms on which other suppliers enter the EU market. It is also possible that any ACP state might be graduated in future – which would, at a stroke, make the GSP an inadequate alternative to EPAs.

It would be logical to calculate each state's share of eligible imports for each section (i.e. to exclude from the denominator imports from countries that have been graduated this time). But doing this tends automatically to push some countries above the threshold (even if their exports have not grown relative to those of the others). Given sufficient time, eventually all countries could be graduated as a result of this simple arithmetic process! How might this affect the ACP?

If the graduation exercise were undertaken in 2008 on the basis of the current 15 and 12.5% thresholds and in relation to eligible imports, and if the eligible countries retained their 2003 relative trade shares, an additional 23 country/sector graduations would occur. This is over twice the number that will be graduated for the first time in 2005, but it includes no ACP states. The affected countries would be India (in four sections), Russia and South Africa (in three), Indonesia, Thailand and United Arab Emirates (in two), plus Argentina, Brazil, Malaysia, Mexico, Philippines, Saudi Arabia and Ukraine. In addition, of course, there would be 'genuine' graduations, i.e. the removal of countries whose exports had increased relative to their peer's exports.

One way to avoid this would be to use covered rather than eligible imports in the exercise. This would be possible, and would avoid any 'graduation creep' from this source – but not from another. The other potential source arises from the Commission's intention to remove from the GSP countries with bilateral or regional trade agreements with the EU that provide equally or more favourable market access. Since these countries would no longer be listed in the GSP, they would not contribute to covered imports.

This reform is presented as a sensible 'tidying up' exercise but, of course, it is also a move away from the creation of a single, universal umbrella for EU trade policy towards developing countries. The draft Regulation does not remove any countries on this

criterion for the period to 2008. This is presumably because even those agreements that foresee more favourable market access are still in their implementation period; they will be more favourable than the GSP only once fully implemented. This is the case, for example, with the Trade, Development and Co-operation Agreement (TDCA) with South Africa. South African exports of roasted groundnuts to the EU under the TDCA enter duty free, whereas the GSP rate is 7.2%; some South African car bumpers, on the other hand, currently pay a tariff of 2.2% under the TDCA, even though the GSP rate is zero.

Because no country has been removed this time, the draft Regulation provides no guidance on how it might be done and whether any ACP state would be affected directly. This gives rise to two queries: one concerning apparent inconsistencies between the July Communication and the draft Regulation (see Box 3) and the other on how the graduation formula will be applied from 2008.

Since countries that are no longer in the GSP cannot contribute, by definition, to covered imports, an unchanged graduation formula would apply the 15 and 12.5% thresholds to a smaller basket of imports. Evidently, some GSP beneficiaries that currently fall below the threshold will in 2008 be above, even if their exports have not increased relatively.

Any attempt to identify such effects must be speculative. Not only is it unclear which countries might be deemed to have 'GSP-equivalent' accords, but who knows which states' exports will increase fastest. None the less, Table 3 provides an illustration of the possible implications. It shows the extra countries that would be graduated from the regime after 2008 if all the main countries which currently have a bilateral or regional trade agreement with the EU were removed from the GSP.

Six new country/sector graduations occur (compared with nine first-time graduations in 2005) but, again, there are no ACP graduates. This is just as a result of this 'tidying up' exercise, since no other changes have been assumed.

As with the query over the use of covered or eligible imports as the denominator, it is perfectly possible for the EU to avoid this 'graduation creep'. It could decide simply to maintain the denominator as at present or to raise the 15 and 12.5% thresholds proportionately. But in the absence of any guidance, the effect of the draft Regulation must be to create uncertainty – not least in the minds of potential investors.

GSP+

What it is – and who is eligible

The proposed GSP+ (special incentive arrangements for sustainable development and good governance) replaces the current scheme's three types of special arrangement relating to labour rights, protection of the environment, and illegal drug production and trafficking. It offers substantially improved preferences over the Standard GSP, and covers a broader range of products. For those countries

Box 3. Future exclusions from the GSP

Will countries be removed from the GSP only if their specific agreement has become as favourable as the GSP, or will their specific agreement be 'improved' up to GSP levels to facilitate their removal? The July Communication and the draft Regulation **appear** to say different things.

The draft Regulation would exclude an FTA member from the GSP 'if this agreement covers at least all the preferences provided by the present [GSP] scheme for this country' (preamble: para. 15). But the July Communication argues that, when making removals from the list, 'the Community **would of course** ensure that no country would lose as a result of this because GSP benefits for any particular product which formerly received GSP treatment should be consolidated into the FTA in question' (para. 6.3, emphasis added).

The difference could be critical to the negotiations on EPAs. It might imply, for example, that EPAs including LDCs must offer access to the EU for all members that is equivalent to EBA.

Table 3. Countries vulnerable to graduation from 2009 due to beneficiary removal[a]

HS		Brief description	New graduation in 2009
Section	*Chapter*		
I	1–5	Live animals; animal products	Argentina
II	6–14	Vegetable products	–
III	15	Animal or vegetable fats and oils and their cleavage products	–
IV	16–24	Prepared foodstuffs; beverages; tobacco	–
V	25–27	Mineral products	Russia, United Arab Emirates
VI	28–38	Products of the chemical or allied industries	Russia
VII	39–40	Plastics and rubber and articles thereof	–
VIII	41–43	Raw hides and skins, leather, furskins and articles thereof	India
IX	44–46	Wood and articles thereof	–
X	47–49	Pulp of wood or of other fibrous cellulosic material	–
XI	50–63	Textiles and textile articles	India
XII	64–67	Footwear, headgear, umbrellas etc.	–
XIII	68–70	Articles of stone, plaster, cement asbestos, mica or similar	–
XIV	71	Precious or semi-precious stones; precious metals and articles thereof	–
XV	72–83	Base metals and articles thereof	–
XVI	84–85	Machinery and mechanical appliances; electrical equipment	–
XVII	86–89	Vehicles, aircraft, vessels and associated equipment	–
XVIII	90–92	Precision instruments; clocks; musical instruments	–
XX	94–96	Miscellaneous manufactured articles	–

Note: [a]The table covers only 'main countries', i.e. those that are among the top 15 sources of GSP imports in any section. It is based on the values of covered imports in 2003 according to Commission figures with those for countries with bilateral/regional agreements with the EU removed (the latter having been identified from UK Tariff).

included in the special arrangements, simple *ad valorem* or specific duties will be suspended on all products covered by the GSP. For items subject to an *ad valorem* and a specific duty, the *ad valorem* element will be suspended. Duty suspensions will not apply to sections from which any given country has been graduated.

In order to benefit from these additional preferences, a country must:

- have ratified and effectively implemented:
  - 16 core human and labour rights UN/ILO Conventions; and
  - at least seven (of 11) conventions related to environment and governance principles;
- commit itself to ratify and effectively implement the remainder of the conventions;
- undertake to maintain the ratification of the conventions and their implementation, and to accept regular monitoring and review of its implementation record; and
- be classified as 'vulnerable' (see below).

Beneficiaries must have ratified all 27 conventions by 31 December, 2008.

Limitations on GSP+

GSP+ will not be available to every developing country that ratifies all the agreements. Countries

must also satisfy additional criteria related to the value of their exports set out in Article 9.2(a) and (b) of the draft Regulation. These specify that a country is vulnerable only if it meets both of two criteria:[8]

- a diversification criterion – the country is not classified as high income and the five largest HS sections account for over 75% of its covered imports (Article 9.2 (a)); and
- a smallness criterion – the country's covered imports represent less than 1% of the EU's total covered imports (Article 9.2 (b)).[9]

Two questions are whether the GSP+ criteria are 'development friendly' and whether they would sustain a WTO challenge. Table 9.4 lists the countries that would not be eligible for the special incentive arrangements – even if they ratified and implemented all the stipulated conventions – because they do not meet either of the two criteria. There are no ACP states in the group.

Three of the excluded states – India, Pakistan and Vietnam – are classified by the World Bank as low-income countries; the July Communication identified low-income countries as one of the categories on which the GSP should focus. Twelve of the 21 countries in Table 4 have per capita incomes of $2,000 or less, which means that 30 richer developing countries will be eligible for GSP+ (if they sign up to the conventions). Five GSP beneficiary countries are richer than all of the countries listed in Table 4; such statistics might be relevant to any WTO challenge (see Box 4). And all of the tsunami-affected states other than Sri Lanka are included in the table.

Table 4. *A priori* exclusions from GSP+

Country[a]	GNI per capita 2003 (US$)[b]
Argentina	4,220
Brazil	2,860
China	960
Egypt	1,470
India	470
Indonesia	710
Jordan	1,760
Lebanon	3,900
Malaysia	3,550
Mexico	5,940
Morocco	1,170
Pakistan	420
Philippines	1,030
Russian Federation	2,130
Saudi Arabia	8,530
South Africa	2,630
Thailand	2,000
Tunisia	1,990
Ukraine	780
United Arab Emirates	n/a
Vietnam	430

Sources: Data provided by the Commission; World Bank

The potential effects

The impact of GSP+ could be very substantial, but only if a high proportion of the countries not listed in Table 4 are accepted. The new regime replaces two very different types of arrangement.

Deep but geographically restricted preferences under the special anti-narcotics regime that provided substantial additional preferences to nominated countries. They have been well used by the beneficiaries.

Shallow but geographically unrestricted preferences under the special regimes for protection of labour rights and the environment that provided modest additional preferences and have not been much used. Only two countries (Moldova and Sri Lanka) currently benefit under the former, and none under the latter. Two possible (linked) reasons for the low take-up are that: first, countries have been unwilling to accept the conditions (which are in areas considered contentious in the WTO), especially, second, when the gains from so doing are modest.

Will the applications for GSP+ be more substantial than for the labour/environment protection schemes? And will the applications succeed? If the answer is 'yes', the impact could be profound. GSP+ beneficiaries will be among the EU's 'most preferred' group. There could be three types of effect.

- Trade creation. The number of countries and products facing no tariff barriers in the EU would increase, resulting in more trade.
- Trade diversion. Countries elevated from the 'middle' to the 'most preferred' group would find

Box 4. The WTO dimension

The unfavourable WTO ruling on the special 'anti-narcotics' preferences in the current GSP has contributed to the design of the GSP+ (WTO 2004a). Importantly, the Appellate Body ruled against a claim by India that the GSP must offer 'identical' tariff preferences to all beneficiaries. It confirmed that different preferences may be given provided that the difference responds 'to a widely-recognized "development, financial [or] trade need"...' (para. 164). But it also found that the justification given for the antinarcotics regime failed to satisfy this criterion.

The Commission argues that the eligibility conditions for GSP+ do satisfy the criterion. But it remains to be seen whether the a priori exclusion of the countries listed in Table 5 would lay the scheme open to a further WTO challenge.

The Appellate Body gives an example of the 'objective standard' that could justify differential treatment for sub-groups within the GSP. The required '[b]road-based recognition of a particular need...' that would justify such differentiation is exemplified by recognition 'set out in the WTO Agreement or in multilateral instruments adopted by international organizations...' (para. 163).

Whilst the conventions that eligible countries must apply appear plausibly to have such recognition, the same does not appear to apply to the diversification and smallness criteria.

that they have a competitive advantage over those that remain in the middle group and that they no longer face a competitive disadvantage compared with those that are already in the 'most preferred' group. They can expect to acquire some market share from both types of competitor. By the same token, if some current beneficiaries of the anti-narcotics regimes fail to obtain GSP+ they will fall from the 'most preferred' to the 'middle' group – and lose markets.

- Rules of origin. If take-up were widespread, the origin rules would become a less important determinant of trade. The more countries that have identical access terms to the EU market, the less significant it is where the product 'originated'. If, for example, a manufacturer in Pakistan uses inputs from Malaysia, the origin rules will determine whether or not the EU classifies the resulting good as Pakistani or Malaysian. But if the tariff for both Pakistan and Malaysia is 0%, the classification has no commercial importance. This is an important point for the ACP, taken up in Part B.

The relative scale of these effects will be determined by the extent of GSP+ uptake. If many countries become eligible, the trade creation and rules of origin effects will predominate. If few countries become eligible, then trade diversion will be more marked, especially if beneficiaries of the anti-narcotics regime fail to obtain GSP+.

The two changes that appear of greatest potential importance to the ACP are those that foresee a focusing of GSP benefits and their enhancement for certain states. Graduation is the primary mechanism for 'focusing the GSP'. The GSP+ is the main vehicle for enhancement.

Part B: Making the GSP Cotonou Equivalent

Scope and methodology

As the report of the WTO Appellate Body on the EU–India dispute makes clear (Box 4), differentiation within the GSP is acceptable provided it reflects 'a widely recognized "development, financial [or] trade need"...'. How could the GSP be differentiated or otherwise changed? There are three main options, of which two are researched in this paper. The option that is not covered is to create a special tranche of the GSP just for the ACP.[10] The reason this option is not researched in this chapter is that the problems of feasibility that would flow from a special 'ACP tranche' of the GSP do not arise in any way from technical concerns about the product

composition and preferential treatment of the regime. This is self-evident: the regime would need to be available to all ACP states not entering EPAs and would offer tariff treatment at least as good as that under Cotonou. Rather, questions over feasibility would be concerned with the WTO acceptability of such a move. This is an issue that falls outside the current study.

The second option is to integrate the ACP into GSP+ and to alter its provisions (mainly through adding new products) so that it offers Cotonou equivalence in relation to tariffs. The third option is to improve the Standard GSP to bring it to the level of Cotonou. This chapter identifies which products would need to be brought into the GSP net, what changes would need to be made to their tariff treatment, and which non-ACP states would benefit most. This last point is necessary to assess how far the changes would erode ACP preferences.

And therein lies an important methodological point. There is the world of commerce – and there is the world of trade policy and statistics. The latter provides a mirror of the former, but a distorted one. These distortions need to be understood. This chapter, based on an analysis of trade statistics and of proposed changes to public policy, helps to identify the framework within which trade takes place. But there are other factors – that will be known to active traders – that also have a bearing (often very strong) on who sells what to whom. Two clear limitations of a study such as this need to be understood.

First, it can deal only with the products that the ACP actually exports to a significant extent at the present time. Only for these is it possible to identify competitors – and the competitors' terms of access to the EU market. However, if there are products which the ACP expects to export in the future, and these can be specified, an analogous exercise could be done for them as well. Second, the chapter identifies the ACP's 'competitors': whether or not the countries are really competitors with the ACP depends on a range of other market-related factors (such as quality, delivery times, niche markets, national markets). It is beyond the scope of this study to identify which areas of competition exist within these products. By the same token, there may actually be competition between, say, ACP exports of preserved pineapples and another country's exports of fresh pineapples, or other preserved fruits. This type of market-related information is known by those engaged in the trade but cannot be judged from the trade statistics.

Moreover, for reasons of practicality the chapter considers only competitors that supply 10% or more of EU imports. It is assumed that these are the ones most likely to affect market prices. If a major exporter of beef such as Brazil or Argentina, for example, sees a duty cut their competitive response may well affect the prices available to all other suppliers. This generalised effect is less likely in the case of a country supplying only a few percent of EU imports. On the other hand, of course, they may be competing in precisely the niche market targeted by the ACP! For this reason, as well as others that become apparent, the chapter should be seen as a first step in assessing the feasibility of the GSP as a Cotonou equivalent.

Identifying the products

A first, basic requirement for a GSP providing treatment equal to Cotonou is that it covers all of the products that the ACP countries currently export and that receive preference under Cotonou. Although a necessary condition, it is not sufficient. Attention also needs to be given to the relative treatment of the ACP and their competitors. But it is an obvious first place to start.

This section identifies the products for which the current GSP and the proposed new GSP provide less favourable treatment than does Cotonou. The message to be conveyed is that the number of products involved is not huge – and hence it may be feasible to extend the GSP appropriately. On the other hand, neither is it minuscule nor, as might be predicted, uncontentious. So there are certainly obstacles to be overcome.

Current ACP exports to the EU

Table 5 provides summary details of the range of products that the ACP currently export in other than insignificant amounts to the EU and their treatment under the GSP. The table was compiled by analysing EU import statistics twice: once to pick

up products that are relatively important to any ACP state, and the second time to identify any overlooked item that is exported to a substantial value.

Table 5. Non-LDC ACP exports to EU, 2003

	Value ($ bn)	Share
Total	23.3	
'Significant' items[a]	22.0	100.0%
Of which:	15.4	70.2%
MFN zero	1.0	4.7%
Standard GSP zero	3.4	15.7%
Standard GSP not zero (GSP+ zero[b])	2.1	9.5%
Not covered by GSP or GSP+		

Notes:
[a]Any item accounting for 5% or more of any individual non-LDC ACP country's total exports to the EU in 2003 (89 items) or not meeting this criterion, but which the 36 non-LDC ACP countries in aggregate exported to the EU to a value of $10 million or more in 2003 (105 items).
[b]Other than 4 items – see footnote 14.
Source: UNCTAD TRAINS, January 2005

The first 'trawl' identified any item accounting for 5% or more of an individual ACP country's total exports to the EU in 2003. The choice of a criterion linked to the relative share of a country's exports ensured that the study did not overlook any items that are important only for a very small ACP state (and therefore are exported in relatively small values). So, for example, the analysis included frozen herring (Combined Nomenclature (CN) code 03049022) which was exported only by Niue, and only to a value of $2,000 – but which accounted for 40% of Niue's total exports to the EU in 2003. This trawl identified 89 items.

The problem with this approach is that it overlooks some of the items that are exported by the larger ACP states. Some 5% of EU imports from, for example, Côte d'Ivoire, amount to $143.4 million; we did not wish to exclude all imports from Côte d'Ivoire of less than this amount. The second trawl, therefore, identified items that are exported in aggregate by the 36 ACP countries[11] to a value of $10 million or more. This added a further 105 items.

Table 5 presents the findings on the resulting 194 items which the EU imported from ACP countries to a value of $22 billion in 2003. Since the total imports of the EU from these 36 states in 2003 was only $23.3 billion, it can be seen that the two trawls have picked up between them items that account for 94% by value of European imports from the ACP group other than the least developed.

Some 70% of these imports came in duty free because the EU's MFN tariff is set at zero. Preferences are neither given nor possible on such products. Just under 5% were already accorded duty-free access under the GSP. Hence, the end of the Cotonou Agreement would leave unchanged 75% or so of ACP exports because they are in items that either enter duty free under the MFN or would do so under the Standard GSP. The purpose of this chapter is to consider the position of the remaining 25%. These are referred to in the rest of the chapter as 'GSP-relevant' items. Just under two-thirds of the GSP-relevant items are included in the Standard GSP but are not accorded duty-free access. All but four are, however, given duty-free access under the proposed new GSP+.[12] All of the remainder are items that are not covered by the Standard GSP or GSP+, and so would have to be introduced into the scheme for it to provide an adequate alternative to Cotonou.

Potential ACP exports to the EU

Table 5 identifies those products currently exported by ACP states that are imported from the ACP and would face positive tariffs under the GSP, but what of products that the ACP does not currently export to the EU? One of the attractions of the Cotonou Agreement is that it is largely a 'negative list' preference agreement. Except in the case of items covered by the Common Agricultural Policy (CAP) it offers duty-free access for all ACP products that meet the rules of origin. This means that if an ACP country develops a new line of export it can be certain (so long as the item is not covered by the CAP) that it will enjoy duty-free access to the EU. The GSP, by contrast, is a positive list: it specifies precisely which products are covered, and any item that is not mentioned is excluded.

Since it is not possible to identify all the prod-

ucts that the ACP might export in future, a flavour of the range of items that might emerge in their trade with the EU has been obtained by looking at their exports to non-EU markets. In order to keep the task within reasonable limits, a slightly different methodology was employed from that used for Table 5. Instead of identifying all imports that met the two significance criteria and then establishing the EU's tariff treatment, the order of business was reversed. First we produced a list of all the items that are not covered by the GSP, and then we interrogated UNCTAD's TRAINS database to identify all ACP exports of these non-covered items to the world[13] in 2003. The analysis of exports to non-EU markets has necessarily had to be undertaken at the HS 6-digit level. This is because the HS is common only to 6 digits. It is not possible to identify which US or Japanese imports from ACP states fall into each of the EU's CN 8-digit categories. This exercise identified an additional 10 items (at the HS6 sub-heading level). These are products of which the ACP had exports of at least $5 million to the world and which had not been thrown up in the trawl of EU import statistics (either because they were not exported at all to the EU, or because their 8-digit components failed to meet either of the criteria).

Taking the two exercises together, Table 6 provides information on the full list of current ACP exports (to the EU and elsewhere) that are not given duty-free access to the EU under the GSP. For reasons of practicality (there are 85 CN8-digit items derived from EU import statistics and 10 HS6-digit items derived from other countries' import statistics), the table aggregates similar products. Hence, for example, the first row is for a single 8-digit item (fresh or chilled boneless beef) because this is the only GSP-relevant meat item within this HS4 heading that ACP countries export either to the EU or elsewhere. The third row, though, provides data only for the HS4 digit heading fresh or chilled fish, for which there are two separate 8-digit EU imports (with different tariffs).

Columns 4–6 of the table indicate the way in which the GSP is currently deficient as a substitute for Cotonou. Column 4 shows the cases where the product is excluded from the Standard GSP altogether. Column 5 covers products that are included in the Standard GSP but do not receive duty-free access. Finally, Column 6 lists for every item in the table the coverage proposed under GSP+.

Of the two options for achieving Cotonou equivalence investigated in this chapter, the simpler is if all ACP countries become eligible for the GSP+ and its product coverage is extended to include the 28 observations included in Table 6 that it does not cover. This approach would work if all ACP states achieved GSP+ eligibility.

If this did not happen – or was considered undesirable – then the Standard GSP would need to be improved in order to make it Cotonou equivalent. In addition to the requirement that the GSP be extended to include the 28 observations that are not covered by GSP+, all of the items would have to be given tariff treatment commensurate with that available under the Cotonou Agreement.

Preference erosion

A problem for the ACP is that a key advantage for them of Cotonou is that they are treated more favourably than some of their developing country competitors. Clearly, the EU has to take a more rounded view of the development attractions of lower tariffs than do the ACP and cannot simply agree to freeze current trade policy in order to maintain this margin of preference. Even a full extension of Cotonou into EPAs would not achieve the ACP objective of freezing preference margins.

Indeed, the extension of liberal access by the EU to a larger number of countries will enhance the economic impact of a broader GSP+. This enhancement could go further if the EU 'compensated' the ACP by providing new trade support measures. This could be in the form of positive assistance to improve ACP supply capacity and help countries meet EU technical and health requirements. It could also be via 'new preferences' in areas less subject to WTO challenge, such as short-term visas and work permits for service providers under modes 1 and 3.

The scale of these economic gains may be substantially larger than any to be obtained from reciprocity under EPAs. There is a likelihood that the requirement of WTO Article XXIV that a free trade

Table 6. Full list of current ACP exports (to the EU and elsewhere) that are not given duty-free access to the EU under the GSP

Product #		Description	Standard GSP		GSP+[b c]
	Observations[a]		*Excluded*[b]	*Positive tariff*[b]	
02013000	1	fresh or chilled bovine meat, boneless	X		
0202	1	boneless, frozen meat of bovine animals	X		
0302	2	fish, fresh or chilled		5.2 or 11.5	0
0303	3	frozen fish		5.2 or 11.5	0
0304	4	fish fillets and other fish meat, whether or not minced, fresh, chilled or frozen		0, 4, 5.5 or 11.5	0
0306	4	crustaceans		4.2 or 4.3	3.6 or 0
0307	3	molluscs		2.8 or 3.8	0
0603	2	cut flowers and flower buds of a kind suitable for bouquets or for ornamental purposes		5 or 8.5	0
0708	2	leguminous vegetables, shelled or unshelled, fresh or chilled		4.5–10.1	0
07099090	1	fresh or chilled vegetables n.e.s		8.9	0
08030019	1	bananas, fresh (excl. plantains)	X		
0804	2	dates, figs, pine-apples, avocados, guavas, mangoes and mangosteens, fresh or dried		0–2.3	0
0805	2	citrus fruit, fresh or dried	X		
ex 08061010	1	fresh table grapes	(X)[d]		
09050000	1	vanilla		2.1	0
10062098	1	long grain husked – brown – rice, length/ width ratio >=3 (excl. parboiled)	X		
1101	1	wheat or meslin flour	X		

Table 6 (continued)

Product #		Description	Standard GSP		GSP+[b c]
	Observations[a]		*Excluded*[b]	*Positive tariff*[b]	
1107	1	malt	X		
15119099	1	palm oil and its liquid fractions, whether or not refined, but not chemically modified		3.1	0
1513	2	coconut 'copra', palm kernel or babassu oil and fractions thereof, whether or not refined, but not chemically modified		2.2	0
1604	3	prepared or preserved tunas, skipjack and atlantic bonito, whole or in pieces (excl. minced)		20.5	0
1701	3	cane or beet sugar and chemically pure sucrose in solid form	X		
1703	2	molasses resulting from the extraction or refining of sugar	X		
1803	2	cocoa paste, whether or not defatted		6.1	0
18040000	1	cocoa butter, fat, oil		4.2	0
18050000	1	cocoa powder, not containing added sugar or other sweetening matter		2.8	0
18062010	1	chocolate and other food preparations containing cocoa		4.8% + AC max 18.7%	0 + AC
20055900	1	unshelled beans 'vigna spp., phaseolus spp.', prepared or preserved otherwise than by vinegar or acetic acid		15.7	0
2008	2	pineapples, prepared or preserved, whether or not containing added sugar/other sweetening matter/ spirit, nes.		14.9 or 15.7	0

Table 6 (continued)

Product #		Description	Standard GSP		GSP+[b c]
	Observations[a]		*Excluded*[b]	*Positive tariff*[b]	
20094930	1	pineapple juice, unfermented		11.7	0
21011111	1	solid extracts, essences and concentrates of coffee		3.1	0
2208	2	undenatured ethyl alcohol	X		
2302	1	bran, sharps and other residues of wheat	X		
ex 2309	1	preparations of a kind used in animal feed	(X)[e]		
2401	3	unmanufactured tobacco; tobacco refuse		3.9% max 56 €/100 kg or 14.9% max 24 €/100kg	0
24021000	1	cigars, cheroots and cigarillos containing tobacco		9.1	0
2501	1	salts, including table and denatured salt, and pure sodium chloride	X		
28141000	1	anhydrous ammonia		2	0
28182000	1	aluminium oxide (other than artificial corundum)		X	
29051100	1	methanol 'methyl alcohol'		2	0
29161220	1	ethylacrylate		3	0
29321200	1	2-furaldehyde 'furfuraldehyde'		3	0
39041000	1	polyvinyl chloride, in primary forms		3	0
41051010	1	skins of sheep or lambs, in the wet state 'incl. wet-blue', tanned, without wool on, unsplit	X		

Table 6 (continued)

Product #		Description	Standard GSP		GSP+[b c]
	Observations[a]		*Excluded*[b]	*Positive tariff*[b]	
4105	1	skins of sheep or lambs, in the dry state 'crust', without wool on, whether or not split	X		
4106	3	goat or kidskin leather, dehaired	X		
4412	2	plywood, veneered			
		wood and similar laminated wood		3.5 or 6.5	0
54025200	1	filament yarn of polyester, incl. monofilament of < 67 decitex, single, with a twist of > 50 turns per metre		3.2	0
61051000	1	men's or boys' shirts of cotton, knitted or crocheted		9.6	0
61061000	1	women's or girls' blouses, shirts and shirt-blouses of cotton, knitted or crocheted		9.6	0
61091000	1	t-shirts, singlets and other vests of cotton, knitted or crocheted		9.6	0
6110	5	jerseys, pullovers, cardigans, waistcoats and similar articles, knitted or crocheted		9.6	0
6203	2	men's or boys' suits, ensembles, jackets, blazers, trousers, bib and brace overalls, breeches and shorts		9.6	0
62046231	1	women's or girls' cotton denim trousers and breeches		9.6	0
62052000	1	men's or boys' shirts of cotton		9.6	0

Table 6 (continued)

Product #		Description	Standard GSP		GSP+[b c]
	Observations[a]		*Excluded*[b]	*Positive tariff*[b]	
62121090	1	brassieres of all types of textile materials, whether or not elasticated, incl. knitted or crocheted	5.2	0	
76011000	1	aluminium, not alloyed, unwrought	X		
79011100	1	unwrought zinc, non-alloy, containing by weight >= 99.99% of zinc	X		
7601	1	aluminium alloys, unwrought	X		
85299081	1	parts suitable for use solely or principally with television cameras, receivers of radio-telephonic/ telegraphic signals, or for radio or television, n.e.s.		1.5	0
87032390	1	motor vehicles for transport of persons, with spark-ignition internal combustion reciprocating piston engine, cylinder capacity >1 500 but =<3 000cc		6.5	0

Notes:

[a]An observation = 1 CN8 item or 1 HS6 sub-heading.

[b]Only exclusions and tariffs relating to the specific CN8 items (where known) included in any HS4 or HS6 headings shown are listed.

[c]'AC' = agricultural component.

[d]There is GSP coverage from 1–31 January for Emperor variety and from 1 January–20 July and 21 November–31 December for other varieties.

[e]There is GSP coverage for 4 out of c.16 8-digit components of this HS6 sub-heading. It is impossible to know from the trade statistics whether the items being exported are covered or not.

Sources: UNCTAD TRAINS, January 2005; CEC 2004b; UK Tariff 2005.

area liberalise on 'substantially all' trade will be interpreted as requiring ACP states to remove tariffs on only about 80% of their imports from the EU. This will allow them to continue to shelter many sensitive items. And even for those items that will be liberalised, implementation will take place over a transition period of at least 12 years from 2008.

At the same time, though, some account needs to be taken of the extent to which the task of improving the GSP solely for the purpose of making

it Cotonou equivalent would automatically erode the gains that the ACP might hope to achieve from this process. It would not be sensible to use considerable political capital pressing for an extension of the Standard GSP if, in so doing, it meant that the ACP saw their preference entirely eroded.

Evidently, the change to the GSP that would provoke the smallest amount of additional preference erosion would be the extension of GSP+ to cover all ACP GSP-relevant exports. The ACP countries would share their preferential access with all other GSP+ beneficiaries – but so they will regardless of what happens under Cotonou for all products that are not added to the scheme specifically to make it Cotonou equivalent.

If this is the 'least eroding' approach, then the 'most eroding' avenue would be to extend the Standard GSP. To the extent that this is successful it will extend to countries excluded from GSP+ the same benefits as Cotonou currently provides to the ACP (unless such countries are graduated out). Because of their different implications both in terms of political feasibility and 'preference erodability', the two approaches of extending GSP+ or the Standard GSP are dealt with in turn.

Extending GSP+

The objective of this section is to identify the products for which inclusion in the GSP+ would result in an erosion of ACP preferences that has not occurred, and will not occur, anyway. This requires us to identify the competitor countries that would benefit from a favourable change in their access to the EU market as a result of the extension of GSP+. No LDC will fall into this category; EBA provides all LDCs with virtually free access regardless of what happens to GSP+. Nor may countries that have a bilateral agreement with the EU – if the agreement already provides duty-free access on the items in question (now or by the end of the implementation period) then the extension of GSP+ is irrelevant. A third group of countries that would be unaffected by an extension to GSP+ is those that are ineligible because they fail the 'vulnerability' test, because they are graduated out of the GSP for the relevant section, or because they are not GSP beneficiaries.

Table 7 summarises the preference erosion potential of extending GSP+ and provides a pointer to the next step of competitor identification. The shaded rows show products that were identified (at HS6) through analysing ACP exports to the 'world'.

Table 7 takes each of the items identified in Table 6 as being outside GSP+ and indicates the status of all non-ACP, non-LDC, GSP-beneficiary competitors that accounted for 10% or more of EU imports of the item in 2003. Column 5 is the critical one. It indicates whether or not one of these main competitors would be eligible for GSP+ if it were extended. When the column returns 'None' it means that GSP+ extension would not erode ACP preferences – at least in respect of the major competitors. In cases where the response is 'All' there will be full erosion, and where it is 'Some' it means that some competitors would benefit from GSP+ while others would not.

This approach of identifying the main sources of erosion does not work with sugar. Table 7 indicates no non-ACP competitors. This is not because no developing country can export sugar competitively, but because none can export over the EU's high tariffs. Sugar is considered separately below.

Table 8 takes the products for which 'All' or 'Some' is returned in Column 5 of Table 7, and provides further information on the identity of the main competitors and their treatment. There are four problem commodities in addition to sugar. Overwhelmingly the most important (in terms of the value of ACP exports and the number of exporters) is bananas – for which the issues and problems are well known. The key issue is whether or not the extension of the GSP will have any additional effects on the commercial viability of banana exports from the Caribbean on the one hand and West Africa on the other, over and above the changes that are expected to occur following the EU's WTO-induced changes to the banana regime and the lifting of all import restrictions from LDCs from next year.

Similar considerations also apply to rum, which is the next most important item in Table 8 (in both value and number of exporters). Any change to the GSP will need to take account of the accommodations that have been reached as a consequence of

Table 7. Extending GSP+: implications for preference erosion

Product	Description	# ACP exporters to EU	Current non-LDC ACP treatment better, worse or same as main competitors'[a]	Competitors eligible for GSP+
02013000	fresh or chilled bovine meat, boneless	4	Better	None
020230	boneless, frozen meat of bovine animals	5	Better	None
08030019	bananas, fresh (excl. plantains)	14	Better	All
08051030[b]	fresh navels, navelines, navelates, salustianas, vernas, valencia lates, maltese, shamoutis, ovalis, trovita and hamlins	6	All three	None
08051050[b]	fresh sweet oranges (excl. above)	5	All three	None
ex 08061010	fresh table grapes	3	All three	Some
10062098	long grain husked brown rice, length/ width ratio >=3 (excl. parboiled)	3	Better	None
110100	wheat or meslin flour	0	*No GSP competitors*	
110710	malt	1	*No GSP competitors*	
17011110	raw cane sugar, for refining (excl. added flavouring or colouring)	13	*No non-ACP competitors*	
17011190	raw cane sugar (excl. for refining and added flavouring or colouring)	5	*No non-ACP competitors*	
170199	cane or beet sugar and chemically pure sucrose in solid form	6	No GSP competitors	
17031000	cane molasses resulting from the extraction or refining of sugar	3	Same	None
170390	beet molasses resulting from the extraction or refining of sugar	0	*No GSP competitors*	
22084051	rum with a content of volatile substances ±of >= 225 g/hl of pure alcohol 'with a 10% tolerance', in containers holding > 2 l	7	*No non-ACP competitors*	
22084099	rum and tafia, of a value <= 2 ecu/l of			
	pure alcohol, in containers holding > 2 l	9	Better	All
230230	bran, sharps and other residues of wheat	1	Better	None
ex 230990	preparations of a kind used in animal feed	0	*No GSP competitors*	
250100	salts, including table and denatured salt,			
	and pure sodium chloride	7	Same or worse	None
28182000	aluminium oxide (other than artificial			
	corundum)	2	*No non-ACP GSP competitors*	
41051010	skins of sheep or lambs, in the wet state 'incl. wet-blue', tanned, without wool on, unsplit'	4	Same or better	Some

Table 7 (continued)

Product	Description	# ACP exporters to EU	Current non-LDC ACP treatment better, worse or same as main competitors'[a]	Competitors eligible for GSP+
410530	skins of sheep or lambs, in the dry state 'crust', without wool on, whether or not split	1	*No non-ACP competitors*	
41062110	skins of goats or kids, in the wet state 'incl. wet-blue', tanned, without wool on, unsplit	4	Same or better	None
41062190	skins of goats or kids, in the wet state 'incl. wet-blue', tanned, without wool on, split	3	Better	None
41062290	hides and skins of goats or kids, in the dry state 'crust', without wool on, whether or not split	3	Better	None
76011000	aluminium, not alloyed, unwrought	3	Same or better	None
760120	aluminium alloys, unwrought	3	*No GSP competitors*	
79011100	unwrought zinc, non-alloy, containing by weight >= 99.99 % of zinc	1	*No GSP competitors*	

Notes:
[a]All non-LDC, non-ACP GSP beneficiaries supplying 10% or more of the EU market in 2003. 'All three' in this column denotes that the ACP's treatment is potentially the same as, better or worse than its competitors' – according to the date of entry and entry price.
[b]Both these codes now (2005) fall under CN 08051020.
Sources: UNCTAD TRAINS, January 2005; UK Tariff 2005.

the EU's 'zero-for-zero' deal under the Uruguay Round for spirits.

Bananas, rum, and – the most substantial of all, sugar – are all known 'problem commodities', for which it is not really sensible to try to identify 'solutions' purely within the context of this chapter. It is evident that any fully acceptable 'solution' is very difficult to find even without the complication of considering the consequences of the end of the Cotonou Agreement. It is not even certain how sugar can be handled in EPAs.

The other two products in Table 8, though, are less well recognised. Both of the main suppliers of grapes to the EU market (South Africa and Chile) have concluded FTAs with the EU which are likely to reduce the margin of preference of the ACP in due course. One of them, South Africa, is not eligible for GSP+, and so the focus of attention is the EU–Chile Agreement. However, since ACP exports are small, and for climatic reasons unlikely to ever become substantial, it seems plausible that the item could be added to GSP+ without substantially eroding the Cotonou *acquis*.

This applies even more strongly to the fourth item in Table 8, lamb skins. The only major competitor that would be eligible for GSP+ already has duty-free access to the EU market.

Improving the Standard GSP

As explained above, none of the ACP states is excluded *a priori* from the GSP+. Hence, the only reason why an ACP state might be ineligible is if it fails to ratify and implement all of the required conventions. Unlike non-ACP states, the ACP will have until end-2007 to do this. The only reasons, therefore, for not adopting the 'extend GSP+' route

Table 8. GSP+: the key areas of potential preference erosion

CN8	Description	# ACP exporters	ACP export value 2003 ($000)	Cotonou tariff	Main EU suppliers 2003[a]	Value 2003 ($000)	Competitor tariff	Competitor eligible for GSP+?
08030019	bananas, fresh (excl. plantains)	14	547,866	0 in quota (380 €/1000kg net otherwise)	World Costa Rica Ecuador Colombia	2,363,109 546,578 530,490 463,940	75 €/1000 kg net in quota (680 €/1000 kg net otherwise)	Yes Yes Yes
08061010	ex fresh table grapes	3	12,044	0-MFN	World South Africa Chile	677,977 262,269 165,037	5.8-MFN 4.6% to 12.8% +9.6 €/100 kg net	No Yes
22084099	rum and tafia of a value <= 2 ecu/l of pure alcohol, in containers holding > 2 l	9	22,845	0	World Cuba	43,516 16,535	0.6 €/% vol/hl	Yes
41051010	skins of sheep or lambs, in the wet state 'incl. wet-blue', tanned, without wool on, unsplit	4	15,759	0	World Syria Saudi Arabia	138,501 45,042 17,629	0 2	Yes No

Note:
[a]All non-LDC, non-ACP GSP beneficiaries supplying 10% or more of the EU market in 2003.
Sources: UNCTAD TRAINS, January 2005; UK Tariff 2005.

Table 9. The Standard GSP: areas of potential preference erosion on 'new products'

CN8	Description	# ACP exporters	Value of ACP exports 2003 ($000)	Cotonou tariff	Main EU suppliers 2003[a]	Value 2003 ($000)	Competitor tariff	Competitor eligible for GSP+?
02013000	fresh or chilled bovine meat, boneless	4	72,449	4 0%+24.2 €/100kg net (Beef Protocol)	Brazil Argentina	249,066 240,001	} 20% in quota } (12.8%+303.4€/100 kg net otherwise)	No No
020230	boneless, frozen meat of bovine animals	5	16,123	0%+17.6 or 24.3 €/100kg net (Beef Protocol)	Brazil	227,963	20% in quota (12.8%+221.1 or 304.1 €/100 kg net otherwise)	No
08051030	fresh navels, navelines, navelates, salustianas, vernas, valencia lates, maltese, shamoutis, ovalis, trovita and hamlins	6	16,519	0-3.2+7.1 €/100 kg net	South Africa Morocco	116,975 73,983	2.6%-(16%+7.1 €/100kg net) 0-(3.2%+7.1 €/100 kg net)	No No
08051050	fresh sweet oranges	5	11,377	0-3.2	South Africa Swaziland	29,356 6,081	2.6%-(16%+7.1 €/100kg net)	No
10062098	long grain husked – brown – rice, length/width ratio >=3 (excl. parboiled)	3	33,783	Reduced levy	India Pakistan Guyana	113,908 55,164 25,186	Rate in force on day of import	No No
17031000	cane molasses resulting from the extraction or refining of sugar	3	11,570	0	Pakistan	82,676	Rate in force on day of import	No
230230	bran, sharps and other residues of wheat	1	482 81.8 €/t	36.8 or	Austria Russia	947,641	44 or 89 €/t	No
250100	salts, including table and denatured salt, and pure sodium chloride	7	83	0 or 1.7 or 2.6 €/1000kg	Tunisia Poland Israel	9,620 8,333 6,351	0	No

Table 9 (continued)

CN8	Description	# ACP exporters	Value of ACP exports 2003 ($000)	Cotonou tariff	Main EU suppliers 2003[a]	Value 2003 ($000)	Competitor tariff	Competitor eligible for GSP+?
41062110	skins of goats or kids, in the wet state 'incl. wet-blue', tanned, without wool on, unsplit	4	23,270	0	Nigeria	19,042		
					China	17,816	2	No
					Ethiopia	12,473	0	
					Saudi Arabia	8,364	2	No
41062290	hides and skins of goats or kids, in the dry state 'crust', without wool on, whether or not split (excl. further prepared and pre-tanned only and vegetable pre-tanned indian goat or kid hides and skins of subheading 4106.22.10)	3	11,900	0	Nigeria	11,680		
					India	9,077	2	No
					Pakistan	8,095	2	No

Note:
[a]All non-LDC, non-ACP GSP beneficiaries supplying 10% or more of the EU market in 2003.
Sources: UNCTAD TRAINS, January 2005; UK Tariff 2005.

would be that some countries for which the EU wishes to continue strong preferences fail to make the ratifications or that it is considered undesirable to follow this route, perhaps because the WTO compatibility of GSP+ is by no means certain.

In that case the principal option would be to extend the Standard GSP. Two sets of analyses are required to determine how far the Standard GSP could make an acceptable 'non-eroding' platform for a Cotonou-equivalent system. The first is to reopen the analysis of extending product coverage in Table 7. The second is to consider the effects of reducing tariffs to the Cotonou level.

Adding extra competitors for the new products

No new products will need to be added to the GSP over and above those already identified as required to make the GSP+ an acceptable Cotonou equivalent. But the erosion potential of including these new products in the Standard GSP is greater. In addition to the erosion potential noted earlier, account needs to be taken of the fact that the new preferences would also be available to countries that are excluded from GSP+ because they fail the vulnerability criteria.[14]

Table 7 returned 'None' in the Column 5 for 12 of the 28 rows. In how many cases was this because all of the main competitors fail the GSP+ vulnerability criteria? The answer is ten; in the other two all of the main competitors (China and Russia) were also ineligible because of graduation, and would continue to be excluded on this basis from enjoying the benefits of a reduction in Standard GSP tariffs.

Table 9 provides the same data as Table 8 for the new products that could result in preference erosion if Cotonou equivalence were to be achieved by improving the Standard GSP. The key products are beef, oranges, rice and molasses. Apart from the last (which is part and parcel of 'the sugar problem') these are additional to the contentious products thrown up by the extension of GSP+. But the number of ACP exporters is limited.

Cutting tariffs

Having extended the product scope of the Standard GSP to include all relevant items for the ACP, the next step would be to reduce the import duty payable to that provided under Cotonou. A similar approach has been taken to identify competitors and the extent to which preferences would be eroded as was done for the GSP+ above. However, for reasons of practicality (since the list of products is much longer) the information has been split into three tables. Table 10 deals with the items other than clothing and textiles for which the potential preference erosion is greatest, Table 11 covers clothing and textiles, and Table 12 deals with the remaining items where the potential scale of the erosion is smaller. 'Main suppliers' that have been graduated out of the relevant section are indicated in all three tables through the use of strikeout.

Table 10 lists all the items (other than textiles and clothing) for which the Standard GSP tariff is 5% or more. It is here that any preference erosion would be the most substantial. For example, the GSP tariff on fresh or chilled hake (CN 03026966) is 11.5% – and it is paid by South Africa, which is the main supplier, since no lower rate is currently offered under the EU–South Africa TDCA. Since the Cotonou tariff on all of the products covered in Table 10 is zero, it follows that the reduction of the Standard GSP rate to zero would erode ACP preferences by 11.5 percentage points.

For four of the 26 items in Table 10 the main competitors already have duty-free access, and so there would be no preference erosion for the ACP with respect to them. In a further two the competitors are either graduated from the sector or face zero tariffs outside the GSP. And in seven cases there are either no GSP states or no non-ACP states that meet the threshold of 10% of EU imports. In none of these cases does the Standard GSP tariff appear to be so high that it could plausibly have suffocated imports (although other features of the GSP such as origin rules might have done).

The main candidates for attention, therefore, are the remaining 13 items. Only two of these face stiff tariffs, the removal of which would plausibly improve the competitiveness of GSP states *vis-à-vis* the ACP countries. Both are varieties of canned tuna (with a 20.5% tariff). The Standard GSP suppliers that face discrimination, Philippines and Thailand, have already been given a reduced-tariff (12%) quota as part of the deals associated with the

Table 10. Standard GSP preference erosion potential: major items (other than textiles/clothing)

CN8	Description	Standard GSP exporters	Main EU suppliers 2003[a]	Competitor tariff
03026966	fresh or chilled hake	11.5	South Africa	11.5
03026999	fresh or chilled saltwater fish, edible	5.2	Morocco	0
03037811	frozen hake	11.5	South Africa	11.5
03037981	frozen monkfish	11.5	South Africa China	11.5 11.5
03037998	frozen saltwater fish, edible	5.2	Argentina	5.2
03041019	fresh or chilled fillets of freshwater fish	5.5	*No non-ACP*	
03049022	frozen meat of herring	0 or 11.5	*No GSP beneficiaries*	
06031010	fresh cut roses and buds	5 or 8.5	Ecuador	0
06031080	fresh cut flowers and buds	5 or 8.5	Ecuador	0
07081000	fresh or chilled peas 'pisum sativum', shelled or unshelled	4.5-10.1	*No non-ACP*	
07082000	fresh or chilled beans 'vigna spp., phaseolus spp.', shelled or unshelled	6.9 or 10.1	Morocco Egypt	6.9 or 10.1 0 4.1 min 0.6€/100kg net, 6.9 or 10.1
07099090	fresh or chilled vegetables n.e.s.	8.9	*No non-ACP*	
16041411	prepared or preserved tunas and skipjack, whole or in pieces, in vegetable oil (excl. minced)	20.5	Philippines Thailand	20.5 20.5
16041416	loins of tunas or skipjack, prepared or preserved	20.5	Ecuador Colombia	0 0
16041418	tunas and skipjack, prepared or preserved	20.5	Thailand Ecuador	 20.50 0
18031000	cocoa paste (excl. defatted)	6.1	*No non-ACP*	
18032000	cocoa paste, wholly or partly defatted	6.1	Indonesia Malaysia	6.1 6.1
18062010	chocolate and other food preparations containing cocoa	4.8% + AC max 18.7%	*No non-ACP*	
20055900	unshelled beans 'vigna spp., phaseolus spp.', prepared or preserved otherwise than by vinegar or acetic acid	15.7	China	15.7
20082079	pineapples, prepared or preserved, containing added sugar but no added spirit, with sugar content of =< 19 %, in packings of =< 1 kg	15.7	Thailand Indonesia	15.7 15.7
20082099	pineapples, prepared or preserved, in packings of < 4.5 kg (excl. added sugar or spirit)	14.9	Thailand Indonesia Philippines	14.9 14.9 14.9

Table 10 (continued)

CN8	Description	Standard GSP exporters	Main EU suppliers 2003[a]	Competitor tariff
20094930	pineapple juice, unfermented, brix value > 20 but <= 67 at 20oc, value of > 30 {euro} per 100 kg, containing added sugar	11.7	Thailand Indonesia	11.7 11.7
24012010	partly or wholly stemmed or stripped flue-cured Virginia type tobacco, otherwise unmanufactured	14.9% max 24 €/100kg	Brazil	18.4% min 22/max 24€/100kg net
24021000	cigars, cheroots and cigarillos containing tobacco	9.1	Cuba	9.1
44121310	plywood with at least one outer ply of: dark red meranti, light red meranti, white lauan, sipo, limba, obeche, okoume, acajou d'afrique, sapelli, etc.	6.5	China Morocco	10 0
87032390	motor vehicles for transport of persons, with spark-ignition internal combustion reciprocating piston engine, cylinder capacity >1 500 but =<3 000cc	6.5	*No GSP beneficiaries*	

Note:
[a]All non-LDC, non-ACP GSP beneficiaries supplying 10% or more of the EU market in 2003. Those graduated out of the GSP for the relevant section are indicated by the use of strikeout.
Source: UNCTAD TRAINS, January 2005; UK Tariff 2005.

extension of the Cotonou waiver in the WTO. And for the ACP countries, rules of origin are an important constraint; easing of these might offset the loss of tariff preference.

A group of six items face mid-range tariffs of between 10 and 20% (plus one – fresh beans – with a range of tariffs one of which just tops 10%). They are frozen hake and monkfish, prepared beans, preserved pineapples and pineapple juice. There would be significant preference erosion on all of these.

Finally, a group of three items (miscellaneous frozen fish, cocoa paste and cigars) face Standard GSP tariffs of under 10%. Given that this exercise is concerned only with ACP states that are unwilling to accept EPAs, it seems unlikely that modest preference erosion on this limited group of products would prove a stumbling block to acceptance of an improved Standard GSP as the alternative.

Table 11 provides similar information for clothing and textiles. In all except two of the 14 GSP relevant items the Standard GSP tariff is 9.6%. However, in four of these 14 the only competitor exceeding the 10% threshold is Tunisia, which has duty-free access (and in one of the others it is one of two suppliers with China, which is graduated). In a further six there are either no GSP-beneficiary or no non-LDC suppliers that meet the 10% threshold. As with the discussion of Table 10, a Standard GSP tariff of 9.2% cannot plausibly have suffocated trade, and so the removal of the tariff is unlikely to encourage major new suppliers to emerge from the woodwork.

In any case, the impact of any GSP changes to the pattern of world trade in clothing will be dwarfed by the reverberations from the phase-out of the Multifibre Arrangement. By 2008, when the Cotonou trade provisions expire, the pattern of ACP clothing exports is likely to be very different from what it is now.

Table 12 deals only with the minnows – products that already face such low Standard GSP tariffs that any preference erosion will be minor. Even such

Table 11. Standard GSP preference erosion potential: textiles/clothing

CN8	Description	Standard GSP	Main EU suppliers 2003[a]
54025200	filament yarn of polyester, incl. monofilament of < 67 decitex, single, with a twist of > 50 turns per metre	3.2	*No non-ACP GSP beneficiaries*
61051000	men's/boys' shirts of cotton, knitted or crocheted	9.6	*No non-LDC*
61061000	women's/girls' blouses, shirts and shirt-blouses of cotton, knitted or crocheted	9.6	India
61091000	t-shirts, singlets and other vests of cotton, knitted or crocheted	9.6	*No non-LDC*
61101130	men's/boys' jerseys, pullovers, cardigans, waistcoats and similar articles, of wool, knitted or crocheted	9.6	Tunisia
61101190	women's/girls' jerseys, pullovers, cardigans, waistcoats and similar articles, of wool, knitted or crocheted	9.6	*No GSP beneficiaries*
61102091	men's/boys' jerseys, pullovers, cardigans, waistcoats and similar articles, of cotton, knitted or crocheted	9.6	*No GSP beneficiaries*
61102099	women's/girls' jerseys, pullovers, cardigans, waistcoats and similar articles, of cotton, knitted or crocheted	9.6	*No non-LDC*
61103099	women's/girls' jerseys, pullovers, cardigans, waistcoats and similar articles, of man-made fibres, knitted or crocheted	9.6	*No non-LDC*
62034231	men's/boys' trousers and breeches of cotton denim	9.6	Tunisia
62034235	men's/boys' trousers and breeches of cotton	9.6	Tunisia
62046231	women's/girls' cotton denim trousers and breeches	9.6	Tunisia
62052000	men's/boys' shirts of cotton	9.6	India
62121090	brassieres of all types of textile materials, whether or not elasticated, incl. knitted or crocheted	5.2	China Tunisia

Note:
[a]All non-LDC, non-ACP GSP beneficiaries supplying 10% or more of the EU market in 2003. Those graduated out of the GSP for the relevant section are indicated by the use of strikeout.
Source: UNCTAD TRAINS, January 2005; UK Tariff 2005.

impact as there might otherwise have been, however, will be reduced still further since for six of the 21 items all the major competitors are graduated out of the relevant section. In a further four there are no major non-ACP or GSP-beneficiary suppliers. Of the remainder, the maximum tariff is just 4.2% (for cocoa butter).

Table 12. Standard GSP preference erosion potential: minor items

CN8	Description	Standard GSP	Main EU suppliers 2003[a]
03061340	frozen deepwater rose shrimps 'parapenaeus longirostris'	4.2	Morocco, Tunisia
03061350	frozen shrimps of the genus 'penaeus'	4.2	Argentina
03061380	frozen shrimps and prawns	4.2	Argentina, India
03074918 Morocco	frozen cuttle fish 'sepia officinalis' and 'rossia macrosoma'	2.8	India, Thailand,
03075910	frozen octopus 'octopus spp.'l	2.8	Morocco
03079100	live, fresh or chilled molluscs, fit for human consumption	3.8	Tunisia, Indonesia
08043000	fresh or dried pineapples	2.3	Costa Rica
08044000	fresh or dried avocados	0 or 1.6	South Africa, Mexico
09050000	Vanilla	2.1	No non-ACP
15119099	palm oil and its liquid fractions, whether or not refined, but not chemically modified	3.1	Malaysia, Indonesia
15131199	crude coconut oil, in immediate packings of >1kg	2.2	Philippines, Indonesia
15132190	raw palm kernel oil and babassu oil	2.2	Indonesia
18040000	cocoa butter, fat and oil	4.2	Indonesia, Malaysia
18050000	cocoa powder, not containing added sugar or other sweetening matter	2.8	No non-ACP
21011111	solid extracts, essences and concentrates of coffee	3.1	Brazil, Colombia, Ecuador
24012080	partly/wholly stemmed/stripped flue-cured tobacco, otherwise unmanufactured	3.9% max 56 g €/100k	Argentina
24013000	tobacco refuse	3.9% max 56 net €/100kg	Brazil
28141000	Anhydrous ammonia	2	Russia, Ukraine, Algeria
29051100	methanol 'methyl alcohol'	2	Chile, Libya, Russia
29161220	ethylacrylate	3	No GSP beneficiaries
29321200	2-furaldehyde 'furfuraldehyde'	3	China
39041000	polyvinyl chloride, in primary forms, not mixed with any other substances	3	No GSP beneficiaries
44121390	plywood consisting solely of sheets of wood <= 6 mm thick, with at least one outer ply of a tropical wood specified in subheading note 1 to this chapter	3.5	Indonesia, Brazil
85299081	parts suitable for use solely or principally with television cameras, receivers of radio-telephonic/telegraphic signals, or for radio or television, n.e.s.	1.5	China

Note:
[a]All non-LDC, non-ACP GSP beneficiaries supplying 10% or more of the EU market in 2003. Those graduated out of the GSP for the relevant section are indicated by the use of strikeout. Source: UNCTAD TRAINS, January 2005; UK Tariff 2005.

Conclusions

Creating coherence

The broad conclusion of this chapter is positive – not only is it feasible to consider the GSP as a post-Cotonou trade option, but there are economic advantages in so doing. The renewal of the GSP provides an opportunity to consider whether the EU's multifarious trade agreements with developing countries could be brought coherently under one umbrella. The WTO ruling in the case brought by India has provided confirmation that differentiation within the GSP is possible. The EU's commitment in the Cotonou Agreement to provide ACP countries not willing to join EPAs with 'a new framework for trade which is equivalent to their situation' lends an urgency to the task.

The draft Regulation currently under review provides details for the GSP only to 2008, although the scheme is to continue until 2015. This chapter has considered whether the architecture of the new GSP could provide a framework for offering ACP countries equivalent treatment to that which they obtain under Cotonou.

By 'equivalent treatment' we mean a situation in which EU import tariffs are the same and the process of creating the new GSP regime does not result in additional preference erosion that negates the gain for the ACP. Other significant features of a post-Cotonou trade regime have not been given detailed consideration, including most importantly the issues of contractuality and joint decision-making on future change. The reason for the neglect of these points is that the issues are quite clear; what is not clear – and is subject to detailed analysis in this chapter – is the feasibility of creating from the existing architecture of the GSP a regime that offers equivalent treatment on tariffs without accelerating preference erosion to an unacceptable extent.

Also excluded from detailed analysis is the option of creating a special 'ACP tranche' within the GSP. The current Regulation does not provide a direct peg for this, but the GSP+ demonstrates that differentiation is permissible. The key issue would be the political acceptability of a special ACP tranche and its WTO compatibility. The second of these may well be tested over the coming years through the reaction of WTO members to the GSP+. It cannot be assumed that there will be no WTO challenge – nor that if there is such a challenge it will be unsuccessful.

Extending GSP+

The most obvious route for creating a Cotonou-equivalent regime under the GSP is to extend GSP+ (assuming it survives WTO challenge). The analysis in Part B suggests that this is feasible. There will be problems with sugar, bananas and rum – but these are commodities that face serious difficulties regardless of the future trade regime. And until more is known about the way in which these difficulties are to be handled – and, crucially, which ACP countries decide not to join EPAs – it is not feasible to go much further than is done in this chapter in assessing the scale of the difficulty.

There are some advantages to the idea of merging Cotonou and GSP+. As explained in Part A, the economic impact of GSP+ will be heavily influenced by the number of countries that become eligible. In brief, the more the better. If only a few countries are accepted for GSP+ the results are more likely to be trade diverting than trade creating. By contrast, if many countries are accepted there are good reasons to expect significant trade creation.

There will also be a lessening of the problems of the rules of origin. The additional reform of agreeing full cumulation between all GSP+ beneficiaries would clarify the situation still further. At the extreme it would mean that only inputs from the 21 states excluded *a priori* from GSP+ would cause potential problems with the origin rules.

Provided that the broader issues of contractuality etc. can be overcome, the conclusion to be drawn is that an extension of GSP+ to cover all ACP exports would have beneficial economic effects. Indeed, it is possible to argue that the economic effects would be superior to those likely to arise from EPAs, under which liberalisation by ACP states is likely to be partial and long drawn out.

The alternative of improving the Standard GSP to Cotonou levels is more problematic. The number of problem commodities increases to include fish, horticulture and processed tropical fruits. Whilst

not insurmountable, the extent to which this approach would erode ACP preferences is increased.

Endnotes

1. The term 'Standard GSP' is used throughout this chapter to denote what is termed in the Regulation the 'general arrangement', i.e. excluding the more favourable special arrangements (four in the current GSP and two – for sustainable development and good governance (the GSP+) and for LDCs – in the proposed GSP).
2. The first European Community GSP was for an initial phase of ten years (1971–81), subsequently renewed for a second decade (1981–91). The third ten-year offer was delayed pending the outcome of the Uruguay Round, the 1991 scheme being extended with various amendments until 1994. The scheme for 1995–2004 was adopted on 1 January 1995, the legislative acts being Council Regulation 3281/94 in respect of industrial products and Council Regulation 1256/96 in respect of agricultural products. The scheme was revised for the period 1 July, 1999–31 December, 2001 on the basis of Council Regulation 2820/98. The basic structure of the offer was not substantially modified until the end of 2001, with the adoption of Council Regulation (EC) No 2501/2001 of 10 December, 2001 (OJ L 346, 21.12.2001, p. 1), which covered the period 2002–4 and fully incorporated the EBA amendment. Council Regulation (EC) No 2211/2003 of 15 December 2003 (OJ L 332, 19.12.2003) subsequently extended this until 31 December, 2005.
3. Except for agricultural components.
4. 15% in the case of HS 2207 (ethyl alcohol).
5. Since the old graduation applies to different product groups from the new graduation, there could be some change even for this group (if the new graduation excludes a wider range of products than did the old).
6. Although the HS is divided into 21 sections, two – Sections XIX (arms and armaments) and XXI (works of art) – contain no items covered by the GSP.
7. The HS chapters from which it is now newly graduated (because they were not covered by the old graduation) are 31 (fertilisers), 41 (leather, raw hides and skins) and 50–60 (textiles).
8. The descriptive names have been coined by the authors of this chapter.
9. To be calculated using the data available on 1 September, 2004 for an average over three consecutive years.
10. The analysis contained in this part of the chapter is of relevance only to those ACP states – the non-least developed – that do not benefit from duty-free access to the EU under its EBA scheme (which will continue after the expiry of Cotonou). Thus, unless indicated otherwise, the use of the term 'ACP' refers only to the 36 non-LDC members of the group.
11. The 36 countries are: Antigua and Barbuda, Bahamas, Barbados, Belize, Botswana, Cameroon, Congo Republic, Cook Islands, Côte d'Ivoire, Dominica, Dominican Republic, Federation of Micronesia, Fiji, Gabon, Ghana, Grenada, Guyana, Jamaica, Kenya, Marshall Islands, Mauritius, Namibia, Nauru, Nigeria, Niue, Palau, Papua New Guinea, Seychelles, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Suriname, Swaziland, Tonga, Trinidad and Tobago, Zimbabwe.
12. The four exceptions to duty-free access under GSP+ are chocolate (for which the ad valorem duty is suspended but the agricultural component (AC) remains), and three shrimp items (for which the GSP+ tariff is 3.6%).
13. The 'world' being the 72 countries which have so far reported their 2003 imports to UNCTAD.
14. Those countries that are excluded from GSP+ because they are graduated out for the relevant section will continue to be ineligible for preference on the additional items.

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10

EU Assistance to ACP Countries Since 1975

Paul Goodison

Trying to understand the basic figures

Grants and loans

Table 1 sets out the financial allocations made under successive ACP–EU co-operation agreements by EU member states and mobilised by the European Investment Bank. This constitutes the new financial allocation made to ACP–EU co-operation activities at the beginning of each successive ACP–EU co-operation agreement. It does not include additional supplementary allocations that may have been made during the course of the lifetime of the agreement, or funds that may have accrued as interest on monies held by the European Commission, or funds 'rolled over' from previous agreements for administrative purposes.[1]

It should be noted that the composition of grants and loans made available by EU member states and the EIB respectively does not correspond to the grants and loans that are made available to ACP countries. Under earlier Lomé Conventions a variety of loan instruments were financed from grants from EU member states. These included:

- the initial STABEX financing;
- SYSMIN financing;
- 'special loans'; and
- risk capital loans.

However, in the case of STABEX the terms and conditions of assistance were retroactively adjusted to convert the funding into grants. Ultimately, support from the SYSMIN facility, which had provided financial resources on the same terms as 'special loans', was also converted to grants. As a consequence, these funds have been included in Table 2, which sets out the grants received by ACP countries.

In addition, as early as Lomé II, the European Commission converted 'special loans' to certain ACP countries facing financial difficulties into grants.[2] This partly accounts for the increase in grant financing under the NIPs of certain ACP countries over the lifetime of Lomé I and II. NIP allocations also increased in some ACP countries as a result of the Mid-Term Review. Under Lomé II, amounts allocated within the minimum and maximum envelopes were adjusted as part of the Mid-Term Review in the light of the non-programmable aid received by each country, with countries that received less in the way of non-programmable resources getting a corresponding increase in their NIP allocation.[3]

Table 1: Financial allocations agreed under successive Lomé Conventions and the Cotonou Agreement (grants from member states and EIB resources mobilised from capital markets) (million ECU/€)

	4th EDF	5th EDF	6th EDF	7th EDF	8th EDF	9th EDF
Grants	3,000	4,542	7,400	10,800	12,967	13,500
Percentage	88.5	86.9	88.2	90.0	88.7	88.8
Loans	390	685	1,000	1,200	1,658	1,700
Percentage	11.5	13.1	11.7	10.0	11.3	11.1
Total	**3,390**	**5,227**	**8,400**	**12,000**	**14,625**	**15,200**

[Chapter 2 of *The European Development Fund and Economic Partnership Agreements*, Roman Grynberg and Alice Clarke (eds), Commonwealth Secretariat, London, 2005.]

Actual commitments and payments

The actual level of aid made available to ACP countries can only really be measured by the actual disbursements made. While actual disbursements can be measured on an annual basis under each EDF, these figures over time do not necessarily correspond to the amounts made available under each EDF. This arises as a result of the time lag between:

- the allocation of funds to the financial protocol;
- the initial allocation of funds to specific country and regional programmes (notification of the NIP and RIP allocations);
- the primary commitment of funds to specific projects and programmes (through approval of the financing decision);
- the secondary commitment of funds through the signing of contracts for the implementation of specific activities; and
- the final disbursement of funds in line with the commencement and completion of project and programme activities.

This time lag can generate considerable complexity since it can involve administering, in parallel, funds under different financial regulations. The response to this has been, wherever possible, to consolidate unused funds under the latest financial regulation governing the EDF.

This has given rise to a situation whereby at the end of 2004 the following commitments and payments had been made under the 4th to 9th EDFs.

As can be seen, there is a considerable discrepancy between the initial allocation and commitments: in the case of the 6th EDF, commitments exceeded the initial allocation, but since the end of Lomé III payments under each EDF have been less than the commitments made.

Altogether from the 4th to 9th EDFs the EU has allocated ECU/€58,842 million under the various financial protocols to co-operation activities in ACP countries. Of this amount approximately ECU/€48,209.1 million has been committed to specific projects and programmes, while ECU/€36,993.9 million had actually been disbursed in ACP countries by the end of 2004. This represents 62.87% of the total amount committed under the various financial protocols.

Instruments of assistance

The composition of grants and loans received by ACP countries under successive ACP–EU agreements is set out in Tables 3 and 4. Table 3 sets out by instrument of deployment the use of the grants made available to ACP countries in the framework of the various ACP–EU co-operation agreements concluded since 1975. As can be seen, from Lomé I to Lomé IV the number of instruments of co-operation multiplied. Initially the National Indicative Programme was the main framework for aid deployment, encompassing not only the bulk of grant

Table 2. Actual commitments and payments (ECU/€), at the end of 2004

EDF	Initial allocation	Commitments		Payments	
	(million g)	(million g)	%*	(million g)	%*
4th EDF (Lomé I)	3,390	3,053.3[4]	90.06	3,053.3	90.06
5th EDF (Lomé II)	5,227	4,207.4[5]	80.50	4,207.4	80.50
6th EDF (Lomé III)	8,400	8,589.0[6]	102.25	7,207.4	85.80
7th EDF (Lomé IV)	12,000	11,735.3[7]	97.79	10,609.2	88.41
8th EDF Lomé IV bis)	14,625	13,224.1[8]	90.42	9,577.6	65.49
9th EDF (Cotonou)	15,200	7,400.0	48.68	2,339.0	15.39

*% refers to the percentage of the initial allocation
Source: Extracted from tables on the following web pages:
Commitments: http://europa.eu.int/comm/development/body/cotonou/statistics/stat08_en.htm
Payments: http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm

Table 3. Grants received by ACP countries (million ECU/€)

Grants	4th EDF	5th EDF	6th EDF	7th EDF	8th EDF	9th EDF
NIP/IRS/Reserve	2,100[9]	2,328[10]	3,570	5,245	6,632	10,000[11]
Regional	–	600	1,000	1,250[12]	1,300[13]	1,300
STABEX	375[14]	550	925	1,500	1,800	
SYSMIN		280[15]	415	480	575	
Structural Adjustment Support Facility				1,150	1,400	
Emergency			210	250	140	
Refugees			80	100	120	
Total	**2,475**	**3,758**	**6,200**	**9,975**	**11,967**	**11.300**

Table 4. Composition of loan packages to ACP countries (million ECU/€)

EDF	Risk capital[16]	Own resources	Special loans[17]	Total
4th EDF	95	390	430	915
5th EDF	280	685	504	1,469
6th EDF	600	Up to 1,000	600	2,200
7th EDF	825	Up to 1,200	–	2,025
8th EDF	1,000	1,658	–	2,658
9th EDF	2,200[18]	1,700	–	3,900

financing (85%), but also the deployment of 'special loans' and 'risk capital' loans. Indeed, under Lomé I the only nonprogrammable instrument was the STABEX scheme for the stabilisation of export earnings.

From Lomé II, however, an increasingly differentiated range of instruments was introduced, largely in response to the depth of the economic difficulties confronting ACP countries, whose long-term development programmes were being driven off course. By Lomé III there were six distinct financial instruments, with an additional instrument emerging in the course of the Convention, financed partly from the EU budget, partly from the general reserve of the EDF, and partly from a re-allocation of NIP funds to new types of assistance. This experience gave rise to the creation of a seventh instrument of support under Lomé IV, the Structural Adjustment Support Facility.

While funding from the structural adjustment facility was also nominally deployed within the framework of the National Indicative Programme, in reality a separate dialogue on structural adjustment emerged, distinct from the programming process *per se*. This structural adjustment dialogue focused on the policy dimension of development strategies and had an impact on commitment and disbursement rates, contrary to the expected impact of the shift to nominally quicker disbursing support instruments. This coincided with the introduction of so-called 'frameworks of mutual obligations' associated with the deployment of STABEX funds, effectively creating yet a further framework for policy dialogue, and ultimately delays in EDF aid deployment under Lomé IV.

This multiplication of instruments was only to be reversed in 2000, with the signing of the Cotonou Agreement, which established two basic facilities: a facility for long-term development co-operation activities (with a national co-operation and regional co-operation window) and an Investment Facility.

A fluctuating policy on the role of loan financing

A striking feature of the ACP–EU co-operation experience has been the ambiguous position on the role of loan financing in ACP–EU development co-operation. Under Lomé I an extensive amount of finance from member states was used to provide loans to ACP countries. While these loans were on concessional terms, they were nevertheless intended as reimbursable resources. Under Lomé I a total of 43%[19] of the initial grant allocation was scheduled for extension in the form of loans. Ultimately, however, only 17.5% of grant financing was deployed in the form of loans. This fell slightly to 17.3% under Lomé II and to 16.2% under Lomé III. However, the largest proportion of this was in the form of 'special loans', which were later partly converted to grants. Overall, the loan component of the overall EDF package fluctuated in the first three Lomé Conventions from 26.2% to 28.1% of the total financial package made available.[20] This then fell to 16.9% under Lomé IV, when only 7.6% of grants made available by member states were used to finance a soft-loan facility. This followed the EU initiatives in favour of highly indebted ACP countries in the second half of the 1980s and in the 1990s.[21]

Under Lomé IV bis, however, the proportion of the total aid package provided in the form of loans began to creep back up again, to 18.2%, (with some 7.7% of grants from member states being used to finance a soft-loan facility). Under the Cotonou Agreement, however, the proportion of loans within the total aid package returned to the levels of the 1970s and 1980s, with fully a quarter of the total financial package being provided in the form of loans. This required the deployment of 16.3% of the total grant package from EU member states in the form of loans – loans that are increasingly being extended to final beneficiaries at market rates. This move towards the application of market-related rates on EIB-administered loans reflects the revolving fund nature of the Cotonou Agreement Investment Facility.

To these various loans financed from grants from EU member states should be added the loans mobilised by the EIB from European capital markets and extended to ACP countries on concessional terms (so-called 'own resource' loans).[25] There is thus a rather ambiguous EU position on the role of loan financing within the overall EU–ACP development assistance package. This takes on some significance

Box 1. Member states' contributions to the EDF

While each European Development Fund has its own five-year financial allocation, established when the agreement is signed, EDF funds are not simply transferred to the European Commission at the time the overall size of the EDF is agreed. Rather, these funds are made available by EU member states in the light of annual projections by the European Commission of the likely EDF financial resources that will need to be paid out in the next calendar year. Funds are transferred to the European Commission in three instalments in the light of these projections. Until recent years, there was a tendency for the European Commission to over-estimate the level of financial resources that would be required, since it is more difficult to secure supplementary payments from member states, should these be required, than to simply reduce the funds called on from the member states in the course of the year.

The bulk of so-called 'blocked funds' are thus not 'blocked' in bank accounts in ACP countries, but reside with EU member states until such time as these funds are actually required by the European Commission to meet payment obligations under the EDF. In some EU member states these unrequired funds are used to supplement bilateral development co-operation programme activities. In other member states they may come from a general budget for EU-related expenditures and may find their way into co-financing of rural development programmes or other EU-related national expenditures. In still other member states they may revert back to the general government reserve within the budget. Everything depends on the internal financing arrangement established by individual member states.

Table 5. Percentage of grant financing used for grants and loans

	Grants provided as grants		Grants provided as loans		Total grant allocation
	(million ECU/€)	(%)	(million ECU/€)	(%)	
4th EDF (1975–80)	2,475	83.5	525	17.5[22]	3,000
5th EDF (1980–85)	3,758	82.7	784	17.3[23]	4,542
6th EDF (1985–90)	6,200	83.8	1,200	16.2[24]	7,400
7th EDF (1990–95)	9,975	92.4	825	0.6	10,800
8th EDF (1995–2000)	11,967	92.3	1,000	7.7	12,967
9th EDF (2000–2007)	11,300	83.7	2,200	16.3	13,500

Table 6. Proportion of grants to loans under ACP–EU arrangements (million ECU/€)

	Loans	%	Grants	%	Total
4th EDF (1975–80)	915	27.0	2,475	73.0	3,390
5th EDF (1980–85)	1,469	28.1	3,758	71.8	5,227
6th EDF (1985–90)	2,200	26.2	6,200	73.8	8,400
7th EDF (1990–95)	2,025	16.9	9,975	83.1	12,000
8th EDF (1995–2000)	2,658	18.2	11,967	81.8	14,625
9th EDF (2000–2007)	3,900	25.7	11,300	74.3	15,200

in the context of the discussion on EPA-related restructuring assistance since fully EDF aid to industry-related projects has traditionally been extended in the form of loans rather than grants.

Counterpart funds

In addition to these financial instruments made available to ACP countries, over the course of successive Conventions there emerged a further source of financing, which in some ACP countries took on considerable significance, namely 'counterpart funds'. Counterpart funds first emerged in the framework of ACP–EU co-operation from the deployment of EU food aid. Food aid was provided to food-deficit ACP countries, financed from the EU budget, and it was sold locally, generating funds in local currency known as 'counterpart funds'. These counterpart funds could then be used to finance local costs of agreed development co-operation initiatives. Officially, however, counterpart funds do not form part of EC-administered aid programmes to ACP countries. As the development dimension of food-aid operations was increasingly understood, a shift occurred from the export of foodstuffs to the local or regional purchase of foodstuffs for consumption in food-deficit areas. This somewhat reduced the availability of counterpart funds. However, this coincided with a move to import-programme support in ACP countries facing balance of payments difficulties and this new type of support began to generate a considerable volume of counterpart funds, as imported goods were sold on the local market. These import programmes were financed under the National Indicative Programme, Structural Adjustment Support Programmes, and even STABEX interventions. The counterpart funds were then commonly used to provide financial support for government budgets. In some countries, notably Ethiopia, the budgetary support provided by counterpart funds came to account for a significant proportion of total government expenditure. Tracing the volume of counterpart funds made available in the form of budgetary support is a far from straightforward task. The first problem is to reconcile the nominal level of counterpart funds to be generated under the various programmes financed in each country with the actual level of counterpart funds collected in-country as a result of the sale of the

products placed on the market under the commodity-import programmes. This partly relates to exchange rate fluctuations in countries undergoing extreme balance-of-payment difficulties. At what rate should the counterpart funds to be collected be calculated when currency depreciation can be rapid and deep? It partly relates to the administrative efficiency of counterpart fund collection systems set in place and partly to the extent of corruption within the system.

This first level problem is compounded by problems of 'leakage' of counterpart funds once they have been collected. Often substantial counterpart funds nominally exist but in reality are not in the bank accounts into which they should have been paid. These management problems can have a direct bearing on counterpart fund use. Indeed, they can prevent the conclusion of counterpart funds agreements, which provide the basis for using the funds. How then can one get an accurate picture of counterpart funds and their contribution to the stabilisation of public finances and local economic and social development at the ACP level? This is in many respects an impossible task and consequently the value of counterpart funds can only be assessed on a country-by-country, case-by-case basis.

However, with changing patterns of aid deployment under the Cotonou Agreement, the use of counterpart funds is becoming less and less significant.

ACP–EU co-operation funded through the EU budget

In addition to ACP–EU co-operation activities funded through the EDF, a substantial amount of funding has been made available through the EU annual budget. Traditionally, the most important instrument in this regard was the EU food-aid budget. Financial commitments under this instrument were commonly inflated by using the internal EU price as the reference price for the value of the food aid provided (as opposed to much lower world market prices). Other budgetary instruments commonly deployed in support of ACP–EU co-operation activities included:

- the NGO co-financing budget line;
- special thematic initiatives (for example the programme to combat hunger in the early 1980s and the special initiative for highly indebted countries in the latter part of the 1980s); and
- special thematic budget lines (for example Women in Development).

Altogether, under the first four Lomé Conventions the EU budget made an increasing contribution to the total aid received by ACP countries, rising from €259.7 million under Lomé I, when it accounted for 10.4% of total EU aid received by ACP countries, to €1,773.82 million under Lomé IV – 13.9% of total EU aid received by ACP countries.

Total EU Aid to ACP Countries, 1975–2000

Tables 7 and 8 show the total level of aid committed to individual ACP countries over successive Lomé Conventions broken down by the financing instrument.[26] From a recipient-country point of view, with the exception of Lomé IV bis, the proportion of total EU aid going through the NIP has declined throughout the period, with a rapid fall under Lomé IV. The figure under Lomé IV bis is something of an anomaly, since the figures for EIB loans are unavailable[27] and commitments from non-programmable instruments and the EU budget are particularly low. There was in fact only a small increase in actual NIP

Table 7. EDF commitments (million ECU/€)

EDF	NIP	Other EDF	EIB	EU budget	Total
Lomé I	1,953.26	807.48	343.09	359.70	3,463.53
Lomé II	2,572.80	1,392.13	544.01	676.98	5,185.92
Lomé III	4,109.10	2,508.50	720.15	1,177.25	8,515.00
Lomé IV	5,009.10	4,849.60	1,141.00	1,773.82	12,773.52
Lomé IV bis	5,087.90	1,088.27	n/a	929.99	7,108.16

Table 8. EDF commitments (percentage of total aid received from the EU)

EDF	NIP	Other EDF	EIB	EU budget	Total
Lomé I	56.4%	23.3%	9.9%	10.4%	100%
Lomé II	49.6%	26.8%	10.5%	13.1%	100%
Lomé III	48.3%	29.5%	8.5%	13.8%	100%
Lomé IV	39.2%	38.0%	8.9%	13.9%	100%
Lomé IV bis	71.6%	15.3%	n/a	13.1%	100%

commitments between Lomé IV and Lomé IV bis (1.6%) compared to a 21.9% increase in the overall funding package and a 20.1% increase in grant financing.[28] In contrast, the level of non-programmable EDF aid rose consistently under the first four Lomé Conventions, reaching a level almost comparable to programmable aid under Lomé IV. This trend was of course reversed in 2000, with a complete transformation of financing instruments under the Cotonou Agreement and the reversion back to two basic instruments: a long-term development co-operation envelope and an Investment Facility.

EIB aid has fluctuated between 8.5% and 10.5% of the total aid, while from Lomé II to Lomé IV bis the EU budget provided between 13.1% and 13.9% of total ACP aid receipts from the EU.[29]

EU development assistance under the Cotonou Agreement

Under the 9th EDF, which finances co-operation under the Cotonou Agreement, a total of €15.2 billion has been made available. This takes the form of both grants and loans: 74.3% is in the form of grants and 25.7% is in the form of loans. €13.5 billion is drawn from grants from EU member states and €01281.7 billion has been made available from the European Investment Bank's own resources.

In addition, the European Commission sought to identify all those previously allocated aid funds that have not so far been used, with the aim of consolidating them into the 9th EDF. In August 2001 the EC maintained that outstanding balances under previous EDFs totalled some €9,900 million. It is, however, far from clear how this figure was arrived at, given the process of EDF aid deployment (see Box 2).

Of the €11,300 million allocated to long-term development co-operation, approximately €10, 000 million was available for deployment at the national level, with €1,300 million made available for regional programmes (including pan-ACP programmes).

Of this €10,000 million, €7120.8 million was committed to the 'A' allocation of 75 ACP countries. The 'A' allocation covers 'macroeconomic support, sectoral policies, programmes and projects in support of the focal and non-focal areas of Community assistance'. €2003.2 million was nominally committed to the 'B' allocation of some 63 ACP countries. The 'B' allocation covers 'unforeseen needs such as emergency assistance where such support cannot be financed from the EU budget, contributions to internationally agreed debt relief initiatives, and support to mitigate adverse effects of instability on export earnings'. Most ACP countries, however, have not been allowed to draw down on the 'B' allocation,[30] so in actual fact only around 71% of EDF funds for nationally determined long-term co-operation programmes were available for deployment. Under the ongoing Mid-Term Review, however, a process is underway whereby funds are transferred from the 'B' allocation to the 'A' allocation (or withdrawn), enabling ACP countries to make use of the full allocation in their development co-operation activities. As of July 2005 the Mid-Term Review had been completed in 41 ACP countries. In total these revised 'A' allocations, combined with the 'A' allocations not yet subjected to revision under the Mid-Term Review, gave a total level of 'A' allocation funding post Mid-Term Review of €8,032.32 million, or 80% of the envelope for long-term development co-operation at the national level. Revised 'B' allocations in the countries where the Mid-Term Review was already complete came to €788.22, some 7.88% of the envelope for long-term development co-operation at the national level.

Box 2. The 9th EDF Funding Package

Overall amount €15,200 million

Grants from EU member states €13,500 million

EIB own resources €1,700 million

Of the €13,500 million available as grant aid:

- €2,200 million is allocated to the Investment Facility
- €11,300 million is allocated to the Long-term Development Co-operation Facility

Of the €11,300 million allocated to the Long-term Development Co-operation Facility:

- €1,300 million is allocated to regional co-operation and integration
- €10,000 million is allocated to national long-term development co-operation

Of the €10,000 million allocated to national long-term development co-operation:

- €90 million is allocated to the Centre for the Development of Enterprise
- €70 million is allocated to the Technical Centre for Rural and Agricultural Cooperation (CTA)
- €4 million is allocated to the Joint Assembly

The Complex Process of EDF Aid Deployment

Tables in the August 2001 Commission communication showed the following situation with regard to decisions (financing agreements signed), assigned funds (contracts signed), and payments (payments actually transferred) under the 6th, 7th and 8th EDFs (see Table 9).

Table 9. Situation on 31 December, 2000[31] (€'000)

Appropriation[32]	
• 6th EDF	7,829,081
• 7th EDF	11,514,969
• 8th EDF	13,345,115
Decisions[33]	
• 6th EDF	7,496,083
• 7th EDF	10,754,495
• 8th EDF	8,348,082
Assigned funds[34]	
• 6th EDF	7,258,510
• 7th EDF	9,363,127
• 8th EDF	3,796,288
Payments[35]	
• 6th EDF	7,136,123
• 7th EDF	8,499,377
• 8th EDF	1,980,296

Extrapolating from these tables, the following picture emerges with reference to unspent funds. No decisions had been taken (i.e. no financing agreement has been signed) on a total of some €6,090 million. No contracts had been signed for the implementation of actual activities on funds totalling some €12,271 million (these funds had not yet been assigned). Payments still needed to be made on a total of €15,073 million. Thus on 1 January, 2001 €15,073,269,000 of EDF funds were technically unspent. However, €2,802,220,000 of these funds had already been committed in the form of legally binding contracts, while €8,982,804,000 had already been committed to the financing of specific project and programme activities and had moved beyond the first critical stage in the deployment of EDF resources.

This represented a €911.52 million expansion of overall 'A' allocation funding. Taking into account both the 'B' allocations, where the Mid-Term Review had been completed, and the initial 'B' allocations, where no Mid-Term Review had taken place, some €1,184.6 million was currently nominally available under the 'B' allocation. This is an increase of €103 million on aid allocated to national programmes. Of course, 'B' allocations and even 'A' allocations can decline as the Mid-Term Review process is rolled out. Of the 41 countries where the Mid-Term Review had been completed, 10 had a total 'A' and 'B' allocation post Mid-Term Review lower than their initial combined 'A' and 'B' allocation; in the case of one country the final 'A' allocation was lower than the initial 'A' allocation.

With the Cotonou Agreement only entering into legal effect on 1 April, 2003, it is too early to detect any clear patterns in aid deployment.

Table 10. Situation at 31 December, 2000 (€ '000)

	6th EDF	7th EDF	8th EDF	Total
No decisions taken	332,998	760,474	4,997,033	6,090,405
No implementation contracts yet signed	570,571	2,151,842	9,548,827	12,271,240
Money so far unspent	692,858	3,015,592	11,364,819	15,073,269

Table 11. 9th EDF initial NIP 'A' and 'B' allocations and Post Mid-Term Review 'A' and 'B' allocations

Country	Initial 'A'[36]	Initial 'B'	Post MTR 'A'	Post MTR 'B'	Final total
Angola	117.0	29.0	n/a	n/a	-
Antigua	2.6	0.4	n/a	n/a	-
Bahamas	3.9	0.6	n/a	n/a	-
Barbados	6.5	n/a	n/a	n/a	-
Belize	7.8	1.0	n/a	n/a	-
Benin	208.0	6.7	287.9	10.9	298.80
Botswana	39.0	52.0	56.54	39.60	96.14
Burkina Faso	275.0	76.0	432.4	10.7	443.10
Burundi	115.0	n/a	162.39	64.4	226.79
Cameroon	159.0	71.0	126.29	8.7	134.99
Cape Verde	32.0	6.5	44.90	6.5	51.40
Central African Republic	86.0	21.0	94.06	9.4	103.46
Chad	202.0	71.0	209.9	32.9	242.80
Comoros	20.0	7.3	n/a	n/a	-
Dominica	3.7	12.0	10.8	5.3	16.10
Congo (Brazzaville)	43.0	7.3	109.2	n/a	-
Congo (Kinshasa)	171.0	n/a	n/a	-	
Cook Islands	2.0	0.6	2.5	0.6	3.10
Djibouti	29.0	5.8	n/a	n/a	-
Dominican Republic	119.0	57.0	120.80	n/a	-
East Timor	n/a	n/a	n/a	-	
Equatorial Guinea	13.0	4.3	n/a	n/a	-
Eritrea	88.0	8.8	n/a	n/a	-
Ethiopia	384.0	153.7	446.0	77.0	523.00
Fiji	21.0	n/a	n/a	n/a	-
Gabon	34.0	45.0	34.6	36.1	70.70
Gambia	37.0	14.0	n/a	n/a	-
Ghana	231.0	80.0	281.0	42.8	323.80
Grenada	3.5	3.9	9.5	7.8	17.30
Guinea	158.0	63.0	n/a	n/a	
Guinea Bissau	62.0	19.0	73.3	8.3	81.60
Guyana	34.0	14.0	39.64	9.1	48.74
Haiti	180.0	n/a	n/a	n/a	-
Ivory Coast	182.0	n/a	n/a	n/a	-
Jamaica	73.0	27.0	74.15	29.0	103.15
Kenya	170.0	n/a	290.0	26.6	316.6
Kiribati	8.8	2.2	n/a	n/a	-

Table 11 (continued)

Country	Initial 'A'[36]	Initial 'B'	Post MTR 'A'	Post MTR 'B'	Final total
Lesotho	86.0	24.0	106.3	10.3	126.6
Liberia	74.0	n/a	n/a	n/a	–
Madagascar	267.0	60.0	418.49	10.1	428.59
Malawi	276.0	69.0	276.66	21.33	297.99
Mali	294.0	81.0	395.2	12.41	407.61
Marshall Islands	3.5	1.1	n/a	n/a	–
Mauritania	104.0	87.0	115.4	18.0	133.40
Mauritius	33	1.6	48.7	1.1	49.80
Micronesia	4.8	1.4	n/a	n/a	–
Mozambique	274.0	55.0	n/a	n/a	–
Namibia	48.0	43.0	69.43	26.30	95.73
Nauru	1.8	0.5	n/a	n/a	–
Niger	212.0	134.0	332.8	63.8	396.60
Nigeria	222.0	44.0	552.0	7.3	559.3
Niue	2.0	0.6	n/a	n/a	–
Palau	2.0	0.6	n/a	n/a	–
PNG	81.0	85.0	72.5	76.0	148.5
Rwanda	124.0	62.0	176.0	2.1	178.1
Samoa	20.0	7.1	25.17	2.1	27.27
São Tomé & Principe	9.4	3.5	10.33	2.57	12.90
Senegal	178.0	n/a	n/a	n/a	–
Sierra Leone	144.0	n/a	164.7	62.7	227.40
Seychelles	3.9	0.8	n/a	n/a	–
Solomon Islands	6.7	7.8	n/a	n/a	–
Somalia	149.0	n/a	n/a	n/a	–
St Kitts & Nevis	3.4	0.6	6.69	0.6	7.29
St Lucia	4.5	15.0	19.0	9.0	28.00
St Vincent & the Grenadines	5.0	16.0	14.9	12.0	26.9
Sudan	135.0	20.0	n/a	n/a	–
Suriname	11.0	7.0	43.28	1.1	44.38
Swaziland	31.0	12.0	33.07	5.4	38.47
Tonga	3.7	2.0	n/a	n/a	–
Trinidad & Tobago	17.0	0.9	n/a	n/a	–
Tuvalu	3.3	0.7	4.45	0.7	5.15
Uganda	246	117.0	n/a	n/a	–
United Republic of Tanzania	290.0	65.0	393.85	4.55	398.4
Vanuatu	12.0	3.3	17.22	3.3	20.52
Zambia	240.0	111.0	351.5	19.26	370.76
Zimbabwe	108.0	n/a	n/a	n/a	–
Total	7,120.8	2,003.2	788.22		

Sectoral utilisation of EDF assistance

Providing a comprehensive review of the changing sector utilisation of EDF aid to ACP countries is made difficult by the 1992 change in the system of recording the sector/ thematic use of aid, when the EU moved over to the standard OECD classification. However, a fairly clear picture of the sectoral useof EDF aid under the first three Lomé Conventions exists and it is possible to get an indication of actual and planned sectoral aid use aid under Lomé IV and the Cotonou Agreement. Table 12 sets out the sectoral use of aid under Lomé I, II and III (1975–1990). If one takes into account that fully 73.4% of EDF financing going into industrial projects was financed from loan facilities, then the two most important sectors for EDF grant aid deployment from 1975–1990 were agriculture and rural development, and transport and communications. The significance of agriculture and rural development as the focal sector is even more pronounced if the fact that STABEX funds were largely used in the agricultural sector is taken into account. In this context, the agriculture and rural development sector absorbed between 28.8% and 41.39% of EDF resources between 1975 and 1990.

By Lomé IV the shift to commodity assistance programmes which was initiated towards the end of Lomé III had gathered pace, and according to Commission reports 32% of EDF assistance was being deployed in the form of commodity assistance programmes. This is not surprising given the creation of a dedicated ECU1,150 million structural adjustment support facility under Lomé IV and the common practice of deploying conventional NIP funds in parallel with finance from the structural adjustment support facility.[37]

While the share of spending on transportation and communication projects fell slightly as a result of this refocusing of EDF aid programmes, the decline was nowhere near as pronounced as in the sectors of agriculture and rural development.

Under the Cotonou Agreement, on the basis of a review of 61 agreed NIPs, only 7% of total NIP funding was committed to rural development and only 1.1% was committed to agricultural development. In contrast, transportation projects accounted for the planned use of 21.4% of the then programmed NIP funds and structural adjustment support (commodity assistance programmes and budgetary support) for 30%. There has thus been a fundamental shift in the sector use of EDF resources since Lomé III (from 1990).

Table 12. Percentage commitment of EDF resources by sector under Lomé I, II and III

	Lomé I	Lomé II*	Lomé III**
Industrialisation	28.14	20.37	9.18
Tourism	0.50	0.49	0.38
Transport and communication	19.10	18.17	14.6
Agriculture and rural development	16.60	24.49	24.18
STABEX	12.20	14.07	17.21
Education and training	7.43	6.27	2.83
Health	1.55	3.02	1.64
Water/housing/urban infrastructure	3.45	5.71	2.20
Trade promotion	1.06	1.18	0.97
Emergency	4.76	4.38	2.55
Rehabilitation	-	0.57	0.85
Import programmes			9.79
Other	-	2.04	1.21

*Based on a 90% commitment rate

**Based on a 87.7% commitment rate

Table 13. The allocation of funds agreed under 9th EDF National Indicative Programmes

Sector	Percentage of Total Funds Allocated[38]
Structural adjustment	30.7%
Transport	21.4%
Governance	7.9%
Rural development	7.0%
Water	6.7%
Education	6.3%
Minerals	5.0%
Health	4.3%
Civil society	2.9%
Social provision	1.3%
Agriculture	1.1%
Food aid	1.0%
Business	0.6%
Environment	0.5%
Trade	0.1%
Undifferentiated	3.1%

*Allocations made to specific programmes totalling €6,242.6 million

Trends in commitment and payment rates under successive ACP–EU agreements

Throughout successive Lomé Conventions there has been a considerable time lag between the:

- nominal allocation of funds to co-operation programmes (under NIPs and RIPs);
- commitment of these funds to specific projects and programmes (primary commitments);
- signing of contracts for the implementation of specific co-operation activities (secondary commitments); and
- disbursement of funds for the implementation of agreed activities (payments).

In terms of the impact on the ground the key point of aid deployment is the payment of funds for the implementation of activities.

Tables 14 and 15 set out in summary form the cumulative payment and commitment rates under successive ACP–EU co-operation agreements. On average it has taken 13 years to fully disburse (pay out) each five-year ACP–EU co-operation envelope.

Ironically the rates of actual payment of EDF resources were highest under Lomé II and Lomé IV bis and lowest under Lomé IV (1990–95) and the Cotonou Agreement (2002–2005).[39]

The low commitment and payment performance under Lomé IV occurred despite a shift from the mid-1980s towards the use of quicker disbursing aid instruments. Equally Lomé III, the 6th EDF, saw the first introduction of commodity assistance programmes (a key component of which was the €500 million programme for highly indebted poor countries launched in November 1987), yet payment rates remained stubbornly low compared to Lomé I and Lomé II.

After three years they were only 84% of the rate attained under Lomé II. After five years payment rates were on a par with Lomé II but with no notable increase. The payment performance under the 7th EDF, when the new quick-disbursing instruments were fully in place, was even poorer, with payment rates after three years only 82% of those attained under Lomé II and after five years 94% of those attained under Lomé II. Only under the 8th EDF did payment rates exceed those of Lomé II after three years.

However, it should be borne in mind that this was largely attributable to a series of debt-relief initiatives implemented with the EIB and the World Bank. This saw some €350 million committed in 2000 and a further €350 million committed in 2001 (with a total planned envelope under the 8th EDF for such debt relief initiatives of €1,040 million). Taking these initiatives out of the equation, commitment rates in 2000 and 2001 would have been 2.7% lower. This brings commitment rates down to below Lomé II levels. This is evident from the fact that this improved rate of payments was not sustained under the Cotonou Agreement, when payment rates after three years of legal application of the Cotonou Agreement (i.e. by the end of 2004) were only 85% of those attained under Lomé II.

It should be borne in mind that the debt initiative was only the most prominent of the 'global initiatives' implemented under the 8th and 9th EDFs outside the conventional national and regional

Table 14. Rates of payments

	After 3 years	After 5 years	After 8 years	After 12 years
4th EDF	16.87%	42.91%	73.48%	87.33%
5th EDF	18.08%	39.05%	65.47%	79.03%
6th EDF	15.20%	39.78%	67.71%	80.69%
7th EDF	14.92%	36.82%	61.62%	82.69%
8th EDF	19.97%	42.44%	74.99%	-
9th EDF	15.39%	44.14%	-	-

Table 15. Rates of commitments

	After 3 years	After 5 years	After 8 years	After 12 years
4th EDF	48.78%	80.55%	88.81%	92.44%
5th EDF	44.20%	70.07%	88.01%	87.64%
6th EDF	55.50%	81.82%	88.92%	89.69%
7th EDF	40.01%	72.57%	86.96%	97.79%
8th EDF	57.60%	90.42%	-	-
9th EDF	48.68%	93.42%	-	-

programming process.[40] A key feature of a number of these initiatives (but not all) is that they rapidly take funds off the EU books in terms of commitments and payments, but do not necessarily result in increased disbursements in ACP countries.

Under the 9th EDF, for example, €376.5 million[41] has been provided to ACP countries through UN agencies. This is equivalent to some 16.1% of the cumulative payments made under the 9th EDF by the end of 2004.

The anomalous position whereby nominally quicker disbursing instruments actually result in lower rates of payments (although increased in volume terms) would appear to be attributable to one of two factors:

- the delays caused by the intensification of policy dialogue prior to aid commitments and the need to negotiate conditionalities linked to individual programme aid deployment; and/or
- the administrative procedures applied by the EC in the management of EDF resources.

The intensification of policy dialogue would appear to be the most significant factor. Under the later part of Lomé III, but particularly under Lomé IV, one saw the emergence of a multiplicity of forums for policy dialogue. Not only was there the programming process (see Box 3), but the deployment of general import support and sectoral import support commonly required the negotiation of sector or general policy conditionalities.

What is more, the use of counterpart funds generated under these programmes was also the subject of policy dialogue and policy conditionalities. With the introduction of the concept of 'Frameworks of Mutual Obligations' for the deployment of STABEX funds, a further framework for policy dialogue was created. This modification, in particular, resulted in disbursements under the quickest disbursing of the Lomé instruments slowing down dramatically,[42] with STABEX funds nominally committed in the mid-1990s still lying unused until the Cotonou Mid-Term Review. This basic problem in terms of secondary commitments and payments is then compounded by EDF administrative procedures.

In this context it should be noted that payment rates achieved under the 9th EDF have been below those attained under Lomé I and Lomé II after both three and five years of application. Indeed, payment rates under the 9th EDF after five years were even lower than the payment rates achieved under the 8th EDF.

Member states' contributions to the EDFs

The formula used to calculate EU member states' contributions to each EDF is different from the formula used for EU budget contributions. Indeed, there is not so much a formula for calculating member states contributions as a call for contributions at the time of the negotiation of each agreement. Member states' contributions amount to what they would like to contribute, in the light of their historical contribution, with a commitment being made at the beginning of each EDF financing cycle. How-

Table 16. Percentage contribution of EU member states to successive EDFs (million ECU/€)

	4th EDF	5th EDF	6th EDF	7th EDF	8th EDF	9th EDF
Germany	25.95		26.06	25.96	23.36	23.36
France	25.95		23.58	24.37	24.30	24.30
UK	18.70		16.58	16.37	12.69	12.69
Italy	12.00		12.58	12.96	12.54	12.54
Netherlands	7.95		5.64	5.57	5.22	5.22
Belgium	6.25		3.96	3.96	3.92	3.92
Denmark	2.40		2.08	2.07	2.14	2.14
Greece	–	1.24		1.22	1.25	1.25
Ireland	0.60		0.55	0.55	0.62	0.62
Luxembourg	0.20		0.19	0.19	0.29	0.29
Spain	–	(7.55)*		5.90	5.84	5.84
Portugal	–	(7.55)*		0.88	0.97	0.97
Sweden	–	2.73				2.73
Finland	–	1.48				1.48
Austria	–	2.65				2.65
Total EDF	3,000	4,542	7,400	10,800	12,967	13,500

*7.55% was the expected combined contribution of Spain and Portugal

Box 3. The programming exercise

The programming exercise was the process of consultation between the EU and individual ACP governments through which the use of a five-year multi-annual allocation was determined. The government was given the central role in drawing up the National Indicative Programme, which was the ultimate outcome of the programming process. The programming process determined:

- the priority sectors for support;
- the type of assistance to be provided; and
- the most appropriate agencies for implementation of development co-operation activities.

A similar process of programming was applied to the deployment of regional funds, where recognised regional bodies existed. However, under the Cotonou Agreement this programming process was changed and replaced by a concept of 'rolling programming' whereby aid availability could be reviewed in the light of aid use. This preliminary nature of the aid allocation under the Cotonou Agreement was formalised by the specification of an 'A' and a 'B' allocation to each ACP country. As the Cotonou Mid-Term Review process demonstrates, in the majority of cases this is leading to allocated funds being withdrawn from individual countries for redeployment by other means. This is greatly reducing the proportion of EDF funds deployed in support of nationally determined development programmes.

ever, this does not always work and between Lomé IV and Lomé IV bis the UK contribution actually fell, not only in percentage terms but in nominal terms, from ECU1,767.96 million to ECU1,645.51 million. No similar fall occurred in the contributions of other member states. The principal beneficiaries of EU enlargement in 1995 were not the ACP but the UK government, which reduced its contribution to the EDF.

A qualitative review of changing patterns of EU aid deployment to ACP countries

The changing sector focus of EDF aid

There has been a major shift in sector deployment of EDF aid in ACP countries. Under the earlier Lomé Conventions the agriculture and rural development sector was the major focal sector, accounting for the largest proportion of aid deployed. The second most important sector for EDF aid deployment was transportation infrastructure. Since Lomé III, however, the sector focus of EDF aid deployment has shifted. While transportation infrastructure remains a major sector for EDF aid deployment, the deployment of EDF aid to the agriculture and rural development sector has fallen dramatically, with first commodity assistance support and subsequently budgetary support playing a leading role. This is despite the continued centrality of agriculture and rural development to poverty eradication in ACP countries.

New priority areas such as health and education have received increased funding under the EDF in recent years, but the proportion of total EDF funding going to these sectors is still below the average for OECD donors.

Relatively low levels of NIP aid are deployed in support of economic projects such as trade promotion, and private and business sector development. The EC tends to favour using regional funding to support such trade and business development programmes. This is closely related to the regional focus of EPA negotiations and can be seen by the uncharitable to be designed to 'grease the wheels' of economic partnership agreement negotiations.

Equally, recent high-profile initiatives in the form of 'aid to trade' facilities tend, on closer inspection, to consist of an agglomeration of existing activities with some trade component, rather than new financial initiatives linked to addressing new problems in new ways.

The expanding discretionary powers of the European Commission

Over the course of successive Lomé Conventions there has been a trend of increasing deployment of EDF aid through instruments where the EC exercises discretionary control. This growing allocation of discretionary powers to the EC within the EDF aid deployment system is in sharp contrast to the concept of **programming** developed under Lomé I and elaborated under Lomé II. This programming process sought to place nationally determined development plans at the centre of the aid deployment process. Now aid deployment is much more focused on supporting the establishment of the appropriate policy framework, with ACP governments being rewarded if they are deemed to adopt appropriate policies.[43]

This has been associated with a movement away from project aid to programme aid, linked to sectoral and macroeconomic policy dialogue. It manifested itself first in growing levels of commodity assistance and increasingly in the form of budgetary support. The notion of aid being conditional not only upon financial performance (in terms of aid use), but also upon policy performance (in terms of the sectoral and macroeconomic policy frameworks established) was consolidated under the Cotonou Agreement into a formalisation of 'A' allocation and a discretionary 'B' allocation. It was made clear under the Cotonou Agreement that the 'B' allocation was **not an entitlement** but an optional allocation depending on the performance of the country in using the 'A' allocation.

In addition it should be borne in mind that under the Cotonou Agreement the EC retained a higher proportion of NIP funds unallocated and used only slightly over half of the regional allocation for direct allocation to regional organisations. This greatly increased the discretionary funds available to the EC even without the clawed-back 'B' allocations.

To this should be added the unused funds rolled

over from previous EDFs which provided the EC with an extensive fund of over €1 billion to supplement the nominal 9th EDF grant allocation, and over which the EC retained considerable discretion. However, even with these resources in hand, it became apparent in the course of the first four years of the Cotonou Agreement that the EC was overcommitting funds from the general reserve for the funding of special initiatives (the HIV/AIDS Global Fund, the African Security Initiative, the HIPC Initiative and the Water Fund), implemented outside the conventional NIP/RIP framework for the deployment of long-term development assistance. As a consequence, it became clear that the general reserve would not be extensively used to supplement the 'A' country allocations.

This is now evident in the situation emerging from the Mid-Term Review of the Cotonou NIP allocations, where the total combined 'A' and 'B' allocations post Mid-Term Review,[44] are only €113 million higher than the combined initial 'A' and 'B' allocations.[45]

Commitments of EDF resources outside the NIP/RIP framework

Since 1990, but particularly since 1998, the European Commission has begun to deploy a growing volume of EDF resources outside the conventional NIP/RIP framework. This has been most noticeable with regard to the use of regional funds. Under Lomé II (when the volume of regional funds was first clearly stipulated) some 85.8% of funds set aside for regional co-operation were allocated to specific regional co-operation and integration initiatives that were locally led. The percentage share fell consistently over successive agreements and from Lomé IV bis the absolute volume of aid made available to specific regional co-operation and integration initiatives that were locally led also declined.

The deployment of aid outside the NIP/RIP framework has included:

- major debt relief initiatives (HIPC);
- A multiplicity of programmes via UN bodies;
- The Global Fund for HIV/AIDS, Malaria and TB;
- The Africa Security Facility;
- The Water Facility; and
- The Energy Facility.

These horizontal initiatives, all approved jointly by the ACP–EU Council of Ministers, account for a growing proportion of EDF spending.

Table 17. Regional allocations to specific regions from funds set aside for regional co-operation (million ECU/€)

	Lomé I	Lomé II	Lomé III	Lomé IV	Lomé IV bis	Cotonou
West Africa	94.9	141.2	202.98	228.0	228.0	235.0
Central Africa	23.6	59.5	74.89	84.0	84.0	55.0
East Africa	73.7	133.9	203.34	199.0	194.0	223.0
Southern Africa	26.9	70.0	133.02	128.9	121.0	
Indian Ocean	8.3	20.0	25.64	30.0	30.0	
Caribbean	24.9	55.6	71.09	105.0	90.0	57.0
Pacific	10.0	33.9	39.00	35.0	35.0	29.0
Total to regions	262.3	515.0	750.00	810.0	651.0	599.0
Total allocation	–	600.0	1,000.00	1,250.0	1,300.0	1,300.0
Percentage going to regions	85.8	75.00	64.8	50.1	46.7	

Source: Europa/Development – Co-operation by Region, Lomé
http://europa.eu.int/comm/development/body/publications/rep98/regio_en.htm
Regional Allocations Cotonou: http://europa.eu.int/comm/development/body/csp_rsp/rsp_en.cfm

The implications of this trend for EPA negotiations is far from clear. On the one hand, it demonstrates a willingness to deploy EDF aid outside the NIP/RIP framework and within the framework of new initiatives and through new partners. It also provides a rich experience of how to deal with EDF procedures in getting to grips with new challenges (both positive and negative). On the other hand, it is shrinking the pot of EDF funding available to support both traditional NIP/RIP-based development priorities and EPA-related restructuring challenges.

The expanded use of EDF aid

This leads on to a fourth major trend in EDF aid deployment, namely the growing range of development priorities which the EDF facility is meant to address. It should be noted that under Lomé I and Lomé II, EDF aid deployment was primarily focused on long-term development projects, with substantial additional resources being mobilised for deployment in certain crisis-affected ACP regions from the general EU budget. Since Lomé III, however, EDF aid has been used to cover virtually all EU expenditures in ACP countries (notable exceptions are NGO co-financing and certain thematic budget lines). This has included major new areas of co-operation, ranging from debt relief, through the Global Fund for HIV/AIDS, Malaria and TB to security interventions.

EDF resources are thus being spread more thinly than under earlier conventions. This is having a particular impact on the level of funding available for long-term development co-operation activities at the country level, which is declining.

Changing instruments but common commitment and deployment problems at country level

A fifth major trend is the continued problem with regard to the length of time it takes to commit and disburse EDF resources. This has remained a problem despite the shift from areas of support with long lead times and nominally slow rates of commitment and disbursement, for example integrated agricultural and rural development programmes, towards forms of support that are nominally quick disbursing, with swift commitment and disbursement rates (for example commodity assistance programmes or budgetary support).

Unfortunately the shift towards these nominally quicker disbursing instruments has not, until very recently, resulted in a noticeable improvement in the actual rate of payments of EDF resources under successive funds. Lomé III, the 6th EDF, saw the first introduction of commodity assistance programmes, yet payment rates remained stubbornly low. After three years, payment rates were only 84% of those attained under Lomé II. After five years, payment rates were on a par with Lomé II but with no notable increase. The payment performance under the 7th EDF, when the new 'quick-disbursing' instruments were fully in place, was even poorer, with payment rates after three years only 82% of those attained under Lomé II and after five years 94% of those attained under Lomé II. Only under the 8th EDF did payment rates exceed those of Lomé II after three years.

However, this was not sustained under the Cotonou Agreement, when payment rates after three years of legal application of the Cotonou Agreement (i.e. by the end of 2004) were only 85% of those attained under Lomé II (see Table 14 above). This trend is contrary to what one might have expected given the more generalised introduction of quick-disbursing instruments under Lomé IV. This suggests that there are ongoing bottlenecks in the commitment and disbursement of EDF funds through existing arrangements. While there is a general consensus on the existence of the problem, there is no agreement on what needs to be done. For the European Commission, part of the solution lies in moving outside the conventional NIP/RIP aid deployment framework. While this has resulted in increased volumes of EDF commitments, and indeed payments, from the EC, it has not necessarily resulted in an increase in the rate of payment of EDF resources into ACP countries. On occasions intermediate bodies through which aid is deployed (for example the Global Fund for HIV/AIDS, Malaria and TB) have faced their own problems in actually working within EDF procedures. Thus, while these programmes may transfer large volumes of funding off the EC's books, this does not necessarily mean that more money is being spent faster in ACP countries.

Use of grants for loans

Not all aid made available in the form of grants is extended as grants to ACP countries. Under the Cotonou Agreement the use of grants to finance loans returned to the levels of Lomé I, II and III, having fallen dramatically under Lomé IV, when the depth and devastating consequences for development of high levels of indebtedness were appreciated.

Using aid, not simply allocating aid

The situation with regard to commitments and payments of EDF resources (particularly payments, which is the critical point of reference for the aid recipient), suggests that there is little value in expanding the financial allocation to co-operation with ACP countries unless the issue of accelerating actual disbursements is addressed. Even the shift to quicker disbursing forms of support from 1988 onwards did not significantly impact on the actual rate of deployment of EDF aid in ACP countries. This suggests that EDF administrative procedures are poorly suited to quick disbursement. This has important implications if one is looking at supporting time-sensitive initiatives linked to economic changes brought about by the implementation of economic partnership agreements. The issue of the administrative procedures to be used in supporting EPA-related adjustments will be critical to the actual value of any such support facility.

Harmonising member states policies on the use of unrequired funds

Slow payment rates can leave EU member states holding relatively large volumes of financial resources at the end of the financial year, which they have nominally allocated to finance their EDF payment obligations. In some member states these funds are lost to ACP–EU co-operation for that financial year. Establishing a mechanism to ensure that these funds are not lost to ACP–EU co-operation by committing them to quick-disbursing instruments of support linked to EPA-related adjustment processes would appear to be appropriate (for example using funds that are not required to meet EDF obligations each year to provide budgetary support to address the revenue implications of EPAs).

Making sure that aid swiftly reaches the final beneficiary

While the shift to the use of non-traditional channels of aid disbursement has become apparent since Lomé IV bis, and has resulted in quicker rates of aid commitment and primary disbursement, it has not necessarily resulted in the final beneficiary in ACP countries receiving the benefits of the aid any more quickly. There still appear to be delays arising from the need to apply EDF procedures.

Taking policy dialogue out of the equation

A significant factor in the relatively slow commitment and payment rates in recent years (despite the move to quicker disbursing instruments) has been the deepening and multiplication of frameworks for policy dialogue. This slowed down noticeably the rate of disbursement on the quickest disbursing of the Lomé instruments – the STABEX fund. How the issue of policy dialogue/policy conditionalities is to be dealt with under EPAs will be an important determinant of the value of the assistance extended. At one level the situation should be eased, since ACP governments will be pursuing liberalisation in line with EU policy advice. Procedures may, however, need to be modified to reflect these new realities.

Learning from other experiences. With regard to the general issue of procedures to be followed in supporting economic restructuring linked to trade integration, the ACP could usefully explore the principles applied to, and the experience of, the EU's SAPARD programme for new member states, which had as one of its central planks the decentralisation of programme design and implementation within an agreed administrative framework.

Clarifying policy on the role of loan financing

EU policy with regard to the extent and nature of loan financing within the overall EDF aid package has been ambiguous since 1975. There are also ambiguities over the role of concessional financing, particularly the suitability of 'soft' financing where private sector operators are involved (including

small and medium-sized enterprises). These ambiguities could take on considerable significance when it comes to the nature of support to be extended to private-sector-based processes of economic restructuring in preparation for the implementation of EPAs. They could be especially important in the food and agricultural sector, where the EU itself provides expanding volumes of grant-financed aid to enhance the efficiency and international competitiveness of its food and agricultural enterprises throughout the EU.

How this issue is to be dealt with under an EPA restructuring facility needs to be clarified at the outset if extensive delays in concluding financing agreements are to be avoided and if the aid deployed is not to be made available on terms that prove unattractive for productive investments with long lead times before returns are secured.

Learning lessons on budgetary support from the counterpart funds experience

As greater use has been made of direct budgetary support, the use of counterpart funds has declined in significance within the EU overall aid package. But the lessons learnt from counterpart-fund programmes could be relevant for the design and implementation of budget-support measures designed to address the revenue losses arising under moves towards free trade with the EU and the consolidation of regional market integration.

Reviewing the implications of the declining importance of the NIP/RIP Framework

Consideration needs to be given to the implications of the declining levels of total EU aid to ACP countries deployed within the NIP/RIP framework. Is it appropriate to deploy private-sector-led sectoral support linked to EPA-associated restructuring through this framework? Or would other channels of support be more appropriate? If so, what channels?

For EPA-related restructuring programmes that are time sensitive, a key issue is the swift deployment of assistance in ways that allow ACP economic operators to prepare for the changes that EPAs will bring about, rather than simply responding to these changes.

This calls for a thorough-going review of the experience and lessons of other time-sensitive restructuring processes, linked to changes in the rum, banana and rice sector. It also calls for a review of the experience of the various non-NIP/RIP channels used to deploy EDF assistance in recent years, and the efficiency and effectiveness of the various management models established for these programmes, in terms of the timely delivery of assistance to the final beneficiary.

Taking on board the EC's poor performance on economic projects

A major feature of the EDF aid experience is the relative lack of success the European Community has had in managing production-related economic projects and programmes. In many respects this is only to be expected, since the EDF system was not designed to deal with the private sector. As a consequence, EDF procedures are not amenable to providing assistance in a time-sensitive manner. The lead time for EDF projects in the agricultural and rural development sector has traditionally been very extensive, with the consequence that market conditions are very different when the scheme comes on stream, compared to when the scheme was in the design and planning stage. A case in point is the ECU62 million of support extended to large-scale irrigation schemes in Swaziland, which had the aim of extending irrigated smallholder sugar production. While this made good sense in 1992–94 when the programme was being designed, it will now require some serious financial restructuring if its future economic viability is to be assured.

This reality needs to be recognised and addressed, particularly given the recent rhetorical emphasis on 'aid to trade' projects. The sad reality is that, for a variety of reasons, the European Community is simply not very good at providing efficient and effective support to economic projects that are sensitive to market change (precisely the circumstances that will be faced under an EPA). Indeed, this has been implicitly recognised by the European Commission, which has overseen a major shift in the deployment of EDF assistance away from the agriculture and rural development sector to budget

support and transportation-sector programmes. This is profoundly significant in the context of designing assistance packages linked to EPA-related restructuring needs.

Clarifying the role of transportation projects in promoting production and trade in ACP countries

EDF aid remains focused on transport infrastructure projects. Indeed, in one of the major ACP recipients of EDF aid, despite the ever-changing development justification for the deployment of EDF aid (support to national planning processes, support to food strategies, support for macroeconomic adjustment, support for poverty alleviation), the percentage of total NIP aid going to the transportation infrastructure sector has remained constant since Lomé I.

In this context, given that a major component of NIP aid goes to transportation infrastructure projects, the question arises of how relevant the pattern of this aid deployment is to enhancing the competitiveness of ACP enterprises in producing for and supplying national, regional and international markets.

It may well be that the pattern of EDF transport infrastructure investment in ACP countries facilitates trade but does not facilitate competitive production and supply of goods and services in ACP countries for national, regional and international markets.

Annex 1. Additional tables

Table A1. Rates of commitments and payments based on allocations under the financial protocol – 4th EDF (Lomé I)

Year	Commitment (cumulative)	Payment (cumulative)	% Total (€3,390 million) Commitment	Payment
1976	382.2	97.5	11.27	2.88
1977	1,089.9	245.5	32.15	7.24
1978	1,653.8	571.8	48.78	16.87
1979	2,225.9	995.2	73.23	29.36
1980	2,730.8	1,454.5	80.55	42.91
1981	2,881.3	1,900.3	84.99	56.06
1982	2,983.1	2,205.8	88.00	65.07
1983	3,010.7	2,491.0	88.81	73.48
1984	3,037.0	2,676.2	89.59	78.94
1985	3,046.4	2,781.9	89.86	82.06
1986	3,133.5	2,890.4	92.43	85.26
1987	3,133.9	2,960.6	92.44	87.33
1988	3,135.0	2,999.0	92.48	88.47
1989	3,135.4	3,031.2	92.49	89.39
1990	3,053.3	3,053.3	90.07	90.07

Extracted from tables on the following web pages: Commitments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat08_en.htm*; Payments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm*

Table A2. Rates of commitments and payments based on allocations under the financial protocol – 5th EDF (Lomé II)

Year	Commitment (cumulative)	Payment (cumulative)	% Total (€5,227 million) Commitment	Payment
1981	548.9	195.9	10.50	3.75
1982	1,551.7	526.0	29.69	10.06
1983	2,310.3	945.2	44.20	18.08
1984	3,102.1	1,454.7	59.35	27.83
1985	3,662.3	2,041.0	70.07	39.05
1986	4,156.7	2,658.9	79.52	50.87
1987	4,454.7	3,071.8	85.22	58.77
1988	4,600.4	3,422.0	88.01	65.47
1989	4,639.3	3,662.7	88.76	70.07
1990	4,663.6	3,856.7	89.22	73.78
1991	4,599.3	3,993.1	87.99	76.39
1992	4,580.8	4,131.0	87.64	79.03
1993	4,207.4	4,207.4	80.49	80.49
1994				
1995				

Extracted from tables on the following web pages: Commitments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat08_en.htm*; Payments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm*

Table A3. Rates of commitments and payments based on allocations under the financial protocol – 6th EDF (Lomé III)

Year	Commitment (cumulative)	Payment (cumulative)	% Total (€8,400 million)	
			Commitment	Payment
1986	313.2	116.7	3.73	1.39
1987	2,267.5	469.3	40.09	5.59
1988	4,662.0	1,277.0	55.5	15.20
1989	5,986.2	2,301.2	71.26	27.40
1990	6,872.5	3,341.6	81.82	39.78
1991	7,324.7	4,200.8	87.20	50.00
1992	7,445.6	5,115.7	88.64	60.90
1993	7,469.1	5,687.3	88.92	67.71
1994	7,516.9	6,138.5	89.49	73.08
1995	7,562.5	6,404.7	90.03	76.25
1996	7,509.5	6,603.8	89.40	78.62
1997	7,533.7	6,777.6	89.69	80.69
1998	7,489.1	6,931.5	88.56	82.52
1999	7,439.1	7,031.5	88.56	83.71
2000	7,389.1	7,131.5	87.97	84.90
2001	7,789.1	7,139.5	92.73	84.99
2002	8,089.1	7,177.5	95.70	85.45
2003	8,389.1	7,287.5	99.87	86.76
2004	8,589.1	7,475.5	102.25	88.99
2005*	8,789.1	7,710.5	104.63	91.7
2006*		7,941.5	94.54	

*Projections

Extracted from tables on the following web pages: Commitments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat08_en.htm*; Payments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm*

Table A4. Rates of commitments and payments based on allocations under the financial protocol – 7th EDF (Lomé IV (I))

Year	Commitment (cumulative)	Payment (cumulative)	% Total (€12,000 million) Commitment	Payment
1991	859.7	195.5	7.16	1.63
1992	2,820.1	1,084.4	23.50	9.04
1993	4,801.4	1,790.0	40.01	14.92
1994	7,234.3	3,122.4	60.29	26.02
1995	8,708.8	4,417.9	72.57	36.82
1996	9,726.7	5,536.2	81.06	46.14
1997	10,318.5	6,575.1	85.99	54.79
1998	10,435.3	7,394.2	86.96	61.62
1999	10,885.3	8,094.2	90.71	67.45
2000	11,335.3	8,759.2	94.46	72.99
2001	11,735.3	9,377.2	97.79	78.14
2002		9,889.2		82.41
2003		10,329.2		86.08
2004		10,609.2		88.41
2005*		10,784.2		89.87
2006*		10,874.2		90.62

*Projections
Extracted from tables on the following web pages: Commitments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat08_en.htm*; Payments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm*

Table A5. Rates of commitments and payments based on allocations under the financial protocol – 8th EDF (Lomé IV (II))

Year	Commitment (cumulative)	Payment (cumulative)	% Total (€142,625 million) Commitment	Payment
1998	2,224.1	466.6	1.53	3.19
1999 4,524.1	1,051.6	30.93	7.19	
2000	8,424.1	2,921.6	57.60	26.81
2001	10,924.1	4,848.6	74.69	33.15
2002	13,224.1	6,207.6	90.42	42.44
2003		7,859.6		53.74
2004		9,577.6		65.49
2005*		10,967.6		74.99
2006*		11,895.6		81.34

*Projections
Extracted from tables on the following web pages: Commitments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat08_en.htm*; Payments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm*

Table A6. Rates of commitments and payments based on allocations under the financial protocol – 9th EDF (Cotonou Agreement)

Year	Commitment (cumulative)	Payment (cumulative)	% Total (€12,000 million)	
			Commitment	Payment
2002	900	162	5.92	1.07
2003	4,100	928	26.97	6.11
2004	7,400	2,339	48.68	15.39
2005*	10,700	4,239	70.39	27.89
2006*	14,200	6,709	93.42	44.14

*Projections

Extracted from tables on the following web pages: Commitments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat08_en.htm*; Payments: *http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm*

Table A7. Annual EDF payments: Changing importance of STABEX transfers

Year	Total payments	STABEX payments	% Share STABEX
1976	97.5	80	82.1
1977	148.0	37	25.0
1978	326.3	34	10.4
1979	423.4	164	38.7
1980	459.3	63	13.7
1981	641.7	55	12.0
1982	635.6	267	42.0
1983	704.4	71	10.1
1984	694.7	75	10.8
1985	692.0	61	8.8
1986	843.1	246	29.2
1987	835.7	282	33.7
1988	1,196.3	491	41.0
1989	1,297.1	338	26.1
1990	1,256.5	218	17.3
1991	1,191.1	189	15.9
1992	1,941.7	611	31.5
1993	1,353.6	31	2.2
1994	1,781.6	351	19.7
1995	1,563.7	301	19.2
1996	1,317.4	163	12.4
1997	1,212.7	19	1.6
1998	1,439.6	89	6.2
1999	1,385.0	20	1.4
2000	2,635.0	250	9.5

Notes

1. In this context in the European Commission document 'Financial Information on the EDF' (Com(1999) 323 final) the final amount of aid deployed under the 6th EDF is given as totalling ECU9,002.6 million (consisting of ECU5,882.6 million in grants and ECU 1,120 in EIB 'own resources'), while for the 7th EDF the total is given as ECU12,794.2 million (consisting of ECU 11,569.2 million in grants and ECU 1,225 in EIB 'own resources') and for the 8th EDF the total level of funding is given as ECU 14,830.5 (consisting of ECU 13,137.5 million in grants and ECU1,693.0 million in loans). In some instances, figures for the total EDF include funding for co-operation activities in member states' overseas territories. There is thus considerable discrepancy between different European Commission sources on the total volume of funds made available under successive Lomé Conventions. However, in terms of the contributions of EU member states, the key figure is the new financial support contributed under the financial protocol, while for ACP countries the key figure is the actual aid disbursed.
2. In the latter half of the 1980s and the 1990s most of these 'special loans' were converted to grants, particularly as it became apparent that ACP governments were unwilling to take up this component of their NIP for fear of further increasing their indebtedness.
3. See Financial and Technical Co-operation Report 1983 (COM (84) 398 final.
4. Under the 4th EDF a maximum level of commitments of ECU3,135 million was attained by 1989, but by 1990 when the 4th EDF was closed, a total of some ECU82.1 million had been decommitted.
5. Under the 5th EDF a maximum level of commitments of ECU4,663.6 million was attained by 1990, but by 1993 when the 4th EDF was closed, a total of some ECU373.4 million had been decommitted.
6. With funds from the 4th and 5th EDFs carried over to the 6th EDF general reserve, when the 6th EDF was closed in 2005, a total of ECU906.5 million was carried over to the 9th EDF.
7. Under the 7th EDF, by 2002, decommitments of ECU152.3 million had occurred, with these funds being carried over to the 9th EDF.
8. Under the 8th EDF in 2002 a net decommitment of ECU73 million, with these fund being carried over into the general reserve of the 9th EDF.
9. Within this amount between ECU50 and 150 million was set aside for emergency aid and some 10% was nominally allocated to support regional co-operation activities
10. Some ECU60 million per annum was set aside for emergency aid within this allocation, within a maximum of ECU200 million being deployed for the purpose from EDF funds over the life of the convention.
11. Of which some €90 million is allocated to finance the activities of the CDE, some €70 million to finance the activities of the CTA, and some €4 million to finance the activities of the Joint Parliamentary Assembly. Nominally the European Commission also consolidated all previously unused funds into the 9th EDF and these should be added in when looking at the level of funding made available to specific instruments, although in considering the overall level of financial allocation made since 1975 these should not be carried over since this would lead to double counting.
12. This includes an allocation of ECU133 million to the financing of the activities of the CDI (ECU60 million), the Joint Parliamentary Assembly (ECU3 million) and activities related to the development of trade and services implemented at a regional level (ECU70 million). This reduces the amount available to finance regional indicative programme activities to ECU1,117 million. Funds for the activities of the CTA were also drawn from this regional envelope, further reducing the funds available for regional specific co-operation programmes.
13. This includes an allocation of ECU242 million to the financing of the activities of the CDI (ECU73 million), the Joint Parliamentary Assembly (ECU4 million), activities related to the development of trade and services implemented at a regional level (ECU85 million) and institutional development support (ECU80 million). This reduces the amount available to finance regional indicative programme activities to ECU1,058 million. Funds for the activities of the CTA were also drawn from this regional envelope, further reducing the funds available for regional specific co-operation programmes.
14. Initially STABEX support was to be extended in the form of loans, which would be reimbursed into a revolving fund. However, the scale and duration of export earnings losses rapidly undermined the revolving fund concept, so STABEX transfers were retroactively converted into grants. They are therefore considered as grants, since no reimbursement of these 'loans' was required of ACP countries.
15. SYSMIN aid was also initially granted in the form of loans reimbursable on the same terms as 'special loans'. However, this aid was subsequently converted to grants and so is included as part of the grants received by ACP countries.
16. 'Risk capital' loans managed by the EIB have always been grant financed. However, these loans need to be reimbursed and so are not included in the grants received by ACP countries but rather in the table of loans extended.
17 While 'special loans' were later converted to grants, since the pace of this process varied considerably across the ACP and repayments were made on part of these special loans, this instrument is included under loans received by ACP countries rather than grants made available.
18. From 2000 this became known as the Investment Facility.
19. This includes STABEX funds as reimbursable loans as initially conceived.
20. These percentages fall to 19.1%, 18.5% and 14.3% under Lomé I, II and III, if the later conversion of special loans to grants is taken into account. This conversion of special loans to grants accounts in part for the higher total figures of grant financing under the NIPs at the end of Lomé I, II and III compared to the level of grant financing initially allocated to NIPs.
21. In November 1978 a special programme for highly indebted countries was launched. All in all, some ECU500 million was mobilised for this initiative (ultimately around ECU550 million was committed in the framework of the initiative). ECU40 million was drawn from the balance of previous EDFs; ECU60 million from repayments on special loans and risk capital (such repayments should have reverted back to EU member states in proportion to their contribution to the EDF from which the original loan was financed); ECU200 million was drawn from unallocated Lomé III programmable resources; and a further ECU200 million was mobilised from within existing NIP allocations of the countries benefiting from the programme. This money was used to address balance-of-payment problems of highly indebted ACP countries through the provision of commodity assistance via general and sector-import programmes Twelve years later, following a joint ACP–EU Council decision, a total of ECU1,040 million was mobilised for debt relief, deployed via an EIB-administered trust fund (ECU360 million) and a World Bank administered trust fund (ECU 680million).

22. Of which 'special loans' accounted for 14.3%.
23. Of which 'special loans' accounted for 11.1%.
24. Of which 'special loans' accounted for 8.1%.
25. These loans can attract an 'interest rate subsidy' (IRS) from grants set aside for this purpose.
26. These figures only include aid deployed directly in individual ACP countries. They do not include regionally deployed aid or EDF aid deployed through multilateral bodies or global programmes.
27. A single data sheet, listing receipts by each ACP country from Lomé I to Lomé IV bis, has been used for the compilation of this summary table and figures were not provided for EIB operations under Lomé IV bis. While it would have been possible to compile a list of EIB loan agreements signed under Lomé IV bis, this would not have provided a consistent, authoritative figure for actual commitments. Even if a reasonable figure for EIB loans were factored in, however, it would only reduce the NIP contribution to around 60%.
28. It was, of course, under Lomé IV bis that the major debt relief initiatives were launched, accounting for ECU1,040 million in commitments through the EIB and the World Bank. The conclusion of the Cotonou Agreement also saw the consolidation of previously unused funds under the 9th EDF.
29. It is difficult to reconcile these figures with the tables of commitments and payments contained in Tables 2.1.1–2.2.6, which set out cumulative commitments and payments from EDF resources via all instruments of co-operation.
30. Only about 11% had been committed by the time of the Cotonou Agreement Mid-Term Review process.
31. Communication from the Commission to the European Parliament, the Council and the Court of Auditors, 'Financial Analysis of the 6th, 7th and 8th European Development Funds – 2000', Brussels, 22.8.2001 COM(2001) 479 final, p. 3.
32. Total grant financing made available under that EDF for co-operation with ACP countries.
33. The amount of money for which financing agreements have been signed.
34. The amount of money for which contracts with implementing agents have actually been signed.
35. The amount of money which the European Commission has actually paid out.
36. Situation as of 30 April 2003.
37. In some ACP countries STABEX funds were also used to provide commodity assistance.
38. No information on the sectoral programming of funds is available for the following countries (bracketed amounts are the size of the 'A' allocation in million €); Barbados (6.5), Burundi (115), Congo (171), Cook Islands (2), Ivory Coast (182), Liberia (74), Mali (294), Marshall Islands (3.5), Nauru (1.8), Senegal (178), Sierra Leone (144), Somalia (149), St Vincent (5), Sudan (135) and Togo (70). However, it includes SYSMIN allocations for the following countries: Botswana (30), Dominican Republic (30), Gabon (35), Ghana (40), Guyana (4.9), Mauritania (45), Namibia (25), Niger (55), Papua New Guinea (50), Senegal (55), Sierra Leone (25), Surinam (7) and Zambia (9).
39. See Tables A1–A6 for more details of cumulative commitment and payment rates under successive EDFs. It should be borne in mind that the rates of commitment and payment referred to are calculated with reference to the overall size of the EDF. While rates may be lower, the actual volume of resources committed and paid out may well have risen.
40. Other notable initiatives include the Global Fund for HIV/AIDS, Malaria and TB, and the African Peace Facility, established in 2003, and the EC-led Water Initiative.
41. See http://europa.eu.int/comm/europeaid/reports/final-statistiques-un-2004-vers9_en.pdf.
42. From 1976–80 STABEX accounted for fully 26.0% of EDF funds paid out under the 4th EDF. From 1981–85 STABEX accounted for 19.8% of total funds paid out under 4th and 5th EDFs. From 1986–90 STABEX accounted for 29% of the funds paid out under the 4th, 5th and 6th EDFs. With the introduction and implementation of the framework of mutual obligations concept, payments rates began to fall from 1993 onwards and STABEX accounted for only 18.9% of payments under the 5th, 6th and 7th EDFs. From 1996–2000 STABEX accounted for only 6.8% of payments under the various EDFs then under implementation (see Annex 2.8 for details). STABEX payments were particularly important in the first three years of each financing cycle, accounting in some years for between 29 and 42% of payments.
43. Often this takes the guise of Poverty Reduction Strategies.
44. In so far as it has been completed to date.
45. The distribution between countries, however, has of course changed.

11

An Analysis of EU–ACP Aid Flows through the EDF from Lomé I to the Cotonou Agreement and Proposals for the 10th and 11th EDFs

Alice Clarke

Introduction

In recent months the fight against poverty has featured high on the political and public agenda of the international community. There have been a number of widely supported campaigns and prominent economists are heralding a time of change. The 'Make Poverty History' campaign has called 2005 a year of unprecedented opportunity to say 'enough is enough' and campaign for urgent and meaningful change on trade, debt and aid. Jeffery Sachs has highlighted the possibility of eradicating extreme poverty 'in our generation' and argues that humanity, for the first time ever, has the resources, capacity and technology to do so.

In July 2005 issues related to poverty eradication were high on the agenda of the G8 Summit held in Gleneagles, Scotland. G8 leaders agreed to a US$50 billion annual boost to aid by 2010 compared to 2004, and EU members pledged to reach a collective aid target of 0.56% of GNI by 2010, and 0.7% by 2015, reaffirming commitments made at their Barcelona Council meeting in 2002. The EU accession states agreed to provide 0.17% of their collective GNI by 2010, increasing to 0.33% in 2015. The EU President, José Manuel Durão Barroso, reaffirmed the EU's commitment to poverty alleviation in a series of speeches when he was in New York in September 2005 for the UN General Assembly Special Summit on the Millennium Development Goals. The ACP states and the EU have a long history of co-operation aimed at addressing development issues in ACP states to enable them to alleviate poverty in a sustainable manner. This co-operation dates back to 1963, when France initiated the Yaoundé Agreements establishing special relations with Francophone Africa. The current agreement between the 77 ACP states and the EU is the Cotonou Agreement, which was signed in 2000 and covered a twenty-year period.

The Cotonou Agreement sets the framework for the negotiation of the Economic Partnership Agreements that will govern economic and trade co-operation between the ACP and the EU from 2008

Box 1. Excerpts from UN Speeches by EU President José Manuel Durão Barroso

'... the UN's long-standing 0.7% target for official development assistance is an achievable target, not an inspirational goal'

UN Summit Special Plenary on Financing for Development, New York, 14 September 2005

'... the key point is this: fighting extreme poverty and disease is not done by words alone. It is done by turning commitments into reality ... We have the resources. What we need is organisation and political will. Gleneagles was a crucial step in the fight against extreme poverty. Europe must, and will, work to turn the commitments made there into reality.'

New York, 15 September 2005

[Chapter 4 of *The European Development Fund and Economic Partnership Agreements*, Roman Grynberg and Alice Clarke (eds), Commonwealth Secretariat, London, 2005.]

(when negotiations are expected to be finalised). They represent a critical shift in traditional economic and trade co-operation between the ACP states and the EU. Most notably these agreements involve a move away from the traditional system of non-reciprocal trade preferences to a system of reciprocal trade preferences that will be WTO compatible. The European Development Fund is the main financing instrument of the ACP–EU agreement and is managed by the European Commission. Substantial amounts of aid are channelled through the EDF, which accounts on average for 37% of the aid channelled through the EC.[1]

In the light of recent political commitments with regard to aid and with the impending shift to EPAs, this is an opportune time to review EU–ACP aid relations through the EDF and to make proposals on how the Gleneagles commitments with regard to aid levels can become reality within the context of the evolving EU–ACP relationship, which includes the move to a system of reciprocal trade preferences. This chapter therefore presents a historical analysis of EDF aid deployment.

Historical analysis of real EDF allocations from Lomé I (4th EDF) to Cotonou (9th EDF)

What has happened to real aid levels allocated through the EDF between Lomé I (4th EDF) and Cotonou (9th EDF)?

Nominal EDF aid allocations[2] increased from the 4th to the 9th EDF, rising from €3.4 billion to €15.2 billion, a nominal increase of 348%. Despite the increase in nominal EDF aid allocations from the 4th to the 9th EDF, real EDF allocations increased over the same period by only 16%. However, from the 7th EDF to the 9th EDF the real value of allocations declined from a high of €3.5 billion to €3.1 billion in 1975 prices, a real decline of 11.4%. The start of the 7th EDF (1990)[3] coincided with the end of the Cold War and the diminishing geopolitical importance of ACP states to the EU (see Table 1 below and also refer to Table A1 of the Statistical Annex.) This geopolitical transformation appears to have marked a turning point in the value of real aid allocations to ACP countries, particularly in terms of the real value of grant allocations from member states and the real value of grants received by ACP countries.

Table 1. Summary table of real and nominal EDF allocations[4] from the 4th to the 9th EDF (€ million)

EDF	Nominal values[5]	Real values[6]
4th	3390	2696
5th	5227	2586
6th	8400	3264
7th	12000	3514
8th	14625	3463
9th	15200	3131

How have the EU's real EDF contributions per capita and by member states changed between the 4th and 9th EDFs?

The bulk of the total EDF allocation is made up of voluntary contributions from EU member states. In nominal terms, contributions per capita by member states increased substantially from €8.53 during the 4th EDF to €35.44 during the 9th EDF, a nominal increase of 315%. However, real contributions per capita increased only marginally from €6.79 to €7.30 over the same period, a real increase of only 7.5%. However, from the 7th to the 9th EDF real per capita contributions declined from a peak of €8.58 to €7.30, a real decline of 15%. This further illustrates the decrease in EU aid allocated through the EDF from the end of the Cold War (see Table 2 and Table A2 of the Statistical Annex.)

Table 2. Summary table of real and nominal EU per capita EDF contributions from the 4th to the 9th EDFs (€)

EDF	Nominal per capita values[7]	Real per capita values
4th	8.53	6.79
5th	12.71	6.29
6th	20.49	7.96
7th	29.30	8.58
8th	34.65	8.20
9th	35.44	7.30

Turning to overall EU member states' contributions, illustrated in Annex Table A3, all EU member states' nominal contributions to the EDF increased from the 4th to the 9th EDF. In the same period, real contributions from all EU member states increased, except for the UK, the Netherlands and Belgium. However, all EU member states, except Luxembourg, reduced their real contributions to the 9th EDF compared to the peak in the 7th EDF by an average of 12%. The UK, Germany, Netherlands and Italy all reduced real contributions to the 9th EDF compared to the 7th EDF by more than the EU average, reducing their contributions by 32%, 21%, 18% and 15% respectively (see Annex Table A3).

What happened to real per capita (per ACP citizen) EDF allocations to ACP states from the 4th to the 9th EDF?

The Cotonou Agreement aims to ensure that the ACP–EU co-operation process is centred on the 'human person, who is the main protagonist and beneficiary of development'.[8] It is important, therefore, to consider EDF allocations to ACP states in per capita terms.

The general increase in real EDF allocations from the 4th EDF to the 9th EDF by the EU and its citizens did not result in ACP countries receiving more in real per capita terms from the EDF. In fact, real EDF allocations per capita in ACP states have been in sharp decline. ACP citizens were allocated approximately €8.5 in real terms during the 4th EDF while during the 9th EDF they were allocated approximately €4 in real terms, a decline of over 50% in real per capita allocations. This is illustrated below based on data presented in Annex Table A1.

How do real EDF allocations to least-developed countries and non-least-developed countries compare over successive EDFs?

Analysis of real EDF allocations[9] per capita (per ACP citizen) to ACP states based on country classifications[10] (LDC, SIDS and LLC) reveal that real per capita allocations to LDC ACP states have consistently been higher than those to non-LDC ACP states. However, while per capita allocations to non-LDC ACP states followed an upward trend from the 4th to the 7th EDF, per capita allocations to LDC ACP states followed a variable yet declining trend. The divergent trend in real aid allocations to LDCs and non-LDCs is illustrated in Figure 2, which is based on calculations using data in Annex Tables A4 and A6.

The per capita allocations during the 8th and 9th EDFs give only a partial and hence distorted picture. In the case of Lomé IV bis only NIP allocations and non-programmable aid paid out by 2000 are

Figure 1. Trends in real EDF allocations per capita to ACP states from the 4th to 9th EDF

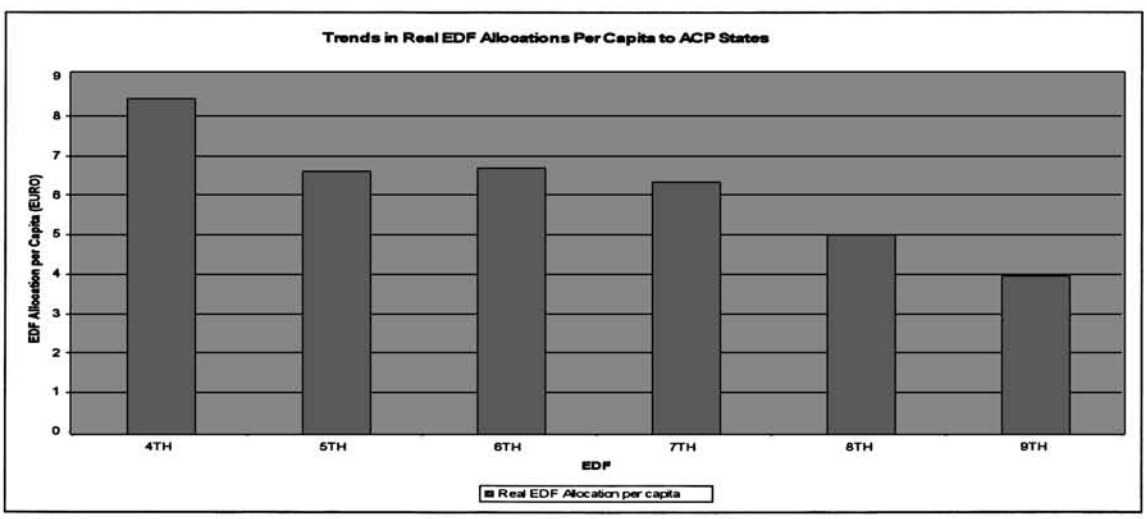
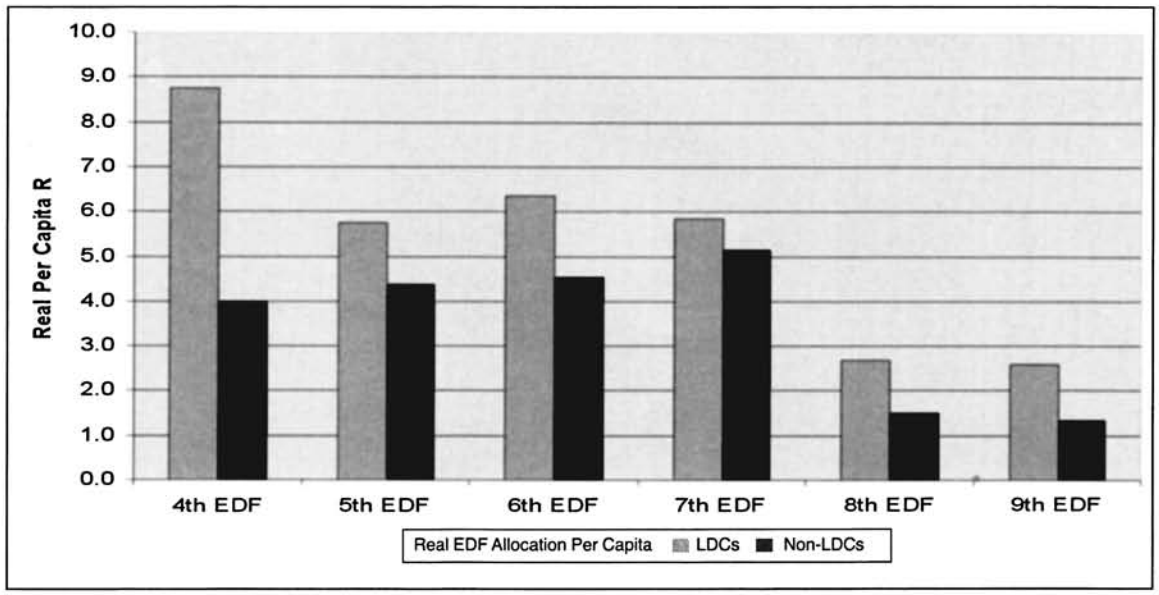


Figure 2. Trends in real per capita EDF allocations to LDC and non-LDC ACP states, 4th to 9th EDF



included and this accounts for the much lower per capita allocation in both categories. Under the Cotonou Agreement only the initial 'A' allocations are used, which accounts for only 71% of the grants potentially available for deployment at the national level, 53% of the total grants allocated by EU member states, and a mere 47% of the total 9th EDF (grants and loan package combined). The divergence in the trend in aid allocations and flows to LDCs and non-LDCs between the 4th and the 7th EDF is nevertheless remarkable, given the increased policy focus over the period on providing aid to the poorest. The questions arise: what factors within the EDF aid deployment process gave rise to this trend and will changes introduced under the Cotonou Agreement (9th EDF) serve to reverse the trend?

Within the LDC group, countries facing additional disadvantages by also being landlocked countries received less than other LDCs[11] during the 4th to 6th EDFs, but more during the 7th and 9th EDFs. LDCS that were also SIDS received substantially more than those ACP countries that were only LDCs, but with the gap narrowing from the 7th EDF onwards. This is in part a result of the small populations of SIDS LDCs and the 'bulky' nature of EDF aid deployment. It may also be a product of the numerous provisions in the Cotonou Agreement to afford LDCs, SIDS and LLCs preferential treatment, although if this were the case this would also be reflected in a consistent ratio of aid between LDCs and non-LDCs, and this has not happened. This is illustrated in Figure 3, which is based on data in Annex Table A5.

What is the distribution of nominal aid allocations[12] by EPA regional groupings (SADC, ESA, ECOWAS, CEMAC, PF and Cariforum) over successive EDFs?

Based on aid allocations[13] to ACP countries that are members of each EPA configuration from the 4th to the 8th EDF, Figure 4 illustrates the distribution of development assistance by region. From the chart it is clear that ECOWAS has been allocated more on average over successive EDFs (38%) than the other regional groups, followed by ESA (34%), SADC (11%), CEMAC (8.1%), Cariforum (5.7%) and PF (3.4%).

Figure 5 shows the distribution of 9th EDF aid allocations by EPA negotiating groups. During the 9th EDF, ECOWAS (39%), ESA (35%), SADC (13%), and Cariforum (6.8%) were allocated more than their average allocation for the 4th to the 8th EDF, while CEMAC (4.3%) and PF[14] (2.5%) were allocated less.

Figure 3. Real per capita EDF allocations to LDCs, LDC SIDS and LDC LLCs (€)

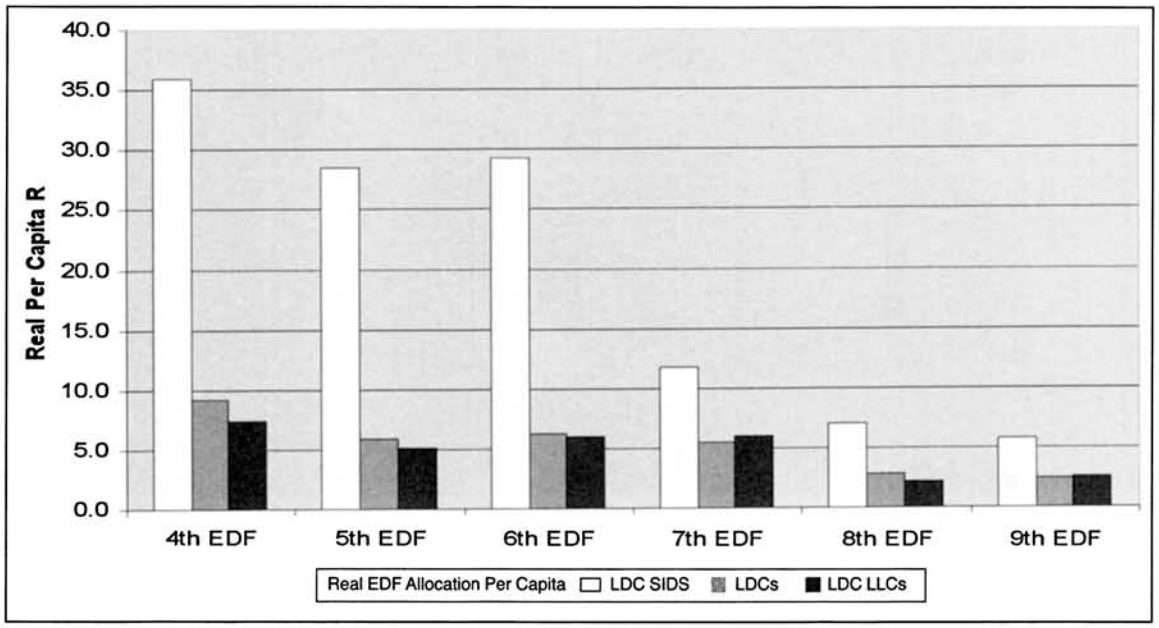
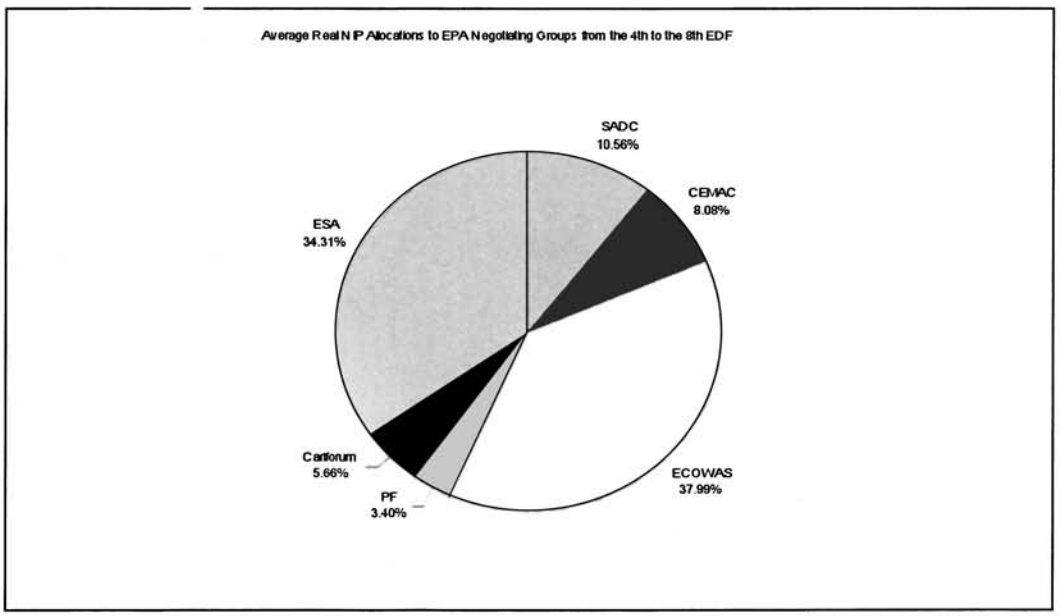


Figure 4. Average real EDF allocations by regional EPA configurations from the 4th to the 8th EDF

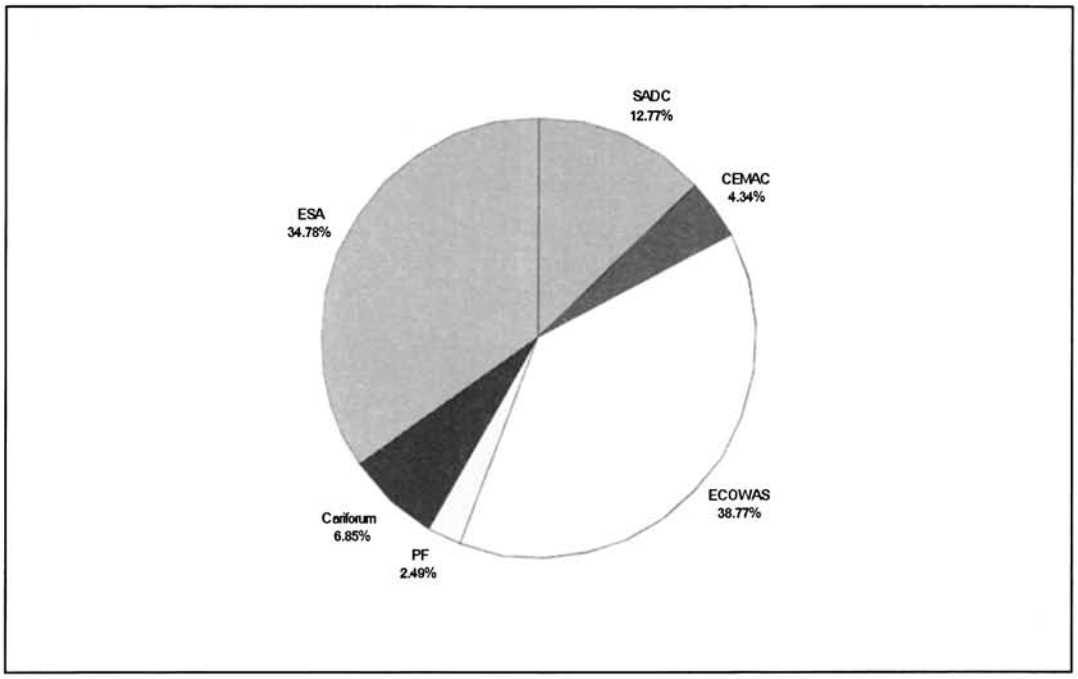


How do total actual payments for each EDF five-year period compare to nominal allocations for each EDF?

So far the above analysis has been based on real allocations rather than actual payments. Below a comparison is made between actual payments under each EDF in the nominal five-year life of each EDF and the nominal allocations for each five-year financing cycle of the EDF.[15]

The actual amount of each allocation spent in each five-year financing cycle exhibited an overall decline, falling sharply from 42.9% during the 4th EDF to 20% during the 8th EDF. In the 9th EDF (based on commission projections) there has been a

Figure 5. EDF allocations by regional EPA configurations for the 9th EDF



slight improvement in fund disbursement of aid in the first five years of the agreement, with 27.9% of EDF allocation actually spent. On average from the 4th to the 7th EDF it took over 16 years to fully disburse each EDF.[18] For the 8th EDF, projections suggest that after nine years 90% of allocated funds will have been paid out, an improvement on the average under previous EDFs. (This is based on projections and not on actual payments.)

How have EU members' DAC flows as a percentage of GNI, and EDF allocations as a percentage of total DAC flows changed over successive EDFs?

EDF contributing members of the EU are major providers of official development assistance, accounting on average for over 47% of total DAC flows between 1975 and 2005.[19] The EU's DAC flows as a percentage of members' GNI exhibited a rising trend from the 4th to the 6th EDF, before exhibiting a declining trend until the 8th EDF and a slight increase during the 9th EDF. Over the whole period, the contribution fell from 0.38% of GNI during the 4th EDF to 0.35% of GNI during the 9th EDF. The average for the period as a whole, however, was 0.38%.

Member countries' total EDF contributions (grant component of the EDF allocation) as a percentage of total DAC flows from the EU showed a variable but rising trend from the 4th to the 8th EDF, before falling back to only 0.06% higher during the 9th EDF compared to the 4th EDF. Over the whole of the period the share of EU members DAC flows channelled through the EDF averaged 8.63%.

How much should the 10th and 11th EDFs be?

Based on the above analysis, what should be the level of the 10th and 11th EDFs? The EU has made public commitments regarding its future aid levels. This section proposes nominal allocations for future EDFs in line with the EU's commitments. At the EU's Council meeting in Barcelona in 2002 and the July 2005 G8 summit at Gleneagles, the EU agreed to increase aid flows as a percentage of member states' GNI. To assess the implications for the EDF, a three-step process was undertaken.

Future levels of EU GNI were projected for

Table 3. Funds allocated and spent during the life of each five-year financing cycle (million €)

EDF	Nominally allocated during the five-year envelope	Actually spent in the five years to which the envelope was allocated	% of total allocation used during the years to which it was allocated
4th (1975–1980)	3390	1454.5	42.9%
5th (1980–1985)	5227	2041.0	39.1%
6th (1985–1990)	8400	3341.6	39.8%
7th (1990–1995)	12000	4417.9	36.8%
8th (1995–2000)	14625	2921.6[16]	20.0%
9th (2000–2005)	15200	4239.0[17]	27.9%

Table 4. EU members' DAC flows as a percentage of members' GNI (million €)

EDF	EU nominal DAC flows[20]	EU nominal GNI[21]	DAC/GNI
4th	37,893	10054469	0.38%
5th	60,316	14084633	0.43%
6th	88,039	21614406	0.41%
7th	113,146	28812019	0.39%
8th	125,023	38638694	0.32%
9th	169,097	47781327	0.35%
Average			**0.38%**

Table 5. EDF allocations as a percentage of EU members total DAC flows (million €)

EDF	Nominal EDF allocations	EU nominal DAC flows	EDF allocations/ EDF members DAC
4th	3,000	37,893	7.92%
5th	4,542	60,316	7.53%
6th	7,400	88,039	8.41%
7th	10,800	113,146	9.55%
8th	12,967	125,023	10.37%
9th	13,500	169,097	7.98%
Average			**8.63%**

2008–2012 (10th EDF) and 2013–2017 (11th EDF). Next, hypothetical DAC flows were calculated for two different scenarios: a Gleneagles commitments scenario, under which the EU applies its aid commitments as listed above, and a business as usual scenario, under which the EU continues to provide historical levels of DAC/GNI. Total EU contributions to the EDF under each scenario were then calculated, based on the historical EDF share of DAC flows. Finally, the total EDF was calculated (i.e. including both contributions from member states and loans). For the first step, EU GNI for each year from 2008 to 2017 (the end of the 11th EDF) was calculated using a linear trend based on EU GNI data covering the years 1975–2004. This is illustrated in Figure 6 (for the EU15) and Figure 7 (for the EU accession states).[22]

For the second step, yearly DAC flows were computed by applying the 'Gleneagles commitments' scenario and the 'business as usual' scenario to the GNI figures for each year (see Annex Tables A10 and A11). Under the Gleneagles commitments

Figure 6. GNI projections for EDF-contributing EU members for 2005–17

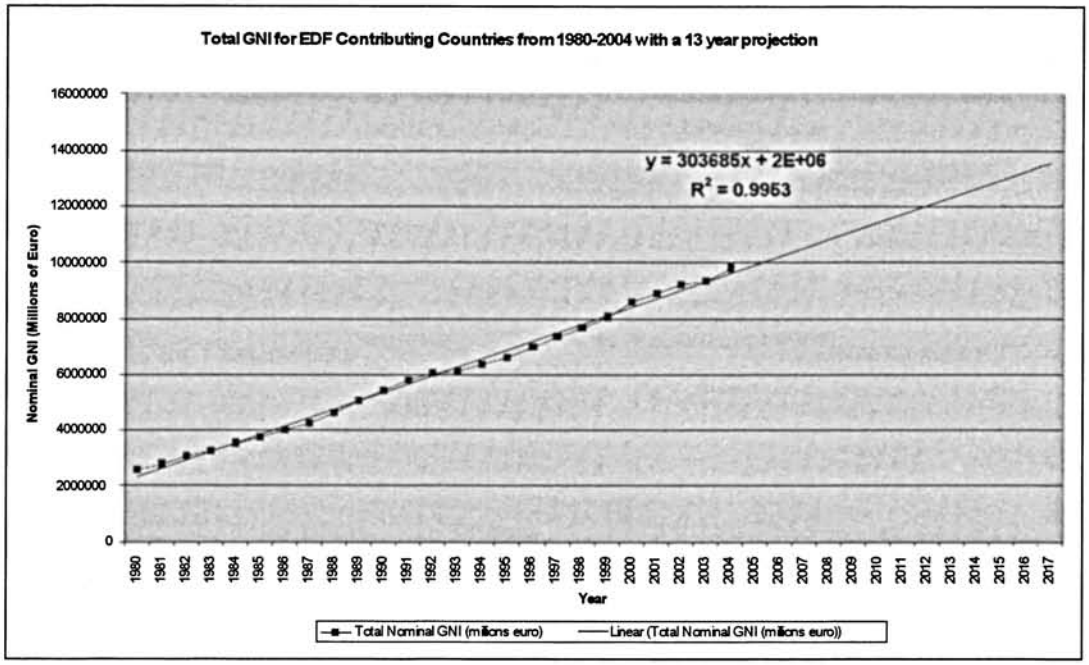
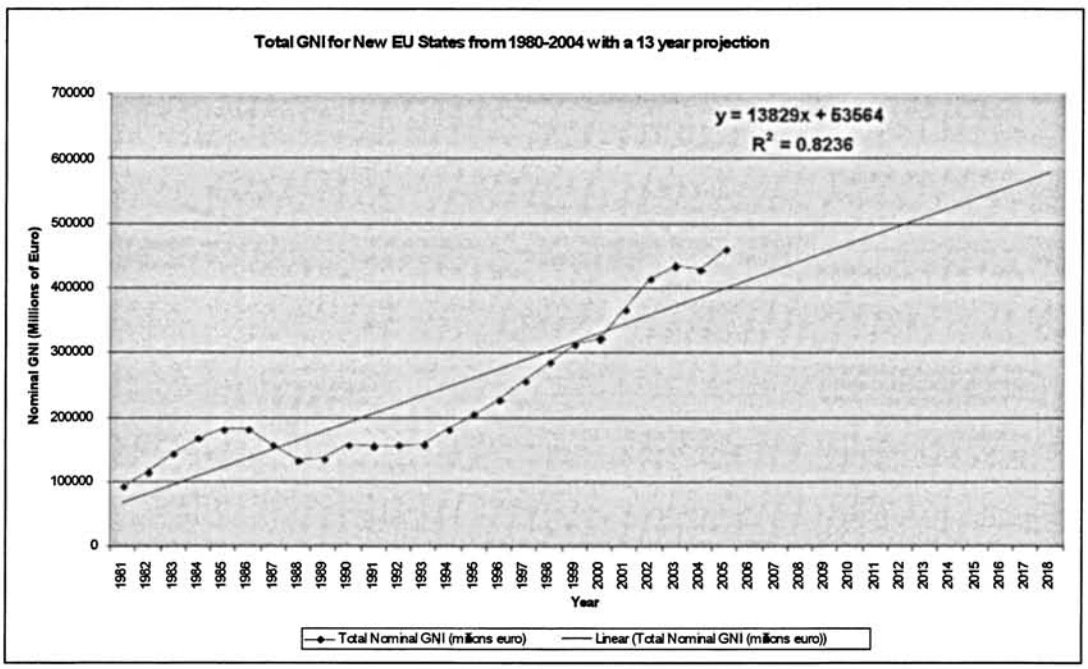


Figure 7. GNI projections for EU accession states for 2005–17



scenario, DAC flows as a percentage of EU member states' GNI reach 0.39% by 2006, 0.56% by 2010 and 0.7% by 2015. The EU accession states reach 0.17% of GNI by 2010, increasing to 0.33% by 2015. Under the business as usual scenario, the EU does not achieve its Gleneagles commitments and

continues providing 0.38% of EU15 GNI as DAC (i.e. average DAC/GNI for the 4th to the 9th EDF) and provides 0.17% of new EU states' GNI as DAC from 2010 to 2017[23] (the end of the 11th EDF).

Total DAC flows for the 10th and the 11th EDF were computed by summing yearly DAC flows for the periods 2008–2012 (10th EDF) and 2013–2017 (11th EDF) for both the Gleneagles commitments scenario and the business as usual scenario (see Annex Tables A10 and A11).

For the third step – i.e. calculating hypothetical EU member states' contributions to the EDF given a certain DAC level – both the Gleneagles commitments scenario and the business as usual scenario are derived by multiplying projected total DAC flows for the 10th and the 11th EDF by 8.63%, which is the average percentage of EDF to GNI for the 4th to the 9th EDF. For the final step, the grant/contribution component is assumed to be 89% of the total EDF, again based on historical trends (see Annex Table A12 for the final calculation).

If the EU continues to follow historical trends and provide 0.38% of GNI as DAC, then under the business as usual scenario the 10th and 11th EDF allocations would be:

- 10th EDF: €21.27 billion; and
- 11th EDF €24.28 billion.

However, if the EU achieves its Gleneagles commitments then the 10th and 11th EDF allocations would be:

- 10th EDF: €27.62 billion; and
- 11th EDF €41.22 billion.

It should be noted that the difference between an EDF based on the full implementation of the Gleneagles commitments scenario and one based on the business as usual scenario is some €6,349 million. What is more, during the 11th EDF, under the Gleneagles commitments scenario the projected nominal EDF allocation would be significantly larger than under the business as usual scenario (€17,395 million larger).

Annex

Table A1. Summary table of nominal, real and per capita EDF allocations from Lomé 1 to Cotonou (million €)

EDF	4th	5th	6th	7th	8th	9th
EDF grant nominal allocation[a]	2475	3758	6200	9975	11967	11300
EDF loan nominal allocation[a]	915	1469	2200	2025	2658	3900
Nominal EDF (Grants + Loans) allocation	3390	5227	8400	12000	14625	15200
Average world inflation rate for corresponding five-year period (1975 = 100)	126	202	257	342	422	486
Real grant allocation	1969	1859	2409	2921	2834	2327
Real loan allocation	728	727	855	593	629	803
Real EDF (Grants + Loans) allocation	**2696**	**2586**	**3264**	**3514**	**3463**	**3131**
ACP population	318,850,833	388,883,000	484,019,500	548,015,000	684,603,447	782,819,255
Nominal EDF (Grants + Loans) allocation per capita of ACP countries	10.63	13.44	17.35	21.90	21.36	19.42
Real grant allocation per capita of ACP countries	6.17	4.78	4.98	5.33	4.14	2.97
Real loan allocation per capita of ACP countries	2.28	1.87	1.77	1.09	0.92	1.03
Real EDF allocation (Grants + Loans) per capita of ACP countries	**8.46**	**6.65**	**6.74**	**6.41**	**5.06**	**3.99**

Source: Financial protocols to each partnership agreement between the EU and ACP, excluding allocations to overseas territories
[a]Information on 5th EDF contributions by country was unavailable; since contributing countries were the same as for the 4th EDF, the same percentage contribution as during the 4th EDF was used to determine 5th EDF contributions, given that the total contribution for the 5th EDF was known.

Table A2. Real per capita EDF contributions of EU member states (€) (using real values of EDF contributions from Table A1 and population figures as below)

	Average population (1975–80)	Nominal 4th EDF contribution	Real 4th EDF contribution	Average population (1981–85)	Nominal 5th EDF contribution	Real 5th EDF contribution	Average population (1986–90)	Nominal 6th EDF contribution	Real 6th EDF contribution
Germany	78319906	9.94	7.91	78156318	15.08	7.46	78168587.8	24.67	9.59
France	53150228.17	14.65	11.65	54613154.2	21.58	10.68	55981194	31.17	12.11
UK	56222296.5	9.98	7.94	56412135.8	15.06	7.45	57099955	21.49	8.35
Italy	55904720.17	6.44	5.12	56543963.2	9.64	4.77	56629049.2	16.44	6.39
Netherlands	13853596.5	17.22	13.69	14336477.6	25.19	12.46	14711463.4	28.37	11.02
Belgium	9826479.833	19.08	15.18	9857344.8	28.80	14.25	9894951.2	29.62	11.51
Denmark	5088360.5	14.15	11.25	5116569.2	21.30	10.54	5127101.6	29.99	11.65
Greece	9301092.5	0.00	–	9814290.8	0.00	–	10025856.8	9.15	3.56
Ireland	3281833.333	5.48	4.36	3494300	7.80	3.86	3527249.6	11.54	4.48
Luxembourg	361054.3333	16.62	13.22	365579.2	24.85	12.30	372582	36.94	14.35
Spain	36335188	0.00	–	38015792	0.00	–	38665845.4	14.44	5.61
Portugal	9403470	0.00	–	9927011.8	0.00	–	10020136.4	0.00	–
Sweden	8245979.167	0.00	–	8328329.6	0.00	–	8427932.2	0.00	–
Finland	4738343.667	0.00	–	4841049.8	0.00	–	4940730.4	0.00	–
Austria	7565585.667	0.00	–	7564894.6	0.00	–	7591008	0.00	–
EDF contribution per EU citizen	351598134.3	8.53	6.79	357387210.6	12.71	6.29	361183643	20.49	7.96

Table A2 (continued)

	Average population (1991–95)	Nominal 7th EDF contribution	Real 7th EDF contribution	Average population (1996–00)	Nominal 8th EDF contribution	Real 8th EDF contribution	Average population (2001–05)	Nominal 9th EDF contribution	Real 9th EDF contribution
Germany	80775823.8	34.71	10.16	82017505.2	36.93	8.74	82458972.46	38.24	7.88
France	57327579.6	45.91	13.44	58319259	54.03	12.79	59617683.56	55.03	11.33
UK	58096762.4	30.43	8.91	59142579.6	27.82	6.59	59673284.46	28.71	5.91
Italy	56805758.4	24.64	7.21	56895390.8	28.58	6.77	57526364.81	29.43	6.06
Netherlands	15228890.4	39.50	11.57	15667872.6	43.20	10.23	16173344.13	43.57	8.97
Belgium	10061699.2	42.51	12.45	10191674.8	49.87	11.81	10352512.2	51.12	10.53
Denmark	5180313.8	43.16	12.64	5292921	52.43	12.41	5382104.621	53.68	11.06
Greece	10407742.4	12.66	3.71	10798372.4	15.01	3.55	11004394.14	15.33	3.16
Ireland	3563721.4	16.67	4.88	3695713.2	21.75	5.15	3963416.11	21.12	4.35
Luxembourg	394920	51.96	15.21	422290	89.05	21.09	447574.8584	87.47	18.02
Spain	39119999.2	16.29	4.77	39689658.8	19.08	4.52	41697629	18.91	3.89
Portugal	9983701.6	9.52	2.79	10113863.2	12.44	2.94	10402097.43	12.59	2.59
Sweden	8697650.4	0.00	–	8849073.6	40.00	9.47	8943813.218	41.21	8.49
Finland	5051825.6	0.00	–	5145488.6	37.30	8.83	5207049.336	38.37	7.90
Austria	7852907	0.00	–	7974759.2	43.09	10.20	8101327.145	44.16	9.10
EDF contribution per EU citizen	368549295.2	29.30	8.58	374216422	34.65	8.20	380951567.5	35.44	7.30

Source: Population figures were obtained from: http://epp.eurostat.cec.eu.int/portal/page?_pageid=1090,30070682,1090_30298591&_dad=portal&_schema=PORTAL

Table A3. Nominal and real EDF contributions of EU member states to successive EDFs (million €)

	Real 4th EDF	Nominal 4th EDF	Real 5th[b] EDF	Nominal 5th EDF	Real 6th EDF	Nominal 6th EDF	Real 7th EDF	Nominal 7th EDF	Real 8th EDF	Nominal 8th EDF	Real 9th EDF	Nominal 9th EDF
Germany	778.50	619.23	1178.649	583.23	1928.44	749.28	2803.68	820.91	3029.0912	717.24	3153.6	649.52
France	778.50	619.23	1178.649	583.23	1744.92	677.97	2631.96	770.63	3150.981	746.10	3280.5	675.65
UK	561.00	446.22	849.354	420.29	1226.92	476.71	1767.96	517.66	1645.5123	389.63	1713.15	352.84
Italy	360.00	286.35	545.04	269.70	930.92	361.70	1399.68	409.82	1626.0618	385.02	1692.9	348.67
Netherlands	238.50	189.70	361.089	178.68	417.36	162.16	601.56	176.14	676.8774	160.27	704.7	145.14
Belgium	187.50	149.14	283.875	140.47	293.04	113.86	427.68	125.22	508.3064	120.36	529.2	108.99
Denmark	72.00	57.27	109.008	53.94	153.772	59.75	223.56	65.46	277.4938	65.71	288.9	59.50
Greece	0.00	0.00	0	0.00	91.76	35.65	131.76	38.58	162.0875	38.38	168.75	34.76
Ireland	18.00	14.32	27.252	13.49	40.7	15.81	59.4	17.39	80.3954	19.04	83.7	17.24
Luxembourg	6.00	4.77	9.084	4.50	13.764	5.35	20.52	6.01	37.6043	8.90	39.15	8.06
Spain	0.00	0.00	0.00	0.00	558.404	216.96	637.2	186.57	757.2728	179.31	788.4	162.38
Portugal	0.00	0.00	0.00	0.00		0.00	95.04	27.83	125.7799	29.78	130.95	26.97
Sweden	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	353.9991	83.82	368.55	75.91
Finland	0.00	0.00	0.00	0.00	0.00	0.00	0.000	0.00	191.9116	45.44	199.8	41.15
Austria	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	343.6255	81.36	357.75	73.68
Total member country contributions	3000.00	2386.22	4542.00	2247.52	7400.00	2875.20	10800.00	3162.22	12967.00	3070.37	13500.00	2780.46

Table A4. Summary table of real and nominal EDF allocations to LDCs and non-LDCs (€)

	4th EDF 1975–1980	5th EDF 1980–85	6th EDF 1985–90	7th EDF 1990–95	8th EDF 1995–2000	9th EDF[24]
LDCs						
Total nominal NIP+Other EDF	2095460000.0	2574030000.0	4520010000.0	6174306000.0	4263500000.0	5400200000.0
Total Real NIP+Other EDF	1676368000.0	1274272277.2	1758758754.9	1810646920.8	1010308056.9	1113443299.0
Average Population	191724000.0	221062267.0	276846733.0	310273729.0	374850740.0	427731288.0
Real per capita allocation	8.7	5.8	6.4	5.8	2.7	2.6
Non-LDCs						
Total nominal allocation	663700000.0	1309800000.0	2028500000.0	3515100000.0	1490380000.0	1704500000.0
Total real allocation	530960000.0	648415841.6	789299610.9	1030821114.4	353170616.1	351443299.0
Average population	133139333.3	148671761.9	173928666.7	200215000.0	232968600	262689289.3
Real per capita allocation	4.0	4.4	4.5	5.1	1.5 1.3	

Table A5. Real per capita EDF allocations to LDCs, LDC SIDS and LDC LLCs (€)

	4th EDF 1975–1980	5th EDF 1980–85	6th EDF 1985–90	7th EDF 1990–95	8th EDF 1995–2000	9th EDF[25]
LDC only						
Total nominal NIP+Other EDF	1297540000.0	1536200000.0	2746900000.0	3642356000.0	2697910000.0	3147000000.0
Total real NIP+Other EDF	1038032000.0	760495049.5	1068832684.8	1068139589.4	639315165.9	648865979.4
Average population	112680833.0	130377600.0	171878000.0	196662000.0	231030540.0	263534987.0
Real per capita allocation	9.2	5.8	6.2	5.4	2.8	2.5
LLC+LDC						
Total nominal NIP+Other EDF	716530000.0	921300000.0	1599700000.0	2152870000.0	1245570000.0	1919000000.0
Total real NIP+Other EDF	573224000.0	456089108.9	622451361.9	631340176.0	295158767.8	395670103.1
Average population	77230500.0	88658833.0	102660167.0	104169563.0	133114000.0	152118009.0
Real per capita allocation	7.4	5.1	6.1	6.1	2.2	2.6
SIDS+LDC						
Total nominal NIP+Other EDF	81390000.0	116530000.0	173410000.0	379080000.0	320020000.0	334200000.0
Total real NIP+Other EDF	65112000.0	57688118.8	67474708.2	111167155.4	75834123.2	68907216.5
Average population	1812667.0	2025833.0	2308567.0	9442167.0	10706200.0	12078293.0
Real per capita allocation	35.9	28.5	29.2	11.8	7.1	5.7

Table A6. Distribution of EDF funding (NIP and Other EDF) to ACP countries

LDC 1 LLC 2 SIDS 3		Lomé I 1975–80		Lomé II 1980–85		Lomé III 1985–90		Lomé IV 1990–95		Lomé IV bis 1995–2000		9th EDF – NIP 2000 onwards using initial 'A' allocation	
Code	**Country**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Initial A**	**Avg. Pop.**
1	Angola					121	8868833	156	101235000	167	117568000	117	13700325
1,2	Burkina Faso	87	6569833	94	7414000	135	8375833	301	9424667	200	10739800	275	12276551
1,2	Burundi	64	3887167	97	4427500	164	5091833	201	5813000	144	6547600	115	7277742
1,3	Cape Verde	10	289000	20	298667	28	325333	38	360667	40	412800	32	476781
1,2	Central African Republic	48	2179833	60	2476667	110	2806500	111	3127167	114	3597200	86	3897718
1,2	Chad	77	4241667	85	4788000	144	5465167	158	6255000	0	7397000	202	8729886
1,3	Comoros	12	331500	22	356167	22	405000	38	461500	32	531200	20	608434
1	Congo Dem Rep	43	25868333	32	29985500	60	34663333	58	40741167	59	47426800	171	53330956
1	Djibouti	6	255667	8	327833	18	408667	28	534500	25	633000	29	715200
1	Equatorial Guinea (Sp)	7	215667	11	264000	26	334167	21	375667	1	434800	13	501285
1	Eritrea			0		0		71		80	3882000	88	4460379
1,2	Ethiopia	167	35280000	206	40474000	545	47042667	409	40982063	0	61266000	384	69574705
1	Gambia, The	23	594000	32	681600	41	835333	34	1024167	32	1229400	37	1454015
1	Guinea	69	4294333	85	4706833	191	5358000	299	6174333	175	7086200	158	8005336
1,3	Guinea Bissau	33	721333	32	834167	44	961667	60	1104000	47	1294800	62	1510631
1,3	Haiti	0		0		0		176	6804333	148	7647400	180	8540737
1,3	Kiribati	6	57500	6	61500	9	68500	6	76000	9	86000	9	98746
1,2	Lesotho	24	1205167	36	1358000	52	1509000	108	1616667	63	1709600	86	1803169
1	Liberia	35	1737833	36	2036167	54	2317833	85	2575500	0	2964800	74	3429653
1	Madagascar	82	8335833	114	9481667	163	10861500	222	12410167	235	14606400	267	17186410
1,2	Malawi	75	5702333	99	6694833	168	7870000	260	8854833	203	9879600	276	11083739
1,2	Mali	100	6240333	126	6972500	176	7905167	272	9044500	218	10340000	294	11795088
1	Mauritania	83	1514667	57	1709833	104	1919333	191	2160333	95	2500400	104	2901030
1	Mozambique	0		0		222	13870167	272	14917667	286	16963000	274	19040697
1,2	Niger	111	5178167	99	6050000	160	7078500	200	8310167	314	10047800	212	11983905
1,2	Rwanda	70	4764333	92	5593000	181	6518833	191	6676167	175	7053200	124	8525065
1,3	Samoa	8	152667	16	156333	25	158167	17	162500	18	168800	20	179094
1,3	São Tomé & Principe	2	87000	12	94167	10	107500	19	123500	10	141800	9	158747

Table A6 (continued)

LDC 1 LLC 2 SIDS 3		Lomé I 1975–80		Lomé II 1980–85		Lomé III 1985–90		Lomé IV 1990–95		Lomé IV bis 1995–2000		9th EDF – NIP 2000 onwards using initial 'A' allocation	
Code	**Country**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Initial A**	**Avg.Pop.**
1	Senegal	142	5165833	171	5947833	272	6848500	222	7826833	198	9034540	178	10391521
1	Sierra Leone	36	3081333	63	3405333	75	3785000	128	4247500	122	4827600	144	5394742
1,3	Solomon Islands	13	210833	16	250167	51	295167	30	343167	19	397600	7	461827
1	Somalia	82	5329000	110	6701333	148	6645833	228	7527167	0	8155800	149	9806098
1	Sudan	159	17996000	189	20918000	293	23756500	292	26397500	54	30158000	135	33825048
1	Tanzania	135	17206833	152	20143833	200	23589667	411	27539167	330	32110200	290	36378540
1	Togo	45	2382833	74	2734333	111	3226167	93	3659000	5	4246800	70	4962258
1,3	Tuvalu	1	9000	1	9000	3	9000	1	9000	2	9000	3	9500
1,2	Uganda	99	12009000	102	13644667	159	15845167	403	18889333	268	21985200	246	25691045
1,3	Vanuatu	4	106500	7	122000	7	136400	12	160000	13	185600	12	212888
1,2	Zambia	68	5278333	149	6215667	106	7227000	212	8343667	222	9486400	240	10536132
3	Antigua & Barbuda	2.08	61666.6667	2.8	61500	6	63000	4.4	64500	4.5	66800	2.6	70026.48503
3	Bahamas	1.88	199333.333	2.1	221333.333	6.7	243166.667	13.6	265666.6667	4.5	294400	3.9	321289.5378
3	Barbados	3.78	247166.667	4.9	251333.333	7.2	255000	13.4	262000	9.6	265400	6.5	270515.027
3	Belize	4.33	136833.333	6.4	155833.333	13	177833.333	17.1	196666.6667	9.5	224600	7.8	264340.2015
2	Botswana	25.37	830500	29.1	991833.333	60.4	1177166.67	90.1	1383666.667	38	1610400	39	1745637.348
	Cameroon	72.13	8146333.33	116.5	9400666.67	304.4	10838500	407.2	12538333.33	158	14443000	159	16290548.86
	Congo Brazzaville	124.37	1671000	199	1956166.67	174.8	2300500	212.9	2710666.667	0.94	3236800	43	3829382.895
3	Dominica	9.47	72000	8.5	74000	11	73000	28.1	72166.66667	31.65	72400	3.7	72000
3	Fiji	19.82	603500	32.6	665500	24.1	718833.333	27.2	754833.3333	27.5	792600	21	834268.0968
	Gabon	17.82	643500	25.1	752333.333	29.5	880500	56.9	1030833.333	36.2	1199800	34	1360099.663
	Ghana	59.95	10445500	160.8	12069500	122.7	14300333.3	275.4	16332333.33	154.4	18837800	231	20801653.77
3	Grenada	2.58	91000	9.6	89500	10.8	91833.3333	21.6	94166.66667	9.02	96800	3.5	104072.38
3	Guyana	16.98	748333.333	49.2	759428.571	26	742500	58.9	736666.6667	37.29	752400	34	771058.7406
	Ivory Coast	66.16	7459000	155.6	9019166.67	465.4	10823666.7	488.7	12833666.67	152.77	15074200	182	17068433.42
3	Jamaica	22.54	14455000	36.3	2221166.67	51.6	2353166.67	182.6	2433333.333	60	2540000	73	2646063.284
	Kenya	85.21	15120166.7	144.8	18231166.7	225.5	21605666.7	296	25017000	173.1	28728200	170	32365495.96
3	Mauritius	22.75	928833.333	21.3	993666.667	43.2	1036833.33	56.9	1089500	45.4	1160600	33	1231545.566

Table A6 (continued)

LDC 1 LLC 2 SIDS 3		Lomé I 1975–80		Lomé II 1980–85		Lomé III 1985–90		Lomé IV 1990–95		Lomé IV bis 1995–2000		9th EDF – NIP 2000 onwards using initial 'A' allocation	
Code	**Country**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Total**	**Avg. Pop.**	**Initial A**	**Avg.Pop.**
	Namibia	0		0		0		108.3		65.18	1785600	48	2065422.559
	Nigeria	14.96	66042833.3	53.8	77073833.3	39	89626833.3	380.5	103539333.3	0	120762000	222	137517259.1
3	Papua New Guinea	13.32	2902833.33	87.8	3295500	183.3	3747000	186.6	4241333.333	50.18	4884000	81	5576230.51
3	Republica Dominica (Sp)	0		0		0	690833.333	157.9	796166.6667	113	803400	119	776036.12
3	Saint Kitts and Nevis	1.69	43833.3333	2.2	44333.3333	5	42333.3333	4.7	41500	3	42200	3.4	47592.62776
3	Saint Lucia	4.76	112000	6.7	120166.667	9	129500	35.9	139166.6667	36.26	151800	4.5	163103.6467
3	Saint Vincent & the Grenadines	3.78	95500	7.1	100166.667	10.2	104500	42.1	109166.6667	34.67	113200	5	118535.0306
3	Seychelles	3.09	62333.3333	7.9	65833.3333	7.9	68500	7.5	72500	5.5	78600	3.9	86088.61613
3	Surinam	19.18	361333.333	23.4	370500	27.9	394500	35.8	405500	32.8	417000	11	439678.4939
2	Swaziland	28.43	522666.667	29	611166.667	34.9	713166.667	45.6	833666.6667	41.5	989000	31	1124006.62
3	Tonga	4.69	92000	11.8	94833.3333	12.8	95333.3333	10.2	96666.66667	7.38	98800	3.7	101504.4417
3	Trinidad and Tobago	12.58	1044333.33	14.5	1131500	26.5	1200000	49.1	1240500	23	1277600	17	1315167.615
2	Zimbabwe			61	7849833	89.7	9434667	199.9	10883500	125.54	12169200	108	13312233
Total		2759	324863333	3884	369734029	6428	441906567	9533	500365229	5587	596062540	6988	676720252

Table A7. DAC flows, GDP of EDF contributing members, EDF allocations, primary commitments and payments (million €)

		Inflation*	DAC flows**	GDP for five-year period**	EDF allocations	EDF primary commitments	EDF payments	Real GDP	Real DAC flows	Real EDF primary commitments	Real EDF payments	Real EDF allocations
1975–80	DAC countries Total	125.7216604	86,488						68793.40414			
	EDF members (10) Total	125.7216604	37893	1012583788	2475	2730.8	1454.5	8054171.297	30140.49039	2172.099853	1156.920769	2696.432731
1980–85	DAC countries Total	202.0890005	149	055					73757.00206			
	EDF members (10) Total	202.0890005	60316	13894944.97	3758	3977.9	3368.4	6875656.237	29846.31703	1968.39016	1666.79037	2586.484166
1985–90	DAC countries Total	257.3731115	194	838					75702.37485			
	EDF members (12) Total	257.3731115	88039	21819638.19	6200	7880.7	5428.7	8477823.525	34206.84083	3061.974871	2109.272398	3263.7442
1990–95	DAC countries Total	341.5318003	234	180					68567.48265			
	EDF members (12) Total	341.5318003	113146	28922013.96	9975	8942.6	7831.7	8468322.402	33129.07546	2618.379897	2293.110039	3513.582041
1995–00	DAC countries Total	422.3272983	238	586					56493.05658			
	EDF members (15) Total	422.3272983	125023	38515295.74	11967	10877.2	7989.7	9119774.142	29603.24547	2575.537988	1891.82656	3462.953984
2000–05	DAC countries Total	485.5312906	316	732					65234.13756			
	EDF members (15) Total	485.5312906	169097	49016793.58	11300	17300	14889	10095496.32	34827.19267	3563.107123	3066.537685	3130.591229

*Average World Inflation Rate 1975=100, http://www.imf.org/external/pubs/ft/weo/2005/01/index.htm
*http://www.oecd.org

Table A8. Payments (million €)

	4th EDF	5th EDF	6th EDF	7th EDF	8th EDF	9th EDF	Total EDF	Total for each five-year period of the EDF
1976	97.5	97.5						
1977	148	148.0						
1978	326.3	326.3						
1979	423.4	423.4						
1980	459.3	459.3	1454.5					
1981	445.8	195.9					641.7	
1982	305.5	330.1					635.6	
1983	285.2	419.2					704.4	
1984	185.2	509.5					694.7	
1985	105.7	586.3					692.0	3368.4
1986	108.5	617.9	116.7				843.1	
1987	70.2	412.9	352.6				835.7	
1988	38.4	350.2	807.7				1196.3	
1989	32.2	240.7	1024.2				1297.1	
1990	22.1	194.0	1040.4				1256.5	5428.7
1991		136.4	859.2	195.5			1191.1	
1992		137.9	914.9	888.9			1941.7	
1993		76.4	571.6	705.6			1353.6	
1994			451.2	1332.4			1783.6	
1995			266.2	1295.5			1561.7	7831.7
1996			199.1	1118.3			1317.4	
1997			173.8	1038.9			1212.7	
1998			153.9	819.1	466.6		1439.6	
1999			100.0	700.0	585.0		1385.0	
2000			100.0	665.0	1870.0		2635.0	7989.7
2001			8.0	618.0	1927.0		2553.0	
2002			38.0	512.0	1359.0	162	2071.0	
2003			110.0	440.0	1652.0	766	2968.0	
2004			188.0	280.0	1718.0	1411	3597.0	
2005*			235.0	175.0	1390.0	1900	3700.0	14889
2006*			231.0	90.0	928.0	2470	3719.0	

Source: Extracted from tables on http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm
*EC Estimates

Table A9. Primary commitments (million €)

	4th EDF	5th EDF	6th EDF	7th EDF	8th EDF	9th EDF	Total EDF	Total for each five-year period of the EDF
1976	382.2						382.2	
1977	707.7						707.7	
1978	563.9						563.9	
1979	572.1						572.1	
1980	504.9						504.9	2730.8
1981	150.5	548.9					699.4	
1982	101.8	1002.8					1104.6	
1983	27.6	758.6					786.2	
1984	26.3	791.8					818.1	
1985	9.4	560.2					569.6	3977.9
1986	-12.9	494.4	313.2				794.7	
1987	0.4	298.0	1954.3				2252.7	
1988	1.1	145.7	2394.5				2541.3	
1989	0.4	38.9	1324.2				1363.5	
1990	17.9	24.3	886.3				928.5	7880.7
1991		-64.3	452.2	859.7			1247.6	
1992		-18.5	120.9	1960.4			2062.8	
1993		-373.4	23.5	1981.3			1631.4	
1994			47.8	2432.9			2480.7	
1995			45.6	1474.5			1520.1	8942.6
1996			-53.0	1017.9			964.9	
1997			24.2	591.8			616.0	
1998			-44.6	116.8	2224.1		2296.3	
1999			-50.0	450.0	2300.0		2700.0	
2000			-50.0	450.0	3900.0		4300.0	10877.2
2001			400.0	400.0	2500.0		3300.0	
2002			300.0	0.0	2300.0	900	3500.0	
2003			300.0	0.0	0.0	3200	3500.0	
2004			200.0	0.0	0.0	3300	3500.0	
2005*			200.0	0.0	0.0	3300	3500.0	17300.0
2006*			0.0	0.0	0.0	3500	3500.0	

Source: Extracted from tables on http://europa.eu.int/comm/development/body/cotonou/statistics/stat08_en.htm
*EC estimates

Table A10. Gleneagles Commitments Scenario

			10th EDF					11th EDF		
EU 15 contributions	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Projected nominal GNI levels	10806865	11110550	11414235	11717920	12021605	12325290	12628975	12932660	13236345	13540030
Gleneagles Commitments (GC) (DAC/GNI)	0.39%	0.39%	0.56%	0.56%	0.56%	0.56%	0.56%	0.70%	0.70%	0.70%
Projected DAC flows (GC)	42147	43331	63920	65620	67321	69022	70722	90529	92654	94780
New EU states	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Projected nominal GNI levels	454605	468434	482263	496092	509921	523750	537579	551408	565237	579066
Gleneagles Commitments (GC) (DAC/GNI)			0.17%	0.17%	0.17%	0.17%	0.17%	0.33%	0.33%	0.33%
Projected DAC flows (GC)			820	843	867	890	914	1820	1865	1911
Total EU DAC flows	42147	43331	64740	66464	68188	69912	71636	92348	94520	96691
Total DAC flows by EDF					284869					425107

Table A11. Business as usual scenario

			10th EDF					11th EDF		
EU 15 contributions	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Projected nominal GNI levels	10806865	11110550	11414235	11717920	12021605	12325290	12628975	12932660	13236345	13540030
Business as usual (BAU) (DAC/GNI)	0.38%	0.38%	0.38%	0.38%	0.38%	0.38%	0.38%	0.38%	0.38%	0.38%
Projected DAC flows (BAU)	41066	42220	43374	44528	45682	46836	47990	49144	50298	51452
New EU states	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Projected nominal GNI levels	454605	468434	482263	496092	509921	523750	537579	551408	565237	579066
Business as usual (BAU) (DAC/GNI)	0.17%	0.17%	0.17%	0.17%	0.17%	0.17%	0.17%	0.17%		
Projected DAC flows (BAU)			820	843	867	890	914	937	961	984
Total EU DAC flows	41066	42220	44194	45371	46549	47726	48904	50082	51259	52437
Total DAC flows by EDF					219401					250408

Table A12. 10th and 11th EDF projected nominal allocations (million €)

Gleneagles commitments scenario		
	10th EDF	**11th EDF**
Projected total EU DAC Flows (EU15 + new states)	284,869	425,107
Projected member state contributions to the EDF	24,584	36,687
Projected loan component of the EDF*	3,038	4,534
Projected total EDF 27,623	41,221	
Business as usual scenario		
Projected total EU DAC flows (EU15 + new states)	219,401	250,408
Projected member state contributions to the EDF	18,934	21,610
Projected loan component of the EDF	2,340	2,671
Projected total EDF	21,274	24,281

*Using the fact that the loans were on average 11% of the total EDF allocation from 4th–9th EDF

Endnotes

1. In 2002, the EU budget and the EDF contributed €6.5 billion to its various development partnerships, of which €2.4 billion went to the ACP states.
2. EU member states' grant allocations and EIB own resource loans.
3. 4th EDF 1975–1980, 5th EDF 1980–1985, 6th EDF 1985–1990, 7th EDF 1990–1995, 8th EDF 1995–2000, 9th EDF 2000–2005
4. The allocations in this table covers both EU member states' grants to the EDF and EIB own resource loans.
5. Source: Financial Protocols of each Partnership Agreement between the EU and ACP excluding allocations to overseas territories.
6. Real aid levels allocated through the EDF were calculated by dividing the total allocation for each EDF by the average inflation index for the corresponding five-year period using 1975 as the base year. Therefore the total nominal allocation for the 4th EDF was divided by the average inflation index for 1975–1980. Therefore nominal and real EDF allocations for the 4th EDF differ, even if the base is 1975, because it is being assumed that each EDF is spent over its five-year period and therefore the average inflation index for each five-year period is used as a deflator. This method is used based on the hypothetical assumption that each EDF is spent within its five-year period. This is not in fact the case. From the 4th to the 7th EDF it took on average slightly longer than 16 years to disburse each five-year envelope. The calculations made thus overestimate the real value of aid received by ACP countries. The inflation indices were obtained from http://www.imf.org external/pubs/ft/weo/2005/01/index.htm.
7. The nominal per capita EDF contribution refers only to the grants from EU member states' governments made available to the EDF and does not include own resource loans mobilised by the EIB.
8. Cotonou Agreement, Article 9, para. 1.
9. Allocations are composed of National Indicative Programme allocations as well as other EDF.
10. Classifications are based on UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (UN-OHRLLS) classifications.
11. There are numerous provisions in the Cotonou Agreement to afford LDCs, SIDS and LLCs preferential treatment. These provisions can be found in Article 2 (Differentiation and Regionalisation), Article 35 (3), Article 56 (2), Article 63 (a), Article 68 (3), Article 84 (1), Article 87(1), and Article 89(a).
12. Aid allocations are composed of National Indicative Programme (NIP) allocations as well as other EDF. See Annex Table A4.
13. 2002 onwards – using initial 'A' allocation.
14. Including data for the Cook Islands, Marshal Islands, Micronesia, Nauru, Niue and Palau.
15. Nominal actual payments were extracted from tables on http://europa.eu.int/comm/development/body/cotonou/statistics/stat11_en.htm
16. The first year in which payments were made under the 8th EDF was 1998. The payments made covered three years of actual payments from 1998–2000.
17. The first year in which payments were made under the 9th EDF was 2002. The payments made covered the four years from 2002–2005.
18. It took 15 years for the 4th EDF, 13 years for the 5th EDF, 21 years for the 6th EDF and 16 years for the 7th EDF. See Annex Table A6.
19. The average for 1975–2005 is 47.26%. See Annex Table A5.
20. Five-year average DAC flows for current EU membership at time of EDF.
21. Five-year average GNI for current EU membership at time of EDF.
22. See Annex Table A10 for the dataset underlying these figures.
23. Considering that the EU15 contributed on average 0.38% of GNI as DAC from the 4th to the 9th EDF and committed to reach 0.39% by 2006 as their initial commitment, it is reasonable to assume that new EU states in a business as usual scenario would also maintain their initial commitment of 0.17% by 2010 throughout the time period being considered, that is 2008–2017.
24. Inflation indices were approximately as follows: 4th EDF, 126; 5th EDF, 202; 6th EDF, 257; 7th EDF; 342; 8th EDF, 422; and 9th EDF, 486.
25. 2002 onwards, using initial 'A' Allocation.

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12

An Assessment of the Overall Implementation and Adjustment Costs for the ACP Countries of Economic Partnership Agreements with the EU

Chris Milner

Introduction

Non-reciprocal, preferential access to the EU for ACP countries under the Lomé provisions was challenged under the rules of the WTO. Preferences granted to specific developing countries can only be maintained, in a GATT-consistent manner, on a basis of reciprocity. In the Cotonou Agreement, the successor to Lomé, the EU proposed negotiating a series of Economic Partnership Agreements, under which the EU and regional groupings of ACP countries offer reciprocal trade preferences to each other. In order to continue to gain preferential access to the EU, each ACP regional trading group would have to give the EU preferential access to their own regional market. The questions facing ACP countries are whether the benefits of an EPA outweigh the costs of granting preferential access to the EU and how the issue of adjustment costs should be addressed in negotiations. The certain benefits are continued preferential access for ACP exports[1] and there are possible benefits from discriminatory liberalising of imports. The costs arise from the adjustment to liberalisation of ACP countries' domestic markets to imports from the EU.

The Cotonou Agreement between the EU and 71 ACP partner states was concluded in February 2000, covering various dimensions including economic relations, aid and trade co-operation. On trade co-operation, the general principle of a WTO-compatible EPA arrangement for the future was agreed. The EU applied to the WTO for an eight-year waiver to provide a transition period for any new arrangement; this was granted at Doha. Over this period the EU and ACP states planned to negotiate and try to agree a new WTO-compliant trade agreement, which would then be implemented over a transitional period starting at the latest by 2008. Such an arrangement could allow asymmetry, in other words more gradual liberalisation by ACP countries (the EU proposed a further 10- to 15-year transition period before the EU could export duty free to ACP countries under an EPA).

Although most ACP countries have indicated they would like to negotiate with the EU as a block (some are inclined to negotiate alone), the EU has been adamant that negotiations should be with regional groupings of ACP countries. In fact, when the proposal was first discussed in the latter half of the 1990s, the term Regional Economic Partnership Agreement (REPA) was used. Negotiations between the EU and various ACP regional groupings were supposed to start in late 2003, but stalled and were delayed until April 2004.

The terms of reference for this study require that:

- the nature of the implementation and adjustment costs are identified and approximated for individual ACP countries and for the ACP grouping of countries as a whole;
- the above costs are decomposed into their components, that is negotiating, legislative, fiscal and sectoral adjustment costs; and
- given the above two points, a negotiating target is established for the European Development Fund for ACP adjustment to EPAs, including guidance on the mechanisms of disbursement of adjustment assistance over time, across countries (according to the degree of adjustment involved) and between the public and private sectors of the adjusting ACP countries.

Nature and costs of EPAs: An overview

The EU's long-term aim is to establish free trade areas with each of the three ACP regions as a replacement for the Lomé agreements. GATT Article XXIV allows for the negotiation of customs unions or free trade areas that offer preferential treatment to member countries, subject to certain conditions. The most important of these is that the free trade area should 'eliminate duties and other restrictive regulations of commerce ... on substantially all the trade between constituent territories in products originating in such territories' (GATT Article XXIV, para. 8(b)). There does not appear to be an agreed definition of what 'substantially all the trade' means in practice. It appears that both qualitative and quantitative aspects are important. On the former, exclusion of whole sectors (for example agriculture) is likely to be prohibited. On the latter, full liberalisation of 80–90% of trade between the partners is likely to be required, but even this raises a number of complex questions (for example whether it is the volume or value of trade and whether this should occur before or after liberalisation).

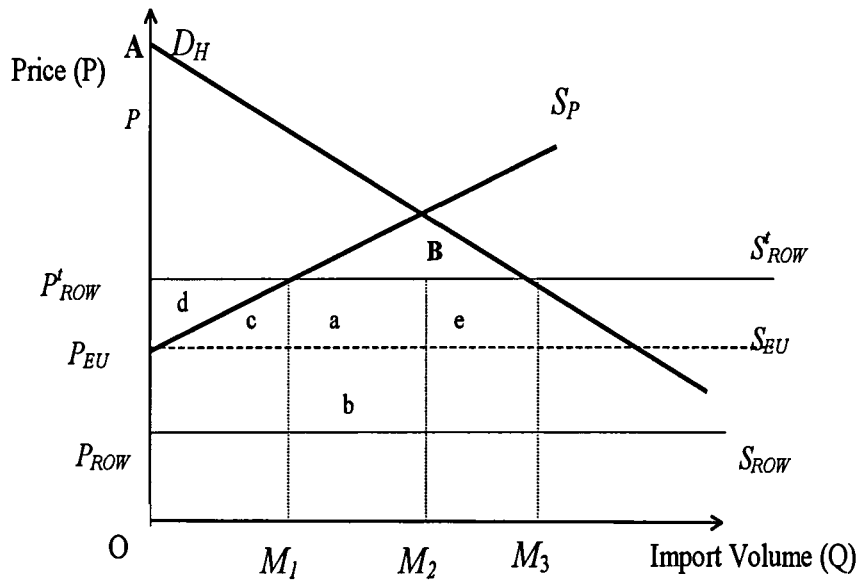
Any interim arrangements leading to the full establishment of the free trade areas 'shall include a plan and schedule for the formation of such a customs union or such a free trade area within a reasonable length of time' (GATT Article XXIV, para. 5(c)). In this context 'a reasonable length of time' is likely to mean not more than ten years. This would mean that if an EPA is to begin in 2008, full liberalisation of 'substantially all the trade' would need to be achieved by 2018. Within this time period, though, there do not appear to be any symmetry requirements; the ACP partner countries can liberalise much more slowly than the EU, subject to their meeting the 'reasonable length of time' criterion. Given the present non-reciprocity of trade relations between the EU and ACP countries, some asymmetry is likely to be desirable (and has been accepted in principle by the EU).

Conceptual framework

The key effects of introducing reciprocity by an ACP (home) country member (H) can be illustrated by Figure 1 (see also McKay, Milner and Morrissey, 2005). The partner country's (P) supply curve is upward sloping and the supply for two (initial) outside suppliers (here the EU and the rest of the world (ROW)) is assumed to be infinitely elastic. The analysis is partial equilibrium in nature, markets are assumed to be perfectly competitive, and there is perfect substitutability between both imports from alternative sources and imported and domestically produced import substitutes.

Assume that H and P have already formed a pref-

Figure 1. Effect of an EU–ACP EPA



erential trading area (PTA), and that small developing countries can be viewed jointly as being small relative to the EU and ROW who supply at constant cost (prices P_{EU} and P_{ROW} respectively). In the case of Figure 1 we assume for expositional convenience that $P_{EU}>P_{ROW}$; therefore subsequent discriminatory trade policies by the PTA towards the outside countries can have both trade creating and diverting effects. The line D_H represents the home country's demand for imports, S_P the partner's supply of exports, and S_{EU} and S_{ROW} are the respective export supply functions for the two outside country groupings. We start with a PTA and a non-discriminatory (*ad valorem*) tariff (t) on extra-regional imports (where $Pt_{ROW}=P_{ROW}(1+t)$ but P_{tEU} is not shown in the case of the higher cost EU supplier). The home country imports OM_2 in total, with OM_1 coming from the partner country and M_1M_2 from the rest of the world. By ruling out domestic production capability we can define welfare (W) by reference to consumer surplus with respect to the import demand function, D_H. Thus W for the home country is given by the triangle $ABP_{t\,ROW}$ plus the tariff revenue on extra-regional imports (area $a + b$).

Now assume that the PTA introduces a discriminatory tariff policy towards extra-regional countries, and as a result of an EPA with the EU continues to impose tariff t on imports from the rest of the world but allows in imports from the EU duty free. The relevant supply price is now P_{EU}, with the total quantity of imports expanding from OM_2 to OM_3 and imports coming now wholly from the EU. There are strictly three components of this trade effect of the EPA: a consumption expansion effect M_2M_3; a 'trade diversion' effect M_1M_2; and a 'trade creation' effect OM_1. The last two of these effects need more careful explanation.

In the case of standard PTA analysis, trade diversion usually relates to diverting trade from more efficient extra-regional suppliers to less efficient intra-regional suppliers. The EPA, however, diverts between extra-regional suppliers; M_1M_2 is imported from the less efficient EU rather than from the rest of the world. The resource cost of this is represented by the area b, with total tariff revenue lost by the home country government being area $(a + b)$.[2] Similarly, in terms of standard PTA analysis, trade creation usually describes the displacement of less efficient home production by globally efficient extra-regional production. In this case, however, the EPA involves the replacement of intra-regional imports by more (but here not globally) efficient extra-regional imports from the EU. The global resource-saving on this 'trade creation' (or trade-source substitution) effect is shown by area c in Figure 1. This, and the loss in producer surplus for partner country exporters (area d), allows consumer surplus on this component of the trade effect of the EPA to increase by area $(c + d)$. Thus the welfare implications for the home country of shifting from the PTA to the EPA are ambiguous, the consumption and trade-creation effects increasing welfare and the trade-diverting effect reducing welfare, i.e. $W = (c + d + e) - b$. Clearly, the more efficient the EU is, the smaller the costs of trade diversion and the greater the probability of a welfare-improving EPA. In the extreme, as S_{EU} tends towards S_{ROW} then the EPA tends toward the free trade outcome.

Adjustment issues

The net welfare benefits or costs on the import side of introducing reciprocity need to be added to the benefits of continued preferential access for ACP exports to the EU in order to evaluate the overall long-term implications of EPAs for ACP countries. But this is still not a complete evaluation, since the issue of short- to medium-term adjustment costs is abstracted from completely in the above analysis. These adjustment costs will differ across ACP countries depending on initial characteristics and policy conditions, but can be considered under the following headings:

(i) Fiscal adjustment

In order to replace any tariff revenue losses associated with the EPA an ACP country will need to either revise or reform the structure of taxation from non-trade tax sources in order to increase revenue from these alternative sources.

(ii) Trade facilitation and export diversification

If the benefits of reallocating resources (capital, labour, skills and land) away from import competi-

tion towards new export activities (under the stimulus of greater competition on the home market from EU exporters) are to be reaped, actual and potential countries will need support with developing export products and gaining knowledge about export-market opportunities.

(iii) Production and employment adjustment

In Figure1 the displacement of imports from the pre-EPA regional supplier by EU exports will tend to induce falls in production and employment in the partner ACP country. However, where the home country has a production capability (which was for convenience not considered in Figure 1), there will be a similar displacement to production and employment in the import-competing sector by the growth of EU exports to ACP countries. Since the reallocation of displaced resources from current (pre-EPA) activities to export sectors will not be immediate and smooth, then the ACP countries will need assistance with the adjustment experienced by workers (compensation for unemployment, support for relocation and retraining) and by firms (closure, production line restructuring, etc.).

(iv) Skills development and productivity enhancement

The costs of adjustment (contraction of import-substitution activities and expansion of export sectors) will fall over time and scope for dynamic benefits from export development will be increased by increasing productivity levels in ACP countries. Increasing competitiveness and productivity levels in preparation for the full implementation of EPAs requires support through the enhancement of workers' skills, the improvement of firms' organisation and management structures, and the development of supportive economic policies and infrastructures.

(v) Negotiation and legislation

In addition to the direct economic and financial costs that will fall on individuals, and on private and public-sector organisations in ACP countries, the ACP countries will need to negotiate and implement EPAs. Indeed, some negotiation costs have already been incurred, but more negotiations are required. Once the EPAs are agreed, there will be a need to implement the agreements through legislative reform, administrative change, public-sector training and adjustment assistance programme support. These will all involve additional public administrative costs in ACP countries.

Note that the focus above is on the process of domestic structural changes associated with the introduction of reciprocal import liberalisation in ACP–EU relations. It does not seek to deal with all aspects of the costs of an EPA. For example, if import liberalisation induces a rapid growth of imports in excess of growth of exports to the EU, then the EPA may induce balance-of-payments or foreign-exchange problems. This study does not consider issues of macroeconomic policy management in a post-EPA environment. Similarly it does not attempt to incorporate any costs imposed on ACP countries resulting from changes in the special regimes for specific export commodities (for example for sugar and bananas).

Methodology for assessing costs

The present study does *not* seek to set up a precise methodology to identify and quantify the country-specific adjustment costs that each ACP country might experience as part of the process of implementing an EPA. A number of studies of this nature exist, for example CREDIT (1998, 2004) and Greenaway and Milner (2000). There are both methodological, resource, and data constraints on doing so. Whether formal partial or general equilibrium methods were applied, there would be difficulties in capturing the dynamics of the adjustment and growth processes involved. There would also be enormous data requirements for detailed tariff, trade, production and employment statistics for each country; for some countries these may not be available. This would, if feasible, constitute a very large, long-term research project. Rather than adopt a formal and comprehensive economic modelling approach, a more concise (albeit less formal) methodology to approximate the adjustment costs across the ACP grouping will be adopted. By matching up project costs from the implementation of earlier policy-reform programmes (drawn up by the

World Bank) with the expected implementation of EPA reform programmes, we are able to provide guidance as to the scale of adjustment costs involved. Note that this methodology offers advantages over an economic modelling approach. An economic modelling approach might estimate the changes in economic variables such as imports, tariff revenue, domestic production and employment. But the economic changes associated with the adjustment to an EPA do not provide a direct indication of the adjustment costs. Those costs relate either to other aspects of the economic adjustment process that are difficult to quantify (i.e. the length of time that unemployed workers are unemployed and the loss of income experienced by those workers), or to aspects associated with the implementation of policy reforms within the government administration (for example introduction of tax reforms to replace falls in customs duty) and the private sector (for example the introduction of skills retraining or business organisation enhancement). The actual costs of adjustment incurred by ACP countries are in any case dependent on the pace and degree of adjustment that they experience. This will in turn be fashioned by what exactly is negotiated on EPA implementation (trade coverage, phasing, etc.), and also by what is put in place to help the ACP countries to become more adaptable and able to adjust to trade liberalisation in a less costly manner. The focus therefore of the ACP negotiations should not be to try to identify a level of compensation for the uncertain and rather unpredictable costs of adjustment to an EPA. It should, by contrast, be to consider what is required (and what it will cost) to bring about adjustment to an EPA in a less costly manner; in other words to identify the costs of making the EPA countries more adjustable and adaptable. Indeed, with a compensating-for-adjustment approach the danger is that the funds will be used to give offsetting policy interventions (subsidies, etc.) to sectors subject to greater competition post-EPA, which will serve to avoid or resist adjustment. By contrast, the ACP countries need support with increasing adaptability and the capacity to adjust so that they can benefit from an EPA and thereby reap its development benefits.

Categorising countries

For each of the types of adjustment costs identified in the previous section, namely fiscal adjustment costs, trade facilitation and export diversification

Table 1. Illustration of classification methodology

Country Size[a] \ Degree of Adjustment	Low Adjustment (1)	Medium Adjustment (2)	High Adjustment (3)	Other[b] (4)
Micro (1)	C_{11}	C_{12}	C_{13}	C_{12}
Small (2)	C_{21}	C_{22}	C_{23}	C_{22}
Medium (3)	C_{31}	C_{32}	C_{33}	C_{32}
Large (4)	C_{41}	C_{42}	C_{43}	C_{42}
Very Large (5)	C_{51}	C_{52}	C_{53}	C_{52}

[a]Population size: micro <1 million; small 1–5 million; medium 5–15 million; large 15–100 million; very large >100 million.

[b]Unavailability of data on proxy adjustment indicator makes it impossible to classify the country.

costs, production and employment adjustment costs, and skills development and productivity enhancement costs, we identify a proxy indicator of potential adjustment required under that category of adjustment cost (for example dependence on trade tax revenue for government revenue for fiscal adjustment). This allows us to classify each ACP country according to country size and degree of each type of adjustment.

Table 1 illustrates this classification process. The broad classification into low, medium and high adjustment inevitably introduces a qualitative assessment, but avoids trying to measure the inter-country adjustment needs in a precise, continuous manner. The table further distinguishes between countries on the basis of size, for which we use population size as a proxy. Other size proxies could have been used, for example GDP, but population is a widely used measure of country size. Again, we group rather than measure size on a continuous basis. Although the extent of the adjustment costs will include elements that are fixed or invariant with country size and will be fashioned by other country characteristics, we can accommodate this in part through the non-linearity of the setting of the cost (C) estimates for each cell in the table.

The methodology, therefore, is in several stages. ACP countries are allocated to cells for each type of adjustment cost. The costs for each cell are set on the basis of programme costs from World Bank reform programmes (either by exact matching or by interpolation), with costs increasing with the degree of adjustment (i.e. $C_{13}>C_{12}>C_{11}$) and with the size of country (i.e. $C_{51}>C_{41}>C_{31}>C_{21}>C_{11}$). (Note that in the case of the other or unclassified column we set costs at the medium level on the principle of offsetting errors.)

Fiscal adjustment

The amount of direct fiscal loss for any one ACP country that results from the EPA-induced lowering of tariffs on imports from the EU will depend on a range of factors. They include the level of current tariffs on imports from the EU, the amount of imports from the EU prior to the tariff reduction, and the amount of imports that are diverted from non-EU sources as a result of the discriminatory liberalisation of tariffs.[3] Given the need for simple criteria for classifying countries, the share of trade tax revenue in each country's tax revenue will be used as the indicator of the degree of potential fiscal adjustment cost associated with an EPA. There are good grounds for taking this more general indicator. Firstly, more specific indicators, such as the current average tariff on imports from the EU or the share of current imports from the EU, may be misleading. The tariff revenue effects may not be well indicated by these specific indicators, since the revenue-maximising tariff rate varies across countries as does the scope for import source substitution from non-EU sources of supply. Secondly, it is not the revenue effect itself that captures the cost of fiscal adjustment. The decline in customs revenue is a domestic redistribution from the government to consumers of imported goods. For the governments of some countries, any decline in customs revenue can be relatively easily offset by increasing tax collection from other sources (for example sales and income taxes). For others, the absence or underdevelopment of the tax regime makes this switch of revenue generation more difficult and more costly to resolve. The adjustment costs may be associated with a range of legislative and administrative changes, hiring and retraining costs, or infrastructure developments required to extend or develop tax revenue generating capacity in the non-trade tax domain.

Classifying countries according to trade tax dependence

Using the information set out in Table A1 in Annex 1 on trade tax dependence (the percentage share of trade taxes in total government revenue), ACP countries have been classified using the methodology described in the previous chapter. This classification is summarised in Table 2, taking <20% trade tax dependence as an indicator of relatively low adjustment cost, 20–40% as medium adjustment cost and >40% as high adjustment cost.

Approximating the costs of fiscal adjustment

Table 3 summarises the aims and components of a number of World Bank projects aimed at fiscal reform and/or tax administration reform. These illus-

Table 2. Potential degree of fiscal adjustment required

	Low adjustment		Medium adjustment		High adjustment		Other	
Country size	**Country**	**% trade tax**	**Country**	**% trade tax**	**Country**	**% trade tax**	**Country**	**% trade tax**
Micro	São Tomé & Principe	19	Suriname	37	Seychelles	47	Bahamas, The	–
	Djibouti	17			Comoros	42	Barbados	–
	Equatorial Guinea	15			Cape Verde	41	Belize	–
	Guyana	12					Dominica	–
							Fiji	–
							Grenada	–
							Kiribati	–
							Micronesia, Federated States	–
							Palau	–
							Samoa	–
							Solomon Islands	–
							St Kitts and Nevis	–
							St Lucia	–
							St Vincent & the Grenadines	–
							Tonga	–
							Vanuatu	–
Small	Eritrea	14	Lesotho	39	Gambia, The	60	Liberia	–
	Congo, Republic	13	Guinea-Bissau	35	Swaziland	52	Trinidad and Tobago	–
	Mauritania	11	Mauritius	35	Togo	45		
	Botswana	10	Namibia	30	Central African Republic	45		
	Jamaica	29						
	Gabon	22						
Medium	Zimbabwe	17	Sierra Leone	40	Niger	52	Haiti	–
	Guinea	15	Dominican Republic	32	Mali	50	Somalia	–
	Malawi	13	Chad	30	Benin	43		
	Angola	8	Burundi	29				
	Senegal	27						
	Burkina Faso	26						
	Papua New Guinea	25						
	Zambia	25						
	Rwanda	24						

Table 2 (continued)

	Low adjustment		Medium adjustment		High adjustment		Other	
Country size	**Country**	**% trade tax**	**Country**	**% trade tax**	**Country**	**% trade tax**	**Country**	**% trade tax**
Large	Mozambique	18	Ivory Coast	34	Madagascar	54		
	Cameroon	17	Congo, Democratic Rep.	32	Uganda	50		
	Kenya	12	Tanzania	29	Sudan	44		
	South Africa	4	Ghana	28				
	Ethiopia	26						
Very large	Nigeria	49						

Key: Low adjustment: trade tax/total revenue <20%; Medium adjustment: <20%–40%; High adjustment: >40%; Other: data not available (–)

Table 3. Fiscal adjustment projects

Country	Project title	Aims/objectives	Components
Mauritania (F1)	Fiscal reforms support operation	To undertake a substantial harmonisation of tax and administration tariffs policies and investment incentives to facilitate its integration into the regional and world economies	1. Strengthening tax 2. Broadening the tax base 3. Reducing/eliminating tax and customs duty exemptions
Tanzania (F2)	Tax Administration Reform	To support the Tanzania Revenue Authority (TRA) in increasing revenues accruing to Government, without increasing tax rates	1. Capacity building/institutional development 2. Provision of infrastructure and equipment to TRA tax offices and customs facilities 3. Training and computerisation 4. Support to public awareness/ education programmes 5. Support to review/amend laws and regulations
Pakistan (F3)	Tax Administration Reform	To redress major short- comings in tax administration	1. Management and institutional development 2. Improving revenue operations (direct tax, sales tax, customs excise and customs duty) 3. Strengthening revenue services (audit, voluntary and enforced collection, appeals and dispute resolution, national intelligence and risk management, and customs and tax frauds) 4. Creating a tax-compliant culture 5. Adopting responsive IT systems 6. Infrastructure up-gradation and development 7. Project management and implementation

trate the type of institutional, infrastructural, training and outreach activities that are likely to be involved with the non-trade tax reforms and tax administration reforms required to offset the fiscal declines associated with EPA implementation. The dates of these projects and the project costs (in US$) are set out in Table A2. The countries are also classified according to country size and degree of trade tax dependence.

From these data it is possible to map cost estimates directly into the cell or category (as illustrated in Table 1). To do so the dollar valuation has to be converted into euros (at the current conversion rate of $1 = €0.828) and re-valued with an adjustment for inflation from the start of the project date identified in Table A2 to 2005 (at an assumed inflation rate of 2.5%). Table 4 sets out the resulting grid of fiscal adjustment cost estimates. The codes for illustrative projects from Table 3 (for example F1 represents the fiscal reforms support operation for Mauritania) are used to label the actual cost of these projects (in euros at 2005 equivalent prices).

For the purposes of recording the costs, the relevant cost estimates are crudely 'rounded' and interpolated to ensure the ranking of costs explained above (i.e. increasing costs with country size and with the degree of adjustment). Note, however, that there is also a significant degree of non-linearity,

Table 4. Fiscal adjustment cost estimates (million €)

		Degree of adjustment		
		Low	Medium	High
Country size	Micro	15	20	30
	Small	(29.5) 30 (F_1)	40	50
	Medium	40	50	70
	Large	60	€ 72.6 (F_2) 70	90
	Very large	€ 126.5 (F_3) 125	135	155

given the population bands used to define country size types; for a given category of the degree of adjustment involved, the recorded adjustment cost falls much more slowly than population sizes. This captures the important fixed cost element of adjustment costs, i.e. costs that are invariant with country size.

Trade facilitation and export diversification

Accumulated experience of exporting across a wide range of export products is usually regarded as an indication that countries have institutions (private and public sector) and an infrastructure that are conducive to exporting. Many developing countries have an undiversified export structure, having acquired experience and understanding of exporting a narrow range of traditional exports, either from natural resources or land-based activities. The diversification of exports into non-traditional manufacturing activities may require knowledge of different markets (new commercial contacts, etc.) and market access conditions (for example product standard requirements), and require improved customs procedures to speed up access to intermediate inputs and changes in transport facilities (for example refrigeration facilities at airports). The actual requirements will vary across countries as the pattern of comparative advantage and export potential and initial conditions vary. It should be noted that this is a quite narrow view of trade facilitation. Major infrastructure developments to improve transportation systems may require much larger and more expensive trade facilitation programmes. The proxy used for the degree of trade facilitation support and export diversification required to support the expansion of ACP exports to the EU is the share that manufactured exports make up of total exports; the lower the proportion, the greater the presumed need for support with export diversification.

Classifying countries according to degree of export diversification required

Taking the information in Table A1 in Annex 1 on the percentage share of manufactured exports in total commodity exports, we classify ACP countries (see Table 5) as low adjustment (>25%), medium adjustment (10–25%), and high adjustment (<10%) countries.

Estimating costs of trade facilitation and export diversification

In Table 6 the aims and components of a number of World Bank projects aimed at trade facilitation and export development are summarised. Again, these illustrate a range of activities to reduce international transaction costs and accelerate the export supply response to trade policy reform (though as indicated above they illustrate projects where trade facilitation is relatively narrowly defined). The dates of these projects and the project costs are set out in Table A2, which also gives information on countries' size and degree of export diversification. This provides a basis for matching and establishing the approximate costs of diversification in the context of adjusting to an EPA. (Again, we adjust the project costs from Table A2 for inflation effects and convert into euros.)

Table 7 records the resulting grid of export diversification adjustment costs. The actual costs of TF1,

Table 5. Degree of export diversification required

	Low adjustment		Medium adjustment		High adjustment		Other	
Country size	**Country**	**Manufac. X%**	**Country**	**Manufac. X%**	**Country**	**Manufac. X%**	**Country**	**Manufac . X%**
Micro	St Lucia	26	Suriname	14%	Seychelles	1	Comoros	–
	Dominica	31	Belize	18%	Cape Verde	3	Djibouti	–
	Bahamas, The	31			Grenada	4	Equatorial Guinea	–
	Fiji	35			Solomon Islands	4	Kiribati	–
	Barbados	59			Tonga	4	Micronesia, Fed. Sts.	–
	St Kitts and Nevis	73			Guyana	9	Palau	–
	Samoa	81			St Vincent & the Grenadines	10	São Tomé and & Principe	–
					Vanuatu	–		
Small	Central African Republic	40	Gambia, The	17%	Liberia	1	Eritrea	–
	Togo	43			Gabon	2	Lesotho	–
	Trinidad and Tobago	46			Guinea-Bissau	3		
	Namibia	52			Congo, Republic	3		
	Jamaica	64			Mauritania	6		
	Mauritius	73						
	Swaziland	76						
	Botswana	91						
Medium	Guinea	28	Malawi	10%	Burundi	1	Angola	–
	Sierra Leone	32	Zambia	14%	Mali	2	Somalia	–
	Dominican Republic	34	Chad	18%	Papua New Guinea	2		
	Zimbabwe	38	Burkina Faso	19%	Niger	3		
	Senegal	51			Rwanda	3		
	Haiti	85			Benin	6		
Large	South Africa	63	Ethiopia	14%	Sudan	3		
	Congo, Dem. Republic	75	Madagascar	14%	Cameroon	7		
			Ghana	16%	Mozambique	8		
			Tanzania	17%	Uganda	8		
			Ivory Coast	21%				
			Kenya	24%				
Very large					Nigeria	0%		

Key: Low adjustment: % Manufactures exports (MX%)>25%; Medium adjustment: 10%–25%; High adjustment: <10%; Other: data not available (–)

Table 6. Trade facilitation projects

Country	Project title	Aims/objectives	Components
Moldova (TF1)	Trade and transport facilitation	1. To reduce non-tariff costs to trade and transport 2. To increase revenue and compliance, and reduce smuggling and corruption	1. Improve operations at pilot sites by assisting in preparing automated procedures to collect management data; to implement new border processing procedures and practices, and providing technical assistance and training and computerise the Customs Department 2. Install and implement an Automated System for Customs Data) clearance system, support technical assistance and training, training equipment, at border crossings 3. Implement a transit and inland control system through mobile intervention squads 4. Improve border crossing facilities and setting up secondary inspection areas 5. Facilitate trade by strengthening the private-public partnership
Cambodia (TF2)	Trade facilitation and competitiveness	1. To reduce trade and investment transaction costs 2. To introduce transparency in investment processes, and facilitate access to export markets	1. Application of appropriate IT to border management activities to streamline operations, improve transparency and accountability 2. Finance technical support to establish the exporter assistance window; a technical assistance matching grant facility that would cover 50 percent of the cost of achieving market standards 3. Financing a program of capacity building to implement the Law on Concessions and the Amended Law on Investment
Ecuador (TF3)	International trade and integration	To promote increased socio-economic growth through international trade development and integration with the global economy	1. Modernise international trade management and increase market access through human resource training, renovate office facilities, and implement unfair trade practices safeguards and make regulations WTO-consistent 2. Facilitate entrepreneurial learning and innovation in smaller firms through private-public partnership institutions, and financing of an eco-export programme to assist firms in export market penetration
Colombia (TF4)	Export development	To accelerate the export supply response to Colombia's trade reform programme	1. Adjusting existing government trade policy and administration in the areas of duty exemptions and indirect tax rebates, anti-dumping, and customs so as to facilitate exporter competitivenessand be GATT-consistent 2. Increasing the quality of export promotion, restructuring the Government's public promotion organisation and deregulating and developing trading companies 3. Building export financing capacity by establishing new export finance services and policies in the Foreign Trade Bank, establishing private/public joint venture pre-shipment export credit guarantee and export credit insurance facilities, and providing trade finance training to local banks 4. Initiating capital markets development with regulatory and institutional improvements

TF3 and TF4 are shown in the appropriate cells, with estimated costs (in € million at 2005 equivalent prices) allocated to the other cells, 'rounding' and using the ordering principles referred to above. Again although the amounts are non-linear in absolute costs (increasing with country size), they imply significant non-linearities (decreasing with country size) on a per capita basis.

Production and employment adjustment

The extent of the displacement of domestic production (and the resulting dislocation of workers) following the liberalisation of imports from the EU in each ACP country will depend upon a range of factors. It will, of course, be fashioned by the speed of the lowering of tariffs and the extent to which sensitive sectors are excluded (temporarily or permanently) from the liberalisation. It will also depend on the scale of the domestic tradables or import-competing sector; the larger and more diversified this sector is, the greater the potential dislocation of production and employment. It is probably unwise for governments to attempt to compensate directly all factors of production (owners of capital and workers) for all shocks (irrespective of whether they are caused by policy change or by exogenous factors). Many areas will have to adjust, and the existence of compensation mechanisms is likely to encourage a general resistance to change. Instead, economies need to develop greater capacity to change and adjust, especially in a more open and globalised world. It would also be unfair to develop adjustment-assistance schemes that are directed at compensating for dislocation or assisting relocation from only one specific source, for example trade-adjustment assistance or, in the specific case of EPA trade adjustment, assistance at the expense of developing adjustment assistance in general. The experience of trade-adjustment assistance schemes in the developed countries (for example in the USA and Sweden) has not been a good one, with limited evidence of facilitating adjustment and of cost effectiveness. Instead, emphasis should be given to the development of schemes and programmes that increase the willingness to adjust (for example through the provision of a safety net for all displaced workers or improved employment services) and that encourage mobility (for example through support for retraining or upgrading of skills). It might have been appropriate to assess the extent of the need for employment support and promotion measures through a review of labour-market policies across the ACP countries. The data for this were not readily and comprehensively available and this was beyond the scope of the present work. Instead, therefore, it is presumed that there is a broad need for strengthening provision in this area, and an attempt is made to proxy the degree of potential adjustment within the tradable or import-competing sectors of the ACP countries by the share of industrial production in GDP; the greater the share the greater the potential for

Table 7. Trade facilitation cost estimates (million €)

		Degree of adjustment		
		Low	**Medium**	**High**
Country size	Micro	5	10	30
	Small	12 € 8.4 (TF_1)	25	45
	Medium	20	45 € 43 (TF_3)	65
	Large	50	65	90
	Very large	100 96.4 (TF_4)	130	140

employment and production adjustment from an EPA.

Classifying countries according to degree of industrialisation

Using the information in Table A1 on the percentage share of industrial production in GDP, we repeat the grouping of ACP countries by size and degree of industrialisation: countries with >40% share of industrial production are classified as high adjusters, 20–40% as medium adjusters, and <20% as low adjusters. The resulting groupings are set out in Table 8.

Approximating the costs of production and employment adjustment

Table 9 summarises two World Bank projects aimed at improving employment support and promotion services; their main aim is to support policy and institutional development within the public sector. (Note that the support measures for skills and productivity enhancement to be discussed in the next section will have a much greater private sector focus, and in many senses are not separate from the adjustment support measures discussed here.) The characteristics (size and degree of industrialisation) of the two countries in Table 9 (PE_1 and PE_2) are provided in Table A2, as are the project costs (in US$) and project start dates. Converting into euros and adjusting for inflation as indicated earlier, we have project PE_1 costed at €11.9 million as an example of a small country with medium adjustment needs and project PE_2 as a medium-sized country with medium adjustment needs costed at €22 million. We again, therefore, use these as our guides for the costing of ACP-focused (EPA) employment-adjustment projects, and interpolate the cost grid for the other categories. This cost grid is given in Table 10.

Skills development and productivity enhancement

The opening of the ACP countries to more intense competition from EU producers will increase the pressure to both increase competitiveness in existing areas of production and shift resources towards new areas of production. Increasing competitiveness of existing production is likely to require increases in productivity: improvements in the organisation of production processes, better utilisation of capital and labour, innovation in product design and characteristics, improvements in management, financial and marketing methods, and enhancements in human capital and skills. The shift of resources is likely to require new employment skills and the entry of new businesses into these markets. If EPA is to bring the benefits of increased growth, it will be necessary to enhance public and private sector capacity to deliver training for workers and managers, and to induce greater private sector involvement in training and the innovation process. Again, this is a multi-faceted aspect of the adjustment process, and capacity and conditions will vary considerably across the ACP countries. We take a crude indicator of human capital or education system development, namely secondary school enrolment rates, as our indicator of the degree of adjustment in the capacity of each country that will be required to respond to the EPA-induced need to improve skills and productivity. The lower the enrolment rate, the greater the need for adjustment support.

Classifying countries according to coverage of secondary education

Gross secondary enrolment rates across the ACP are set out in Table A1. Using the same criteria as in previous sections for grouping countries according to country size, we further subdivide countries according to enrolment rates in secondary education; enrolment rates over 60% are classified as low adjusters, between 30% and 60% as medium adjusters and less than 30% as high adjusters. The resulting grouping of countries is given in Table 11.

Approximating costs of enhancing skills and productivity

Table 12 summarises a number of World Bank projects in specific countries on skills and competitiveness development. These illustrate the type of policy, institutions and public/private sector projects that might be needed in ACP countries to enable

Table 8. Degree of employment adjustment required

	Low adjustment		Medium adjustment		High adjustment		Other	
Country size	**Country**	**% Indus. prod/ GDP**	**Country**	**% Indus. prod/ GDP**	**Country**	**% Indus. prod/ GDP**	**Country**	**% Indus. prod/ GDP**
Micro	St Lucia	18	Bahamas, The	36	Equatorial Guinea	89	Comoros	–
	Tonga	15	Seychelles	36			São Tomé and Principe	–
	Djibouti	14	Guyana	29			Kiribati	–
	Palau	13	St Kitts and Nevis	28			Micronesia, Fed. Sts	–
	Vanuatu	9	Fiji	27			Samoa	–
	St Vincent & the Grenadines	24					Solomon Islands	–
			Grenada	23				
			Dominica	21				
			Barbados	21				
			Cape Verde	20				
			Belize	20				
			Suriname	20				
Small	Gambia, The	14	Jamaica	31	Congo, Republic	63	Liberia	–
	Guinea-Bissau	13	Namibia	31	Swaziland	50		
			Mauritius	31	Trinidad and Tobago	49		
			Mauritania	29	Botswana	48		
			Eritrea	25	Gabon	46		
			Central African Republic		22	Lesotho	43	
			Togo	22				
Medium	Burundi	19	Guinea	37	Angola	68	Somalia	–
	Burkina Faso	19	Dominican Republic	33	Papua New Guinea	42		
	Chad	17	Sierra Leone	32				
	Niger	17	Mali	30				
	Haiti	17	Zambia	26				
	Malawi	15	Zimbabwe	24				
	Benin	14	Senegal	22				
			Rwanda	21				

Table 8 (continued)

	Low adjustment		Medium adjustment		High adjustment		Other	
Country size	**Country**	**% Indus. prod/ GDP**	**Country**	**% Indus. prod/ GDP**	**Country**	**% Indus. prod/ GDP**	**Country**	**% Indus. prod/ GDP**
Large	Congo, Dem. Republic	19	Mozambique	34				
	Kenya	19	South Africa	32				
	Sudan	18	Ivory Coast	30				
	Tanzania	16	Ethiopia	30				
	Madagascar	13	Ghana	24				
	Uganda	22						
	Cameroon	20						
Very large			Nigeria	29				

Key: Low adjustment: Industrial production/GDP <20%; Medium adjustment: 20–40%; High adjustment: >40%; Other: data not available (–)

Table 9. Production and employment adjustment

Country	Project title	Aims/objectives	Components
Bosnia-Herzegovina (PE_1)	Employment Support II	1. To provide employment services for an estimated 10,000 people who are either recently retrenched and above 45 years of age and/or those who have been actively seeking jobs for two or more years 2. To bring behavioural change and business change in the employment services	1. Improving the employment services on matching employers with job services vacancies to appropriately skilled active job seekers; and on providing, through private sector service providers, income earning opportunities to active job seekers and to the hardcore unemployed based on the experience of the Pilot Emergency Labour Redeployment Project 2. Upgrading and strengthening the Public Employment Services (PES) capacity to provide and outsource job brokerage and employment services programmes through the development of effective procedures, clear guidelines and regulations, staff training and the piloting of analytical labour market information systems, including introducing labour market research units in the Ministries of Labour 3. Supporting project implementation and coordination between all partners in the Second Employment Support Project (SESP)
Serbia and Montenegro (PE_2)	Employment promotion	To improve the efficiency of labour programmes by piloting and testing new approaches and putting in place innovative labour redeployment programmes, offering employment services in selected areas	1. Design of labour redeployment activities to reintegrate displaced workers into the labour market and mitigate the social costs of enterprise restructuring, through the development of new policies, institutional arrangements and labour 2. Piloting reforms in Public Employment Services, which will design, pilot, and redeployment programmes, evaluate cost-effective public employment services to assist the unemployed to re-enter the labour market through improved employment services, search assistance programmes and small business advisory services 3. Labour market information and evaluation – social impact of restructuring and effects of Active Labour Market Programmes, developing a comprehensive system of labour market information to assess the effects of labour market programmes through the provision of training, services and goods 4. Assistance to the Ministry of Labour and Employment (MOLE) in project management through the provision of training, and goods and services, including the audit of accounts and financial statements

them to adjust to and benefit from an EPA. The dates of these projects and the project costs are recorded in Table A2, as are the characteristics (size and secondary school enrolment rates) of the countries involved. Again, these data are used to anchor the estimated costing for all the cells in the cost grid, taking into account the currency of valuation and inflation. The resulting cost estimates are summarised in Table 13. There is some inconsistency in the ranking of costings. Projects SP1 and SP3 have been taken as base reference costings for the 'micro–small' combination and 'medium–medium' combination. This may, but only may, upwardly bias the estimates for 'micro' states (<1 million population). But it should be noted that the interpolated values for the very large category are considerably smaller than the actual costings for SP5.

Table 10. Production and employment adjustment cost estimates (million €)

		Degree of adjustment		
		Low	Medium	High
Country size	Micro	4	6	15
	Small	10 € 11.9 (PE_1)	12	25
	Medium	20 € 22 (PE_2)	25	40
	Large	40	50	65
	Very large	80	100	125

Negotiation and legislative costs

The methodology for identifying adjustment costs (as set out above) implicitly incorporates the costs of the changes in legislation needed in each area.[4] We do not therefore seek here to identify the specific legislative costs separately; doing so would in any case be extremely difficult. As argued above, the process of negotiating an EPA also imposes training, capacity building and direct negotiating time and costs. The 9th EDF provided funds for supporting capacity building and EPA negotiations. To the extent that some of the support for ACP trade capacity contributes to easing the adjustment costs of an EPA, the contribution could be deducted from earlier cost estimates. But if the final negotiation costs exceed the EDF funding that has been provided so far, then there will be a need for additional funding.

Current trade-related assistance to the ACP

Trade-related assistance (TRA) for the ACP has so far been provided mainly under the 9th EDF (2003–2007). This amounted to €650 million. TRA sought to support the ACP countries in their efforts to deal with trade policy issues (relating to the WTO, EPAs, regional groupings, etc.), to mainstream trade into their development policies and to create the conditions under which they would benefit from trade opportunities. TRA to the ACP has been provided at three different and complementary levels:

1. At an all-ACP level several facilities have covered mostly short-term needs or needs in specific trade-related areas (for example sanitary and phytosanitary requirements). These facilities are accessible to all ACP countries upon submission of requests.

   (a) Facility to support EPA negotiations (€24 million): funded EPA-related studies, technical support, meetings and training throughout the ACP.

   (b) Facility to support ACP countries in WTO negotiations (€12 million): has supported ACP with WTO-related technical assistance, training and meetings.

   (c) Trade.Com (€50 million): a major general capacity-strengthening measure funding a network of 55 regional and national trade advisors throughout the ACP. Further components are helping ACP countries to identify their needs, strengthening local research capacity and helping to implement pilot projects, including projects in the area of sanitary and phytosanitary requirements.

   (d) Pesticides initiative (€29 million): has assisted ACP companies and professional organisations since 2003 in the specific area of compliance with EU rules on pesticides residues. The programme has also helped ensure that the specific needs of ACP countries are taken into account in EU phytosanitary regulations.

Table 11. Degree of skills/ productivity enhancement required

	Low adjustment		Medium adjustment		High adjustment		Other	
Country size	**Country**	**% secondary school enrolment**	**Country**	**% secondary school enrolment**	**Country**	**% secondary school enrolment**	**Country**	**% secondary school enrolment**
Micro	Cape Verde	68.60	Equatorial Guinea	31.20	Djibouti	14.70	Bahamas, The	–
	Belize	71.60	Suriname	50.70	Comoros	20.60	Dominica	–
	Samoa	76.00	Vanuatu	28.50	Fiji	–		
	Guyana	81.00					Grenada	–
	St Lucia	94.30					Kiribati	–
	Barbados	100.00					Micronesia, Federated States	–
							Palau	–
							São Tomé and Principe	–
							Seychelles	–
							Solomon Islands	–
							St Kitts and Nevis	–
							St Vincent & the Grenadines	–
							Tonga	–
Small	Namibia	59.80	Togo	36.20	Mauritania	18.40	Central African Republic	–
	Swaziland	60.00	Gabon	54.40	Guinea-Bissau	20.40	Congo, Republic	–
	Trinidad and Tobago	78.40			Liberia	22.50		
	Botswana	81.80			Gambia, The	27.00		
	Jamaica	83.60			Lesotho	28.00		
	Mauritius	100.00			Eritrea	28.20		
Medium	Dominican Republic	66.40	Malawi	45.20	Niger	6.50	Haiti	–
	Zimbabwe	45.30	Burundi	7.10	Somalia	–		
					Burkina Faso	10.00		
					Chad	11.50		
					Rwanda	12.10		
					Guinea	13.80		
					Mali	15.00		
					Angola	15.50		
					Senegal	19.50		
					Papua New Guinea	21.20		
					Benin	21.80		

Table 11 (continued)

	Low adjustment		Medium adjustment		High adjustment		Other	
Country size	**Country**	**% secondary school enrolment**	**Country**	**% secondary school enrolment**	**Country**	**% secondary school enrolment**	**Country**	**% secondary school enrolment**
					Sierra Leone	23.90		
					Zambia	25.50		
Large	South Africa	90.20	Ghana	37.30	Ethiopia	5.20	Uganda	–
					Tanzania	5.30		
					Mozambique	13.90		
					Madagascar	14.30		
					Congo, Dem. Republic	18.40		
					Cameroon	19.60		
					Ivory Coast	21.70		
					Sudan	28.80		
					Kenya	29.90		
Very Large							Nigeria	–

Key: Low adjustment: Enrolment ratio >60%; Medium adjustment: 30%–60%; High adjustment: <30%; Other: data not available (–)

Table 12. Skills/productivity enhancement projects

Country	Project title	Aims/objectives	Components
Cape Verde (SP_1)	Growth and competitiveness	To increase private sector's competitiveness and participation in economic growth	1. Financial sector reform, including pension reform 2. Investment climate reform, which includes, but is not limited to: tax reform, alleviation of administrative barriers, improved supply chains, and legal reform 3. Post privatisation and divestiture reforms 4. Private sector and institutional capacity building.
Croatia (SP_2)	Technical assistance project for institutional and regulatory reform for private sector development	Encouragement for private sector development, as specified by the Country Assistance Strategy (CAS), through business improvement, conducive to private sector growth	1. Creation of regulatory and institutional frameworks for public utilities, to include advisory services for the design of a new organisational structure, and development of detailed regulations, to assist the Office for the Restructuring and Economics of State-owned Enterprises (ORESE) 2. Strengthening of the Agency for the Protection of Market Competition (APMC), will be accomplished through the provision of advisory services, for the development of secondary legislation for the 1995 Competition Law. Assistance will support the development plan for the APMCin compliance with the Competition Law 3. Institutional strengthening assistance for financial and statistical agencies.
Honduras (SP_3)	Enhancing competitiveness: Trade facilitation and productivity improvement	To improve the investment climate and local firms' capacity to export	1. Improving critical elements of the investment climate 2. Promoting private sector innovation 3. Improving the skills of the labour force 4. Promoting local development in selected pilot areas 5. Developing a communication campaign on themes related to competitiveness 6. Financing the Project Implementation Unit (PIU)
Egypt (SP_4)	Skills development project	To stimulate demand for skills training development among private small and medium-sized private sector enterprises (SMEs)	1. Implement awareness programmes, provide technical advisory services to promote outreach programmes; monitoring and evaluation surveys and assessments; enable beneficiary firms to undertake training needs assessments, plans, develop training proposals 2. Finance a demand-driven training programme on a cost-shared basis with beneficiary small and medium size enterprises, and strengthen the institutional capacity of project intermediaries; support short term production-related in-service training and training for prospective employees 3. Finance goods and technical advisory services to strengthen the institutional capacity of the Project Management Unit
Mexico (SP_5)	Innovation for competitiveness: 1st Phase	To improve the competitiveness of the Mexican economy	1. Strengthening the innovative capacity of the private sector 2. Accelerating advanced human capital formation 3. Increasing the international integration of the innovation system

(e) Fisheries programme (€42 million): has provided specific support since 2003 to improve the sanitary conditions of fish exports.

(Total €150 million)

2. A larger amount of TRA support has been provided under the RIPs in line with the ACP–EU priority attached to regional integration. Funding under the regional programmes has served

Table 13. Skills enhancement and productivity adjustment cost estimates (million €)

		Degree of adjustment		
		Low	Medium	High
Country size	Micro	10 € 11.7 (SP_1)	15	30
	Small	15	20 € 7.7 (SP_2)	35
	Medium	20	30 € 28.7 (SP_3)	45
	Large	40 € 10.9 (SP_4)	50	65
	Very large	80 € 308.6 (SP_5)	100	130

mainly to support regional trade and economic integration, participation of the regions in the EPA process, and capacity building. Allocations for regional integration and trade to the individual regions are as follows:

Caribbean: €50 million

Eastern Africa: €111 million

Southern Africa: €40 million

West Africa: €120 million

Central Africa: €15–20 million

Pacific: €9 million

(Total €350 million)

3. At a national level, several ACP countries have additional funding earmarked for projects which complement funding under the all-ACP and regional programmes.

   (Estimated total amount: €150 million)

Contribution to adjustment costs

Of the €626 million (i.e. the total TRA funding listed above less the facility to support EPA negotiations), some should be viewed as supporting specific aspects of EPA adjustment, in particular trade facilitation and export diversification (i.e. items (c), (d) and (e) above). However, some of the other funding was clearly directed at other issues (e.g. item (b) for WTO negotiations). On other items there is some ambiguity. The regional programmes are to support regional trade and integration, as well as regional participation in the EPA process. To the extent that this latter feature of the regional programmes has more to do with capacity building for the EPA negotiations than EPA adjustment assistance, it should be excluded from the present calculation of adjustment costs. One might conclude therefore that only €121 million of the 9th EDF should be viewed as contributing to the trade facilitation costs of EPA adjustment.

Overall implementation and adjustment costs

The final step in the methodology of this study is to aggregate the costs of adjustment across individual components. A summary of the classifications for each ACP country according to size and whether they are classified as relatively low, medium or high potential adjusters (or 'other' where data have prevented classification) are set out in Table 14. The classification is given for each of the four broad

Table 14. ACP countries by type and extent of adjustments required

No.	Country		Fiscal Adjustment				Trade Facilitation/ Export Diversification				Production/ Employment Adjustment				Skills/ Productivity/ Enhancement			
			Low	Medium	High	Other	Low	Medium	High	Other	Low	Medium	High	Other	Low	Medium	High	Other
1	Benin	MEDIUM			x				x		X						x	
2	Burkina Faso	MEDIUM		x				x			X						x	
3	Burundi	MEDIUM		x					x		X						x	
4	Cameroon	LARGE	x						x			x					x	
5	Central African Rep.	SMALL			x		x					x						x
6	Chad	MEDIUM		x				x			X						x	
7	Comoros	MICRO			x					x				x			x	
8	Congo, Dem. Rep.	LARGE		x			x				X						x	
9	Congo, Rep.	SMALL	x						x				x					x
10	Côte d'Ivoire	LARGE		x				x				x					x	
11	Eritrea	SMALL	x							x		x					x	
12	Ethiopia	LARGE		x				x				x					x	
13	Gambia, The	SMALL			x			x			x						x	
14	Ghana	LARGE		x				x				x				x		
15	Guinea	MEDIUM	x				x					x					x	
16	Guinea-Bissau	SMALL		x					x		x						x	
17	Haiti	MEDIUM				x	x				x							x
18	Kenya	LARGE	x					x			x						x	
19	Lesotho	SMALL		x						x			x				x	
20	Liberia	SMALL				x			x					x			x	
21	Madagascar	LARGE			x			x			x						x	
22	Malawi	MEDIUM	x					x			x					x		
23	Mali	MEDIUM			x				x			x					x	
24	Mauritania	SMALL	x						x			x					x	

Table 14 (continued)

No.	Country		Fiscal Adjustment				Trade Facilitation/ Export Diversification				Production/ Employment Adjustment				Skills/ Productivity/ Enhancement			
			Low	Medium	High	Other	Low	Medium	High	Other	Low	Medium	High	Other	Low	Medium	High	Other
25	Mozambique	LARGE	x						x			x					x	
26	Niger	MEDIUM			x				x		x						x	
27	Nigeria	V. LARGE			x				x			x						x
28	Papua New Guinea	MEDIUM		x					x				x				x	
29	Rwanda	MEDIUM		x					x			x					x	
30	São Tomé and Principe	MICRO	x							x				x				x
31	Senegal	MEDIUM		x			x					x					x	
32	Sierra Leone	MEDIUM		x			x					x					x	
33	Somalia	MEDIUM				x				x				x				x
34	Sudan	LARGE			x				x		x						x	
35	Tanzania	LARGE		x				x			x						x	
36	Togo	SMALL			x		x					x				x		
37	Uganda	LARGE			x				x			x						x
38	Zambia	MEDIUM		x				x				x					x	
39	Zimbabwe	MEDIUM	x				x					x				x		
40	Angola	MEDIUM	x							x			x				x	
41	Cape Verde	MICRO			x				x			x			x			
42	Djibouti	MICRO	x							x	x						x	
43	Dominican Republic	MEDIUM		x			x					x			x			
44	Fiji	MICRO				x	x					x						x
45	Guyana	MICRO	x						x			x			x			
46	Jamaica	SMALL		x			x					x			x			
47	Kiribati	MICRO				x				x				x				X
48	Micronesia, Fed. Sts.	MICRO				x				x				x				X

Table 14 (continued)

No.	Country		Fiscal Adjustment				Trade Facilitation/ Export Diversification				Production/ Employment Adjustment				Skills/ Productivity/ Enhancement			
			Low	Medium	High	Other	Low	Medium	High	Other	Low	Medium	High	Other	Low	Medium	High	Other
49	Namibia	SMALL		x			x					x			x			
50	Samoa	MICRO				x	x							x	x			
51	Solomon Islands	MICRO				x			x					x				X
52	Suriname	MICRO		x				x				x				x		
53	Swaziland	SMALL			x		x						x		x			
54	Tonga	MICRO				x			x		x							X
55	Vanuatu	MICRO				x				x	x						x	
56	Barbados	MICRO				x	x					x			x			
57	Belize	MICRO				x		x				x			x			
58	Botswana	SMALL	x				x						x		x			
59	Dominica	MICRO				x	x					x						X
60	Equatorial Guinea	MICRO	x							x			x			x		
61	Gabon	SMALL		x					x				x			x		
62	Grenada	MICRO				x			x			x						X
63	Mauritius	SMALL		x			x					x			x			
64	Palau	MICRO				x				x	x							X
65	Seychelles	MICRO			x				x			x						X
66	South Africa	LARGE	x				x					x			x			
67	St. Kitts and Nevis	MICRO				x	x					x						x
68	St. Lucia	MICRO				x	x				x				x			
69	St. Vincent and the Grenadines	MICRO				x			x			x						x
70	Trinidad and Tobago	SMALL				x	x						x		x			
71	Bahamas, The	MICRO				x	x					x						x

categories of adjustment costs (fiscal adjustment, trade facilitation/export diversification, production/employment and skills/productivity enhancement). (Note that South Africa has been classified, but it is not included in the cost estimates because it has already negotiated a free trade arrangement with the EU.)

Given the crude nature of the proxies for classifying the degree of adjustment and for the interpolation of costings for the differentiation of countries by degree of adjustment, we do not place much weight on the aggregation of costs for each individual ACP country. These are reported in Table A3 for completeness. It should be recalled also that countries that were unclassified by degree of adjustment because of lack of data were allocated to the medium adjustment category. The recorded country total may therefore understate or overstate the adjustment cost for that specific country. When we aggregate across countries, however, it is probable that this bias will be reduced on the principle of offsetting errors. The total costs estimates for each category of costs and the overall estimates should therefore be more reliable. These are summarised in Table 15.

Table 15. Summary of estimated adjustment costs for ACP countries (million € at 2005 equivalent prices)

	Gross	Net[a]
Fiscal adjustment	3,025	3,025
Trade facilitation/ export diversification	2,401	2,280
Production/employment	1,454	1,454
Skills/productivity enhancement export diversification	2,265	2,265
Overall cost	9,145	9,024

[a]Less €121 million provided by EDF9 – see earlier section on 'Negotiation and legislative costs'

The overall cost of EPA adjustment is estimated at about €9 billion at current prices. This is a substantial figure, when compared with the typical estimates of the net welfare gains of trade liberalisation episodes. These estimates abstract, however, from adjustment cost considerations, and there is relatively little empirical work that sheds light on the appropriateness of this estimate. Table 16 breaks down the ACP-wide adjustment costs by negotiating region. It should be noted that this is a breakdown of the gross cost estimates in Table 15, since we do not know the precise breakdown of the €121 million spending that was netted off for spending under the 9th EDF. For completeness Table 15 also disaggregates the costs by type of adjustment costs for each region.

To assess the credibility of this estimate, an alternative approach to assessing the adjustment assistance issue is described in Annex 2. There we ask how much subsidy to domestic producers would be needed to avoid the adjustments that will be experienced as a result of EPA tariff liberalisation. The subsidy equivalents reported are based on earlier detailed work done for Mauritius. If the same subsidy equivalent in proportional terms (i.e. as a proportion of GDP) as Mauritius would require in order to avoid EPA adjustment costs was applied across all the ACP countries, the overall cost would be about €6 billion. It is not unreasonable to imagine that rational governments would pursue policy interventions that cost less than the costs of adjusting to an alternative policy regime. The ordering of the magnitudes of the cost of adjustment and of the cost of avoiding adjustment is therefore relevant. It should of course be acknowledged that both the subsidy equivalent and adjustment cost estimates are based on a presumed full adjustment. The exclusion of sectors from EPA liberalisation would reduce the need for adjustment and accordingly reduce the costs of adjustment that will fall on firms, workers, etc. in the ACP regions. The costs of the adjustment support programmes identified in this study, however, are unlikely to fall in proportion to any reduction in the trade coverage of the EPA liberalisation, given the fixed cost elements of such programmes.

Table 16. Estimated adjustment costs by region

Region	Fiscal adjustment	Export diversification	Employment adjustment	Skills/ productivity enhancement	Total adjustment costs
Pacific[a]	210	175	82	175	642
CEMAC[b]	270	257	153	200	880
ECOWAS[c]	955	712	422	700	2789
ESA	825	752	415	695	2687
SADC	340	261	217	255	1073
Cariforum[d]	375	199	140	210	924
Gross total[e]	2,975	2,356	1,429	2,235	8,995

[a]Excludes Cook Islands, Nauru, Niue and Tuvalu, for which data were not available for earlier analysis
[b]Plus São Tomé & Principe
[c]Plus Cameroon and Chad
[d]Plus Dominican Republic, but excluding Cuba and Antigua and Barbuda
[e]Somalia is excluded from the above groupings, but was included in earlier analysis

Annex 1. Additional tables

Table A1. ACP countries showing income group, population size, GDP, share of manufactured exports in total exports and trade tax dependence

No.	Country	Population (2004) ('000)	Size	GDP (2004) ($ million)	Trade tax as % of total revenue (2001)	Manufactured exports as % of total exports (2002)	Industrial Output as % of GDP	Gross Secondary School Enrolment (1999/2000) (%)	Net Secondary School Enrolment (1999/2000) (%)
Low income									
1	Benin	6,890	Medium	4,075	43.3	6.0	14.37	21.80	17.40
2	Burkina Faso	12,387	Medium	4,824	26.0	19.0	18.91	10.00	8.30
3	Burundi	7,343	Medium	657	28.7	1.0	19.00	7.10	–
4	Cameroon	16,400	Large	14,733	16.8	7.0	20.00	19.60	–
5	Central African Republic	3,947	Small	1,331	44.8	40.0	22.00	–	–
6	Chad	8,823	Medium	4,285	29.8	17.5	17.00	11.50	7.70
7	Comoros	614	Micro	367	41.8	–	–	20.60	–
8	Congo, Dem. Republic	54,775	Large	6,571	32.0	75.0	19.00	18.40	11.70
9	Congo, Republic	3,855	Small	4,384	12.9	3.1	63.00	–	–
10	Ivory Coast	17,142	Large	15,286	34.3	21.0	30.00	21.70	–
11	Eritrea	4,477	Small	925	14.1	–	25.00	28.20	22.50
12	Ethiopia	69,961	Large	8,077	26.4	14.0	30.00	5.20	–
13	Gambia, The	1,449	Small	415	60.2	17.0	14.00	27.00	23.40
14	Ghana	21,053	Large	8,620	28.4	16.0	24.00	37.30	26.10
15	Guinea	8,073	Medium	3,508	14.5	28.0	37.00	13.80	11.90
16	Guinea-Bissau	1,533	Small	280	34.6	2.7	13.00	20.40	–
17	Haiti	8,592	Medium	3,535	–	85.0	16.77	–	–
18	Kenya	32,447	Large	15,600	12.2	24.0	19.00	29.90	–
19	Lesotho	1,809	Small	1,375	39.3	–	43.00	28.00	19.60
20	Liberia	3,449	Small	448	–	1.3	–	22.50	20.30
21	Madagascar	17,332	Large	4,364	54.4	14.0	13.00	14.30	11.50
22	Malawi	11,182	Medium	1,813	13.0	10.0	15.00	45.20	–
23	Mali	11,937	Medium	4,863	50.0	2.0	30.00	15.00	–

Table A1 (continued)

No.	Country	Population (2004) ('000)	Size	GDP (2004) ($ million)	Trade tax as % of total revenue (2001)	Manufactured exports as % of total exports (2002)	Industrial Output as % of GDP	Gross Secondary School Enrolment (1999/2000) (%)	Net Secondary School Enrolment (1999/2000) (%)
Low income (continued)									
24	Mauritania	2,906	Small	1,357	10.9	5.5	29.00	18.40	–
25	Mozambique	19,129	Large	5,548	17.9	8.0	34.00	13.90	7.30
26	Niger	12,095	Medium	3,081	52.4	3.0	17.00	6.50	5.80
27	Nigeria	139,823	Verylarge	72,106	48.5	0.0	29.00	–	–
28	Papua New Guinea	5,625	Medium	3,909	25.4	2.0	42.00	21.20	21.30
29	Rwanda	8,412	Medium	1,845	23.9	3.0	21.00	12.10	–
30	São Tomé and Principe	161	Micro	62	18.6	–	–	–	–
31	Senegal	10,455	Medium	7,665	26.7	51.0	22.00	19.50	–
32	Sierra Leone	5,436	Medium	1,075	39.8	32.3	32.00	23.90	23.90
33	Somalia	9,938	Medium	–	–	–	–	–	–
34	Sudan	34,356	Large	19,559	44.2	3.0	18.00	28.80	–
35	Tanzania	36,571	Large	10,851	29.2	17.0	16.00	5.30	4.80
36	Togo	4,966	Small	2,061	45.0	43.0	22.00	36.20	23.10
37	Uganda	25,920	Large	6,833	50.0	8.0	22.00	–	–
38	Zambia	10,547	Medium	5,389	25.2	14.0	26.00	25.50	20.70
39	Zimbabwe	13,151	Medium	17,750	16.7	38.0	24.00	45.30	42.30
Lower middle-income									
40	Angola	13,963	Medium	20,108	8.1	–	68.00	15.50	–
41	Cape Verde	481	Micro	948	40.6	2.9	19.72	68.60	–
42	Djibouti	716	Micro	663	17.3	–	14.20	14.70	–
43	Dominican Republic	8,861	Medium	18,673	31.6	34.0	33.00	66.40	40.00
44	Fiji	848	Micro	2,627	–	34.5	27.01	–	–
45	Guyana	772	Micro	786	12.0	9.2	28.58	81.00	–
46	Jamaica	2,665	Small	8,030	28.6	64.0	31.00	83.60	74.70
47	Kiribati	98	Micro	62	–	–	–	–	–

Table A1 (continued)

No.	Country	Population (2004) ('000)	Size	GDP (2004) ($ million)	Trade tax as % of total revenue (2001)	Manufactured exports as % of total exports (2002)	Industrial Output as % of GDP	Gross Secondary School Enrolment (1999/2000) (%)	Net Secondary School Enrolment (1999/2000) (%)
Low middle-income (continued)									
48	Micronesia, Fed. Sts.	127	Micro	226	–	–	–	–	–
49	Namibia	2,033	Small	5,456	29.9	52.0	31.00	59.80	34.20
50	Samoa	179	Micro	363	–	81.4	–	76.00	68.40
51	Solomon Islands	471	Micro	242	–	3.8	–	–	–
52	Suriname	443	Micro	1,109	36.7	14.0	19.58	50.70	–
53	Swaziland	1,120	Small	2,413	52.0	76.0	50.00	60.00	37.30
54	Tonga	102	Micro	213	–	4.4	15.12	–	–
55	Vanuatu	215	Micro	316	–	–	9.39	28.50	22.60
Upper middle-income									
56	Barbados	272	Micro	2,627	–	59.0	20.76	100.00	70.70
57	Belize	283	Micro	1,094	–	18.2	19.71	71.60	36.00
58	Botswana	1,727	Small	8,659	9.9	91.0	48.00	81.80	58.80
59	Dominica	71	Micro	269	–	30.6	21.04	–	–
60	Equatorial Guinea	506	Micro	3,235	14.7	–	88.92	31.20	26.10
61	Gabon	1,374	Small	7,228	21.8	2.0	46.00	54.40	–
62	Grenada	106	Micro	436	–	3.7	22.63	–	–
63	Mauritius	1,234	Small	6,056	34.6	73.0	31.00	100.00	72.50
64	Palau	20	Micro	127	–	–	12.69	–	–
65	Seychelles	85	Micro	704	47.0	1.0	36.06	–	–
66	South Africa	45,584	Large	212,777	3.7	63.0	32.00	90.20	–
67	St Kitts and Nevis	47	Micro	397	–	73.3	28.32	–	–
68	St Lucia	164	Micro	729	–	25.6	18.03	94.30	64.00
69	St Vincent and the Grenadines	108	Micro	403	–	9.5	24.41	–	–
70	Trinidad and Tobago	1,323	Small	12,544	–	46.0	48.81	78.40	63.80
High income: Non-OECD									
71	Bahamas, The	320	Micro	5,260	–	31.2	36.10	–	–

– = not available

Table A2. Selected indicators for project countries

(A) Fiscal adjustment projects

Country	Project dates	Project costs ($ million)	Population (2004) ('000)	Size	GDP (2004) ($ million)	Trade tax as % of total revenue
(F_1) Mauritania	1998–2002	30.0	2,906	Small	1,357.0	10.9
(F_2) Tanzania	1996–1999	70.2	36,571	Large	10,851.0	29.2
(F_3) Pakistan	2004–2008	149.0	152,061	Very large	96,115.0	12.0

(B) Trade facilitation projects

Country	Project dates	Project costs ($ million)	Population (2004) ('000)	Size	GDP (2004) ($ million)	Trade tax as % of total revenue
TF_1 Moldova	2003–2007	9.7	4,218	Small	30,282.0	31.0
TF_2 Cambodia	2005–2009	12.0	13,630	Medium	4,597.0	n/a
TF_3 Ecuador	1997–2003	42.6	13,213	Medium	30,282.0	10.0
TF_4 Colombia	1993–1999	86.6	45,300	Large	97,384.0	38.0

(C) Production and employment adjustment projects

Country	Project dates	Project costs ($ million)	Population (2004) ('000)	Size	GDP (2004) ($ million)	Trade tax as % of total revenue
(PE_1) Bosnia-Herzegovina	2004–2008	14.0	3,836	Small	8,121.0	37.0
(PE_2) Serbia-Montenegro	2003–2006	25.5	8,152	Medium	23,996.0	32.0

(D) Skills/productivity enhancement projects

Country	Project dates	Project costs ($ million)	Population (2004) ('000)	Size	GDP (2004) ($ million)	Trade tax as % of total revenue
SP_1 Cape Verde	2003–2007	13.5	481	Micro	948.0	68.6
SP_2 Croatia	1999–2005	8.0	4,508	Small	34,200.0	n/a
SP_3 Honduras	2004–2007	33.8	7,140	Medium	7,370.0	n/a
SP_4 Egypt	2003–2006	12.5	68,738	Large	75,148.0	83.5%
SP_5 Mexico	2006–2015	382.0	103,795	Very large	676,497.0	73.4%

Size (population): Micro: <1 million; Small: 1–5 million; Medium: 5–15 million; Large: 15–100 million; Very large: >100 million
– = not available

Table A3. Estimated adjustment costs (million €)[a]

No.	Country	Fiscal adjustment	Export diversification	Employment adjustment	Skills/productivity enhancement costs	Total adjustment
1	Benin	70.0	30.0	20.0	45.0	165.0
2	Burkina Faso	50.0	20.0	20.0	45.0	135.0
3	Burundi	50.0	65.0	20.0	45.0	180.0
4	Cameroon	60.0	90.0	50.0	65.0	265.0
5	Central African Republic	60.0	12.0	12.0	20.0	104.0
6	Chad	50.0	45.0	20.0	45.0	160.0
7	Comoros	30.0	10.0	6.0	30.0	76.0
8	Congo, Democratic Republic	50.0	50.0	40.0	65.0	205.0
9	Congo, Republic	30.0	45.0	25.0	20.0	120.0
10	Ivory Coast	70.0	65.0	50.0	65.0	250.0
11	Eritrea	30.0	25.0	12.0	35.0	102.0
12	Ethiopia	70.0	65.0	50.0	65.0	250.0
13	Gambia, The	60.0	25.0	10.0	35.0	130.0
14	Ghana	70.0	65.0	50.0	50.0	235.0
15	Guinea	40.0	20.0	25.0	45.0	130.0
16	Guinea-Bissau	40.0	45.0	10.0	35.0	130.0
17	Haiti	50.0	20.0	20.0	30.0	120.0
18	Kenya	60.0	65.0	40.0	65.0	230.0
19	Lesotho	40.0	25.0	25.0	35.0	125.0
20	Liberia	40.0	45.0	12.0	35.0	132.0
21	Madagascar	90.0	65.0	40.0	65.0	260.0
22	Malawi	40.0	45.0	20.0	30.0	135.0
23	Mali	70.0	65.0	25.0	45.0	205.0
24	Mauritania	30.0	45.0	12.0	35.0	122.0
25	Mozambique	60.0	90.0	50.0	65.0	265.0
26	Niger	70.0	65.0	20.0	45.0	200.0
27	Nigeria	155.0	140.0	100.0	100.0	495.0
28	Papua New Guinea	50.0	65.0	40.0	45.0	200.0
29	Rwanda	50.0	65.0	25.0	45.0	185.0
30	São Tomé & Principe	15.0	10.0	6.0	15.0	46.0
31	Senegal	50.0	20.0	25.0	45.0	140.0
32	Sierra Leone	50.0	20.0	25.0	45.0	140.0
33	Somalia	50.0	45.0	25.0	30.0	150.0
34	Sudan	90.0	90.0	40.0	65.0	285.0
35	Tanzania, United Rep of	70.0	65.0	40.0	65.0	240.0
36	Togo	60.0	12.0	12.0	20.0	104.0
37	Uganda	90.0	90.0	50.0	50.0	280.0
38	Zambia	50.0	45.0	25.0	45.0	165.0
39	Zimbabwe	40.0	20.0	25.0	30.0	115.0
40	Angola	40.0	45.0	40.0	45.0	170.0
41	Cape Verde	30.0	30.0	6.0	10.0	76.0
42	Djibouti	15.0	10.0	4.0	30.0	59.0
43	Dominican Republic	50.0	20.0	25.0	20.0	115.0
44	Fiji	20.0	5.0	6.0	15.0	46.0
45	Guyana	15.0	30.0	6.0	10.0	61.0
46	Jamaica	40.0	12.0	12.0	15.0	79.0
47	Kiribati	20.0	10.0	6.0	15.0	51.0
48	Micronesia, Federated States	20.0	10.0	6.0	15.0	51.0
49	Namibia	40.0	12.0	12.0	15.0	79.0
50	Samoa	20.0	5.0	6.0	10.0	41.0

Table A3 (continued)

No.	Country	Fiscal adjustment	Export diversification	Employment adjustment	Skills/ productivity enhancement costs	Total adjustment
51	Solomon Islands	20.0	30.0	6.0	15.0	71.0
52	Suriname	20.0	10.0	6.0	15.0	51.0
53	Swaziland	60.0	12.0	25.0	15.0	112.0
54	Tonga	20.0	30.0	4.0	15.0	69.0
55	Vanuatu	20.0	10.0	4.0	30.0	64.0
56	Barbados	20.0	5.0	6.0	10.0	41.0
57	Belize	20.0	10.0	6.0	10.0	46.0
58	Botswana	30.0	12.0	25.0	15.0	82.0
59	Dominica	20.0	5.0	6.0	15.0	46.0
60	Equatorial Guinea	15.0	10.0	15.0	15.0	55.0
61	Gabon	40.0	45.0	25.0	20.0	130.0
62	Grenada	20.0	30.0	6.0	15.0	71.0
63	Mauritius	40.0	12.0	12.0	15.0	79.0
64	Palau	20.0	10.0	4.0	15.0	49.0
65	Seychelles	30.0	30.0	6.0	15.0	81.0
66	South Africa[b]	0.0				
67	St Kitts and Nevis	20.0	5.0	6.0	15.0	46.0
68	St Lucia	20.0	5.0	4.0	10.0	39.0
69	St Vincent and the Grenadines	20.0	30.0	6.0	15.0	71.0
70	Trinidad and Tobago	40.0	12.0	25.0	15.0	92.0
71	Bahamas, The	20.0	5.0	6.0	15.0	46.0
	Total	**3,025.0**	**2,401.0**	**1,454.0**	**2,265.0**	**9,145.0**

[a]In 2005-equivalent prices

[b]Excluded from calculation, given separate FTA arrangement with EU

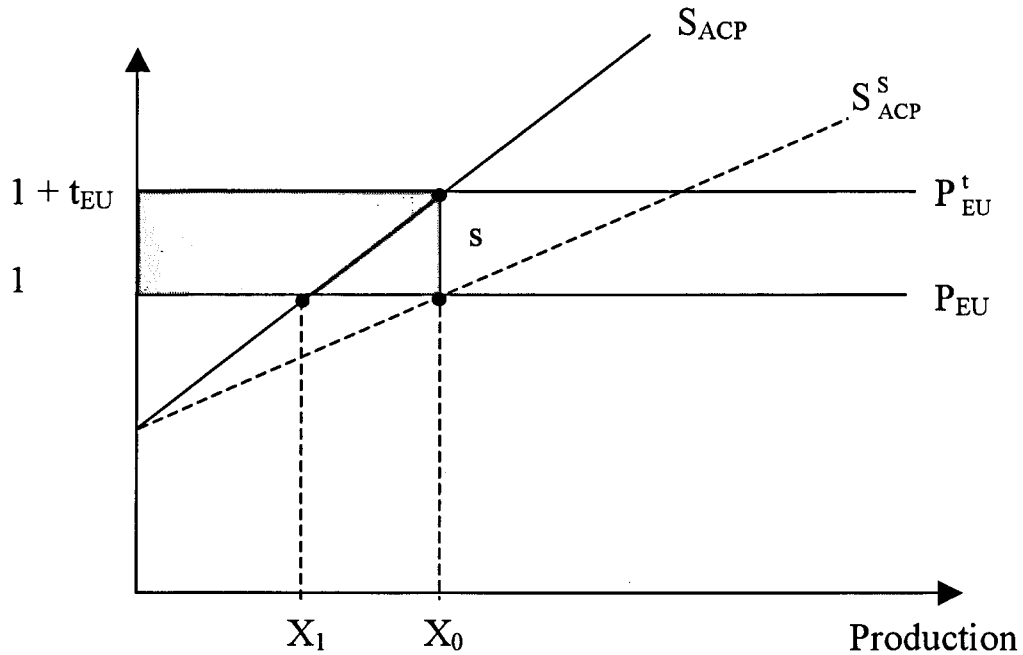
Annex 2. Alternative estimate of the cost of adjustment to EPA (subsidy-equivalent methodology)

Import tariffs on competing imports serve as implicit subsidies to local producers. The creation of an EPA and the lowering of import duties on competing imports from the EU would eliminate the implicit subsidy to local producers. Each ACP country could therefore seek financial support or compensation from the EU for the introduction of reciprocity in ACP–EU trade relations in the form of explicit subsidy equivalents for the eliminated tariffs on imports from the EU for the transitional or adjustment period; these funds would be contingent on the adoption of restructuring programmes by sectors. The conceptualisation and quantification of the 'subsidy equivalent' of the current EU tariff on competing imports is straightforward and directly relates to standard empirical analyses of the effects of an EPA. Consider Figure A1.

Under pre-EPA conditions and the supply curve (S_{ACP}), firms can supply X_0 to the local or regional market by pricing up to the tariff-inclusive price against competing EU imports ($1 + t_{EU}$). The introduction of reciprocity and removal of tariffs on EU imports lowers domestic prices by t_{EU} and causes domestic producers to reduce production to X_1. (Estimates of the production effects of the EPA measure the fall in production, $X_0 - X_1$ fall out of standard partial equilibrium modelling.) The subsidy equivalent of the tariff (t_{EU}) is the subsidy (s) that would shift the domestic supply ($S_{s\,ACP}$) such that at the tariff-free price from the EU (P_{EU}) production can be maintained at the pre-EPA level (X_0). The total subsidy equivalent payment per time period is therefore X_{0s} (the shaded area in Figure A1).

CREDIT (2004) reports estimates of the (annual) total subsidy equivalent of the average tariff on imports from the EU for all sectors of the Mauritian economy. The estimated overall cost of an equivalent subsidy is a little over 1.8 billion Rupees at 2002 prices. This is equivalent to about 1.2% of Mauritian GDP in 2002. If one assumes that the subsidy equivalent of the tariff on EU imports is on average the same proportion of GDP across all

Figure A1. The subsidy equivalent of current tariff protection against EU imports



the ACP countries, one can calculate an aggregate ACP measure of the costs of adjustment (or replacement cost of tariffs *vis-à-vis* EU imports). In Table A4 this assumption is applied, after revising 2004 GDP values in euros (using the same inflation adjustment and exchange rate conversion as applied elsewhere in the study). The aggregate estimated replacement cost of tariff on EU imports for all the ACP countries (excluding Somalia for which GDP data were not available) is about €6 billion.

Table A4

No.	Country	GDP (2004) ($million)	Estimated GDP (2005)[a] ($million)	Subsidy equivalent[b] (€millions)[c]	(€ million)
Low income					
1	Benin	4,075	4,177	50.1225	41.50143
2	Burkina Faso	4,824	4,945	59.3352	49.12955
3	Burundi	657	673	8.0811	6.691151
4	Cameroon	14,733	15,101	181.2159	150.0468
5	Central African Republic	1,331	1,364	16.3713	13.55544
6	Chad	4,285	4,392	52.7055	43.64015
7	Comoros	367	376	4.5141	3.737675
8	Congo, Dem. Republic	6,571	6,735	80.8233	66.92169
9	Congo, Republic	4,384	4,494	53.9232	44.64841
10	Ivory Coast	15,286	15,668	188.0178	155.6787
11	Eritrea	925	948	11.3775	9.42057
12	Ethiopia	8,077	8,279	99.3471	82.2594
13	Gambia, The	415	425	5.1045	4.226526
14	Ghana	8,620	8,836	106.026	87.78953
15	Guinea	3,508	3,596	43.1484	35.72688
16	Guinea-Bissau	280	287	3.444	2.851632
17	Haiti	3,535	3,623	43.4805	36.00185
18	Kenya	15,600	15,990	191.88	158.8766
19	Lesotho	1,375	1,409	16.9125	14.00355
20	Liberia	448	459	5.5104	4.562611
21	Madagascar	4,364	4,473	53.6772	44.44472
22	Malawi	1,813	1,858	22.2999	18.46432
23	Mali	4,863	4,985	59.8149	49.52674
24	Mauritania	1,357	1,391	16.6911	13.82023
25	Mozambique	5,548	5,687	68.2404	56.50305
26	Niger	3,081	3,158	37.8963	31.37814
27	Nigeria	72,106	73,909	886.9038	734.3563
28	Papua New Guinea	3,909	4,007	48.0807	39.81082
29	Rwanda	1,845	1,891	22.6935	18.79022
30	São Tomé and Principe	62	64	0.7626	0.631433
31	Senegal	7,665	7,857	94.2795	78.06343
32	Sierra Leone	1,075	1,102	13.2225	10.94823
33	Somalia	-			
34	Sudan	19,559	20,048	240.5757	199.1967
35	Tanzania, United Rep. of	10,851	11,122	133.4673	110.5109
36	Togo	2,061	2,113	25.3503	20.99005
37	Uganda	6,833	7,004	84.0459	69.59001
38	Zambia	5,389	5,524	66.2847	54.88373
39	Zimbabwe	17,750	18,194	218.325	180.7731

Table A4 (continued)

No.	Country	GDP (2004) ($million)	Estimated GDP (2005)[a] ($million)	Subsidy equivalent[b] (€millions)[c]	(€ million)
Lower middle-income					
40	Angola	20,108	20,611	247.3284	204.7879
41	Cape Verde	948	972	11.6604	9.654811
42	Djibouti	663	680	8.1549	6.752257
43	Dominican Republic	18,673	19,140	229.6779	190.1733
44	Fiji	2,627	2,693	32.3121	26.75442
45	Guyana	786	806	9.6678	8.004938
46	Jamaica	8,030	8,231	98.769	81.78073
47	Kiribati	62	64	0.7626	0.631433
48	Micronesia, Federated Sts.	226	232	2.7798	2.301674
49	Namibia	5,456	5,592	67.1088	55.56609
50	Samoa	363	372	4.4649	3.696937
51	Solomon Islands	242	248	2.9766	2.464625
52	Suriname	1,109	1,137	13.6407	11.2945
53	Swaziland	2,413	2,473	29.6799	24.57496
54	Tonga	213	218	2.6199	2.169277
55	Vanuatu	316	324	3.8868	3.21827
Upper middle-income					
56	Barbados	2,627	2,693	32.3121	26.75442
57	Belize	1,094	1,121	13.4562	11.14173
58	Botswana	8,659	8,875	106.5057	88.18672
59	Dominica	269	276	3.3087	2.739604
60	Equatorial Guinea	3,235	3,316	39.7905	32.94653
61	Gabon	7,228	7,409	88.9044	73.61284
62	Grenada	436	447	5.3628	4.440398
63	Mauritius	6,056	6,207	74.4888	61.67673
64	Palau	127	130	1.5621	1.293419
65	Seychelles	704	722	8.6592	7.169818
66	South Africa	212,777	218,096	2617.157	2167.006
67	St Kitts and Nevis	397	407	4.8831	4.043207
68	St Lucia	729	747	8.9667	7.424428
69	St Vincent & the Grenadines	403	413	4.9569	4.104313
70	Trinidad and Tobago	12,544	12,858	154.2912	127.7531
High income: Non-OECD					
71	Bahamas, The	5,260	5,392	64.698	53.56994
	Total				5998.072

[a]GDP (2004) * 1.025 (i.e. assumed 2.5% inflation rate)
[b]Estimated GDP (2005) * 0.012 (i.e. assumed rate of GDP of 1.2% as in case of CREDIT (2004) study of subsidy equivalent of Mauritius tariff on EU imports
[c]US$ values expressed in euros at rate $1 = €0.828

Endnotes

1. Although LDC ACP countries would gain preferential access under the EU's Everything But Arms (EBA) initiative.
2. The revenue is redistributed from the government to domestic consumers, and in that sense it is not 'lost' by the country.
3. A number of recent studies recognise the fiscal consequences of trade liberalisation for developing countries (for example IMF, 2005).
4. Note that this is not the case for the alternative methodology for measuring adjustment costs. In that case the cost of negotiations and legislative changes would have to be added on.

13

A Strong Cocktail or a Weak Punch? A Case Study of EDF Assistance to the ACP Private Sector

Adam Dunlop

Introduction

New trade negotiations for WTO-compatible Economic Partnership Agreements (EPAs), between the Africa, Caribbean and Pacific (ACP) group of states and the European Union (EU), began in September 2002. For ACP industries and companies, the stakes in these negotiations are high. The negotiations represent the last opportunity to negotiate programmes of assistance to help adjust to the inevitable loss of preference that new WTO compatible trading arrangements with Europe will bring. Managing this transition to market liberalisation is one of the major strategic issues facing many ACP industries. Some ACP sectors have been 'early liberalisers' as external events have curtailed their preferential access to the EU market earlier than expected. The ACP banana sector is one example, the ACP rum industry another. Which industries are next? And are they ready to seize the moment?

This study shows how the ACP Caribbean rum sector sought to address the industry's sudden loss of preference in the post-Lomé negotiations (1998–2000). It also shows how – after a political deal was agreed by the EU and ACP in early 2000 to assist the sector – the stakeholders had to overcome a number of obstacles in order to begin implementation of a programme of transitional assistance that met the industry's needs. It is hoped that stakeholders from both the EU and ACP might find this experience instructive as both parties seek to manage the ACP transition out of preference. The study is also intended to be an input into the ongoing debate concerning how best to use European Development Fund (EDF) resources to develop the ACP private sector.

The broader picture: The impact on ACP industries and ACP–EU trade relations

The experience of the ACP rum sector raises important questions that cut across many themes for the signatories to the ACP–EU Cotonou Partnership Agreement. These relate to (i) the impact of trade liberalisation on ACP industries and how this should be managed by the EU and ACP; (ii) the question of whether the EU is able, and willing, to provide transitional support to other ACP industries as they move from non-reciprocal trade preferences to freer trade; and (iii) the extent to which the EU and ACP are really prepared to fully involve the ACP private sector in development co-operation through programmes under the Cotonou Agreement which runs from 2000 to 2020. The following points are important to place the programme in context, and demonstrate its wider significance for ACPEU trade relations:

Rum is an early liberaliser among ACP industries

For the ACP rum sector, the end of preferences was determined by the EU–US Agreement on Distilled Spirits, sometimes called the 'Zero for Zero' Agreement, in March 1997. As a result of Zero for Zero, rum became one of the first ACP industries to embark on the transition out of preferences. What has happened to rum – the unexpected and rapid curtailment of preferential access to Europe – may be repeated with other ACP producers. Any one of the numerous parallel trade negotiating processes facing the ACP could have the same impact on

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ACP industries. These include the current ACP–EU trade negotiations for WTO-compatible EPAs by 2008, the reform of the Common Agricultural Policy (CAP), the Free Trade Area of the Americas (FTAA) negotiations, the reform of the Generalised System of Preferences (GSP) in 2004, and the ongoing WTO Round of multilateral trade negotiations. Are other ACP industries ready to negotiate the terms of their own economic transitions out of preferences?

Europe has accepted the principle of transitional support for ACP industries

During the post Lomé negotiations, the ACP countries, Caribbean governments, regional negotiators, trade ministers and the Caribbean rum industry sought to have Europe recognise a general principle. That is, when developed countries liberalise the market for established products from preferential suppliers in developing nations, transitional support is essential if the industry concerned is not to fail. In the case of rum, the European Commission and EU member states finally accepted this principle by establishing the rum programme. But is the EC able, and willing, to offer other ACP industries transitional support, particularly when the costs of the EU enlargement will be straining the EU's budget?

An ACP private-sector entity is playing the lead role in managing the 8th EDF rum programme

The rum programme is the EC's second-largest ACP private sector programme after PROINVEST, a new €110 million facility that aims to promote investment and technology flows to enterprises operating within key sectors in the ACP states. Uniquely, the rum programme will be managed on behalf of the Caribbean Forum of ACP States (Cariforum) by an ACP private-sector association, the West Indies Rum and Spirits Producers Association (WIRSPA).[1]

By agreeing to this, the EU and ACP have made real, perhaps for the first time, their stated commitment in the Cotonou Partnership Agreement to make non-governmental actors full partners in the delivery of development. Does this suggest a new willingness on the part of the EU and ACP to make ACP private-sector actors central partners in the delivery of development? Has a new precedent been created for future EDF assistance to the ACP private sector?

Why did Caribbean rum need a support programme in the first place?

The history of European treatment of rum from the ACP group of states – including the negotiation and delivery of the 8th EDF rum programme – is complex. In the words of the Chairman of WIRSPA, the story 'could fill many pages of a book that would read more like a high stakes novel than a work of historical fact'. A summary of the main events in this process is set out in the Annex.

Under the Rum Protocol contained in all Lomé agreements since 1975, Caribbean ACP rum exporters received duty-free access under quota to the European market. Once shipped, the product was then branded, bottled and distributed by major European drinks companies, who captured the value added. The quota restrictions largely confined Caribbean ACP producers to supplying low-value commodity rum in bulk to Europe. The industry argued that quotas discouraged investment in the development of locally owned Caribbean rum brands, as any increase in demand could not be met by increased supply because of the quotas imposed by the EU.

In early 1996, the EU finally removed quotas on ACP rum. Only a few months later in November 1996, the EU and the United States (US) trade negotiators agreed to negotiate a 'Zero for Zero' Agreement on Distilled Spirits. This was a severe and unexpected blow for the ACP rum sector. The Zero for Zero Agreement was proposed in the margins of the 1996 WTO Ministerial Conference in Singapore to facilitate the conclusion of a separate Information Technology Agreement. Surprisingly, the ACP were not consulted, even though Zero for Zero would erode the value of ACP rum preferences to both the EU and US markets, under Lomé IV and the Caribbean Basin Initiative (CBI), respectively.

The ACP Caribbean rum industry, with the full support of its government ACP representatives and

negotiators, decided to address the damage done in the post-Lomé trade negotiations. Tough negotiations over a sustained period resulted in a Joint Declaration on Rum (XXV) being agreed just before the negotiations closed. The Declaration defines the main elements of an EDF programme of assistance for the rum sector. It states:

> *The Community is prepared to provide sufficient funds to finance during the preparatory period, in consultation with the ACP sector concerned, an integrated sector-specific programme for the development of ACP exporters of rum, which could in particular include the following measures:*
>
> - *Enhancing the competitiveness of existing exporters of rum;*
> - *Assist in creation of rum marques or brands by ACP region or country;*
> - *Enabling marketing campaigns to be designed and implemented;*
> - *Assist ACP rum producers to meet environmental and waste management standards and other norms in the international markets including the Community market;*
> - *Assist the ACP rum industry to move out of bulk commodity production into higher value branded rum products.*

The long road from planning to implementation

The negotiation and delivery of the rum programme spanned a full five years from March 1997 – when the EU–US Zero for Zero Agreement was finalised – to August 2002, when programme implementation began. During this time, a wide variety of EU and ACP actors, from both the public and private sectors, played a role at one time or another. On the EU side, keeping its side of the bargain was initially complicated by the fact that the initial stages in the design of the rum programme coincided with major reforms of the European Commission (EC) services.

After political agreement had been reached between the EU and ACP on the Joint Declaration on Rum during the post-Lomé negotiations in February 2000, the Directorate General (DG) Development of the European Commission was made responsible for the delivery of the programme. DG Development maintained lead responsibility within the Commission until late 2000, when the EC embarked on the internal reform. As part of this reform process, policy responsibilities were divided between the programming of aid – which remained with DG Development – and the delivery of programmes, which was assigned to a new Commission institution, EuropeAid Co-operation Office (AIDCO). From early 2001, AIDCO was given primary responsibility for the rum programme dossier, with input from both DG Development and DG Trade.

Some ACP observers have suggested that the Commission reforms led to delays to the start of programme implementation because of the new reporting lines and remits of the institutions involved. They added that the implementation of the programme was also complicated because only a small number of senior policy officials from DG Development were actually aware of the circumstances surrounding the high-level political deal on rum that was struck between the EU and ACP in the post-Lomé negotiations.

The next two sections present a summary of the views of officials from the European Commission, EU member states, the ACP, and industry representatives on the difficulties faced by the parties in making the programme a reality. The EC's role in this process is analysed first, including the issues that arose during the final approval procedures with EU member states.

Determinant factors in the EC's quest to keep its promise

No tradition of working directly with the ACP private sector

EC officials acknowledged that the Commission is not used to working with the ACP private sector. For them, the challenge was to strike the right balance between respecting the Commission's internal controls and procedures and meeting the need for flexibility that is essential to work successfully with private sector actors. They further stated that the EC's procedures for programming development

assistance under the EDF, which were described as 'heavy', are designed for governments, and not for private sector actors.

Within a wider context, some EC officials pointed to the contradictory pressures and expectations that outsiders normally have of the EC's development co-operation activities. On the one hand, the EC's counterparts and beneficiaries of EDF assistance expect quick responses and decisions. On the other hand, European taxpayers and parliamentarians require thorough and transparent procedures in the management and delivery of aid programmes to ensure legitimacy. All of the EC officials interviewed for this study emphasised that the identification and appraisal stages of the 'Project Cycle' had to be absolutely rigorous because the rum programme was unusually large and ambitious and, uniquely, for the first time was to be implemented by an ACP private sector entity.

The EC is prepared to take risks

The officials interviewed were quite unanimous that one of the key elements for them was the level of trust and confidence that was developed between the Commission and WIRSPA during the detailed negotiations on the programme between January 2000 and mid-2002. One AIDCO official noted 'the calibre of the WIRSPA representatives inspired confidence and persuaded the Commission to take risks'. They agreed that this was essential to build trust and instil confidence in an institution that is unaccustomed to working with the ACP private sector.

Other officials also noted that WIRSPA showed itself to be fully aware of the EC's sensitivities regarding transparency and the use of public funds for ACP private sector actors. They added, 'WIRSPA was a very good partner who facilitated the whole process'. It is much harder for the EC to work with weaker industries. WIRSPA also 'knew how to input into the process', and was able to 'provide information and put forward strong arguments quickly as and when required'. They further noted that most of the leading players within the Caribbean rum industry were familiar to the EC as they had visited Brussels on numerous occasions. This was also viewed as a positive for the EC because, according to one official, there was less danger of EDF resources 'getting lost' within the industry.

Several EU member states requested that additional checks and balances be integrated into the programme to cope with the possible risks. As a result, the Commission proposed a system for the ongoing monitoring of the programme. Unusually, it was agreed that this would be done externally rather than through the Evaluation Unit within AIDCO. One EC official noted that this new concept will now be introduced for other EDF private sector programmes for the ACP private sector, such as PROINVEST.

EC officials also pointed to several instances where the Commission was prepared to adapt its normal working practices in the design of this unique programme.

- A derogation from EDF procedures was agreed in relation to the provision of bank guarantees. Private sector entities are usually permitted to manage EDF programmes only if they can provide an appropriate bank guarantee. In this case, WIRSPA was unable to provide all the necessary guarantees, as it is an association of national associations. As such, it has few assets to support a bank guarantee.
- In keeping with the decentralised approach adopted by the EC for this programme, EC officials agreed to allow a higher degree of flexibility for WIRSPA and CARIFORUM to take decisions and make payments for goods and services.
- Thirdly, the EC worked closely with WIRSPA to draw up a 'Manual of Procedures' that was quite specific to the rum programme. Elements of the matching grant scheme under the EU–ACP Business Assistance Scheme (EBAS) facility were incorporated, as were lessons from previous EC decentralised co-operation programmes.

The EC was locked in double negotiations

EC officials were effectively engaged in double negotiations. On one side were CARIFORUM and WIRSPA, and on the other were the EU member states at the EDF Committee. These negotiations

were made more complex because the rum programme was so unique for a variety of reasons. Firstly, it had been agreed as part of a political deal at the end of the post-Lomé trade negotiations to help ACP rum producers deal with the problems arising from the unilateral liberalisation of the European rum market. Secondly, politically agreed support for an ACP industry in economic transition to a liberalised market does not fit into the normal criteria for development co-operation programmes using EDF resources. Thirdly, the Caribbean is comprised of mainly middle-income developing countries and therefore is less of a priority in terms of EDF assistance to alleviate poverty. Many of these issues came to the surface when the Commission presented the draft financing proposal to the EDF Committee in September 2001.

EU member states were concerned about the risks of working with the ACP private sector

The concerns raised by EU member states when considering the financing proposal for the rum programme were varied. Some reflect the philosophical difficulties that EU member states have with supporting commercial enterprises in the ACP private sector. These should be considered within the ongoing debate within Europe concerning how to promote private sector development within ACP states. The following is a summary of some of the concerns that arose during EDF Committee discussions on the draft financing proposal. These were highlighted in interviews or correspondence with European officials:

- **The need to target SMEs.** Several EU member states expressed concerns about the size of the enterprises that will benefit from the programme. Commission officials responded that the programme gives a clear emphasis to SMEs that will benefit from preferential treatment in terms of accessing resources. They also made clear that large non-ACP owned companies should not be the main targets of the programme. This issue highlights the concerns of EU member states regarding the legitimacy of supporting commercial, profit-making ACP enterprises using EDF resources.
- **The role of grants for the ACP private sector.** During the EDF Committee discussions, two EU member states proposed that the €70 million of grant resources should be converted into loans. EC officials have indicated that grant resources from the EDF are rarely used for financing capital investment for the ACP private sector. In this regard, one EC official noted that 'this would be very unlikely to happen again', regardless of whether cost sharing is a main element of the programme. One DG Development official noted 'that the role of grants in private sector development in ACP countries should be clarified, to define what grant EDF resources should be used for'. The official also noted that in future, grant resources from the EDF would be used as seed funding to attract the participation of commercial banks in economic activities in the ACP private sector. In future, it would be harder to justify large sums of grant resources from the EDF being directed to the ACP private sector.
- **Competing commercial interests within Europe.** One official from a Northern European state noted that several EU member states were uncomfortable with the notion of assisting ACP enterprises to compete with European companies. This view was echoed by another European official who emphasised that 'it is easier to do development co-operation in areas where there are no competing interests', such as in the health and education sectors. The issue of competing commercial interests within Europe was felt particularly strongly when the marketing element of the rum programme was discussed within the EDF Committee.
- **The relevance of the programme to poverty alleviation. Several EU member states questioned** how the programme would have a positive impact on poverty alleviation in ACP countries, the main overarching objective of EDF assistance. The issue of whether economic transition programmes for ACP industries are legitimate vehicles for poverty alleviation remains unresolved. This raises important questions such as whether the EDF Committee is the correct forum for reviewing trade-related assistance programmes. Some within the ACP have commented that the

8th EDF rum programme is a poverty prevention programme. They point to the final text in the Annex, to the Financing Agreement, which states 'the project is directed at preventing a further deterioration in the socio-economic conditions of the region (in terms of jobs, export earnings and tax revenue losses) that would be brought about by the ongoing trade liberalisation in the spirits market'.[2]

The strong public–private dialogue within the Caribbean ACP enhanced the programme's legitimacy

EC officials also viewed the strong relationship that had been established between WIRSPA and Cariforum as essential to the programme. They observed that the Cariforum–WIRSPA relationship was a model of public–private relations, and this axis of trust between the regional public and private sectors made the EC's work much easier. Cariforum's strong endorsement of the programme was essential for the EC as this 'persuaded the EC to go much further than we normally do' in the design of the programme. The project was clearly also 'demand driven' with a high degree of regional ownership. Both these issues encouraged the EC and convinced it to take risks.

At the level of AIDCO it was considered very unusual for an ACP private sector association to be entrusted with the management of its own programme, and that this 'was the major achievement'. The inter-governmental body Cariforum had proposed that WIRSPA, an ACP private-sector association, be given the lead role in implementing the programme. This represented a major break from the past, as the issue of who should receive EDF resources has rarely been a source of public–private consensus in ACP countries. It was therefore agreed among the stakeholders that WIRSPA would be the executing agency and the Project Management Unit (PMU) should be located within the WIRSPA secretariat in Barbados.

Determinant factors in the Caribbean ACP countries' quest for a result on rum

Regular dialogue with other ACP parties

Caribbean ACP officials have commented that 'there was no negative comment or hostility' from either Africa or the Pacific even though the 8th EDF rum programme will only benefit rum producers in Caribbean ACP countries. This was mainly because the ACP was kept informed of the rum industry's position, both during and after the post-Lomé negotiations. During the post-Lomé negotiations, WIRSPA and Caribbean negotiators maintained a direct dialogue with the ACP Secretariat on the general matters of principle involved and made sure that the lead ACP Ambassadorial Negotiators on Trade, although from non-rum-producing nations such Namibia and the Cameroon, had a full understanding of the issues surrounding the rum dossier.

After the post-Lomé negotiations had concluded, contact with the ACP was maintained through the ACP Working Party on Rum, a subcommittee of the ACP Trade Committee which meets in Brussels at Ambassadorial level. This Working Party comprises EU Ambassadors from Caribbean rum-producing states and other ACP rum-producing nations such as Fiji, Madagascar, and Mauritius.

The industry made the job of the officials easier by always presenting background briefs with relevant information and supporting arguments. WIRSPA's private-sector diplomacy also extended beyond public officials: interested nongovernmental organisations (NGOs) were briefed, as were journalists from Caribbean newspapers and specialist publications in Europe. During these briefings, WIRSPA made clear to anyone who would listen that addressing the damage done to the rum industry by the 1997 Zero for Zero Agreement was an issue of principle for future ACP–EU trade relations.

The industry had a clear strategy and invested in the process

During the course of early 1997, rum industry leaders decided on a multifaceted response strategy for the industry's relations with Europe, which aimed to ensure that the Zero for Zero Agreement did not become a 'knock out blow' for the sector. This strategy was based on effective private-sector diplomacy. Its ultimate objective was to have the EU recognise that the industry had been damaged by Zero for Zero, and that it required support to undergo the

rapid transition from preference to free trade that Zero for Zero had created. WIRSPA sustained this highly proactive strategy throughout the negotiation of the Joint Declaration on Rum in the post Lomé negotiations in December 1999 right through to the implementation of the programme in August 2002.

Two-way information flows

WIRSPA also realised that it had to have the most up to date information regarding any discussions or developments within Europe that could impact on the treatment of Caribbean rum. WIRSPA was able to develop an 'over the horizon' information capacity that enabled the industry to monitor any discussions or developments that could have an impact on the rum dossier. This was facilitated by the proactive support of Caribbean government officials in Brussels and WIRSPA's advisers in Europe, who maintained a constant 'watching brief' on relevant developments.

Within the Caribbean, WIRSPA briefed and continually updated governments through each local association. This ensured that key actors such as Caricom (Caribbean Community) officials and the Caribbean Regional Negotiation Machinery (CRNM) negotiators were kept fully updated. During the post-Lomé negotiations, a comprehensive industry negotiating position paper was produced and distributed among Caribbean and ACP officials outlining the industry's requirements from these negotiations. This position paper was then integrated into the Caribbean regional negotiating position for the post-Lomé negotiations. It enabled Caribbean officials to raise the issue of rum at every regional and ACP meeting.

Alliances were established to encourage political support

During the period 1997–2002, WIRSPA forged a number of alliances with interested parties within Europe and the Caribbean. These alliances were essential for demonstrating that the rum programme had widespread political support within the EU and the ACP. They also ensured that the momentum for early implementation of the programme was maintained, particularly during the delays arising from the Commission reform in 2001.

A chronology of all the activities and interventions that occurred at a political level would run into many pages. The following is a summary:

- several supportive Resolutions on rum were passed at the ACP–EU Joint Parliamentary Assembly;
- questions were asked by sympathetic Members of Parliament of the UK government during parliamentary debates in London;
- European MEPs also raised the issue of rum with the EU President and EC Commissioners;
- the WIRSPA Chairman delivered presentations to the European Parliament Development Committee in Brussels and the Joint ACP–EU Parliamentary Assembly in the Bahamas in 1999;
- the European Parliament's Budget Committee signalled their political support for assisting the industry by approving a budget line in late 1999; and
- the Lead ACP Ministerial Trade Negotiator raised the issue of rum with EC Trade Commissioner Pascal Lamy, and Caribbean Heads of State raised the issue of rum in letters to several of their European counterparts.

WIRSPA also nurtured its relations with interested groups within the international distilled spirits industry. Three separate Accords were reached with the French CIRT-DOM producers. This support from within Europe undoubtedly helped the French Government to understand WIRSPA's aims during and after the post-Lomé trade negotiations. WIRPSA also maintained a relationship with other distilled spirits industry groups in Europe.

WIRSPA met on a regular basis with the Brussels representatives of EU member states and provided them with briefing papers as and when appropriate. This helped to establish the credibility of WIRSPA as an effective and responsive regional private-sector institution. Meetings were also held with senior officials from the French and British governments, both of which have political and strategic interests in the Caribbean. WIRSPA also

established a continuous presence in Europe through its appointed EU advisers.

Finally, WIRSPA maintained an ongoing and supportive dialogue with key European Commission officials in DG Trade, AIDCO and DG Development who were responsible for delivering the rum programme.

Will the ACP private sector now become a full partner?

Some observers have suggested that the rum programme represents an encouraging first sign that the EC will implement the numerous Cotonou commitments to make non-governmental actors full partners in the delivery of development. However, recent developments in Brussels indicate that this optimism could be misplaced, and the rum programme may not in fact reflect a fundamental shift in the EC's thinking on private sector development in ACP countries after all.

Several of those interviewed in early 2003 referred to the new Commission proposal for the use of 9th EDF resources.[3] The EU Council adopted the proposed 'Financial Regulation' in March 2003, which will apply to all EDF programmes under the 9th EDF.[4] One of the main aims of the proposal, drafted by DG BUDGET, is to bring the EDF's financial procedures into line with the main EU budget procedures. Worryingly for some within the ACP, some provisions of the new 9th EDF Financial Regulation appear to preclude ACP private sector actors from managing EDF programmes in the future.

The potential implications of the 9th EDF Financial Regulation are wide-ranging. Firstly, private-sector entities, whether from the EU or ACP, may no longer be permitted to manage EC projects using EDF assistance. In practical terms, private-sector support instruments such as EBAS and DIAGNOS, which were managed externally by European consultancies under contract to the EC, may not be repeated. Secondly, the new 9th EDF Financial Regulation could also mean that the rum programme, with its unique achievement of entrusting the management of the programme to an ACP private-sector association, may never be repeated. This led one Caribbean official to mournfully comment that the programme is likely to be 'a prototype of one', regardless of whether it is successful or not.

Some Brussels officials have indicated that the Commission proposal for a 9th EDF Financial Regulation appeared to contradict the spirit and the letter of the Cotonou Agreement, which has private-sector development as one of its main aims. Within the private sector provisions of the Cotonou Agreement, the ACP private sector is recognised as a central partner in the delivery of development. Against

Box 1. The 9th EDF Financial Regulation: Closing the door to the private sector?

The following two paragraphs from Article 14 of the Financial Regulation appear to impose new limitations on the role of private-sector entities in programmes using 9th EDF resources.

Paragraph 3 states:

'Within the limits laid down in paragraph 2, the Commission may entrust tasks involving the exercise of public authority, in particular financial implementation tasks, to:

(a) the executive agencies referred to in Article 15 [which states that 'the executive agencies shall be legal persons under Community law created by Community decision,..']

(b) national public sector bodies governed by private law with a public service mission and providing adequate financial guarantees for the implementation of the tasks assigned to them.....'

Paragraph 7, sub-paragraph 2, states:

'The tasks which the Commission may entrust by contract to external private sector entities or bodies other than those referred to in point (b) of the first sub-paragraph of paragraph 3 shall be technical expertise tasks and administrative, preparatory or ancillary tasks involving neither the exercise of public authority nor the use of discretionary power.'

this background, it is certainly surprising that the ACP were not formally consulted on this EC proposal in view of its major implications for future EDF assistance to the ACP private sector under Cotonou.

What conclusions can we draw?

During the series of informal interviews conducted for this case study, the €70 million 8th EDF rum programme was variously described as 'groundbreaking', 'a model of public–private partnership' and, by one rather pessimistic observer, as a 'prototype of one'. Some within the ACP have commented that this sum was in effect a compensation package for the early liberalisation of the industry's preferential market in Europe that began in 1997. EC officials have been notably more reluctant to use the word 'compensation', perhaps for fear that a precedent may be set for other ACP industries.

Several interviewees pointed to the considerable risks taken by both the European Commission and their ACP counterparts in making the programme a reality, and by giving the ACP private sector such a central role in its management. They warned that lessons can only be identified from this experience once the programme has run its course, which will be in 2007. For these more cautious observers, the jury is out on whether this experience does indeed provide the EU and ACP with a test case worth emulating.

This case study revealed some unease among EC, EU member states and ACP officials about the present direction of EC policy towards private-sector development in ACP countries. In that respect the Commission's proposal for the 9th EDF Financial Regulation was described as very disappointing. The proposal and new Financial Regulation suggest that the commitment to promoting public–private partnership in the ACP remains uncertain in Brussels. The question can be raised whether the 9th EDF Financial Regulation signals the end of the Commission's brief experiment with working directly with ACP private-sector actors.

What is clear from the various interviews with the stakeholders is that there are wide-ranging views within the European Commission – and EU member states – about how best to stimulate private-sector development in ACP countries. As one Brussels-based Caribbean official noted, the 'EC should not be considered a monolith' on such issues. Many of these tensions surfaced during the design of the rum programme, when some EC officials made clear their opposition to the programme and its strong private-sector-led approach. It could be argued that in respect of the 8th EDF rum programme, the views of the more private-sector-friendly camp within AIDCO and DG Development prevailed. It could also be argued that, in relation to the new 9th EDF Financial Regulation, the more risk-averse camp of EC officials redressed the balance.

A re-energised debate is needed on EDF assistance to the ACP private sector

Although it was never stated explicitly by any of the interviewees, there appears to be a need for a re-energised debate within Europe and the ACP on how best to stimulate private-sector development in ACP countries. Clearly, major contributions are urgently needed from the ACP private sector itself if it is to articulate its needs from EDF assistance under Cotonou. This debate could seek to resolve some of the outstanding questions:

- What is the role of EDF grant resources in ACP–EU development co-operation for private sector development in ACP countries? Where should EDF grant resources be used instead of loans?
- How can the ACP make best use of the new ACP–EU Investment Facility – which will have at its disposal €2.2 billion – under the management of the European Investment Bank (EIB)?
- Does the ACP private sector want EC private-sector support instruments such as DIAGNOS and EBAS to continue? In this regard, it should be noted that the European Commission is in the process of reviewing these instruments.
- Is the new 9th Financial Regulation consistent with the provisions of the Cotonou Partnership Agreement, which has private sector development as one of its main objectives?

- What will be the impact of the Commission's decision to devolve authority to EC delegations in the ACP? Will it make the approval and implementation procedures faster?5

The engagement of the ACP private sector in these policy debates will of course be essential if EDF assistance is to closely match the needs of the intended beneficiaries. Without this engagement, the priorities for private-sector development in ACP countries will continue to be set by public sector officials, either in Brussels or ACP capitals.

Both the EU and ACP need private-sector support mechanisms

Both EC and Caribbean officials highlighted the important role of the DIAGNOS facility in ensuring the Caribbean rum industry's needs were rapidly assessed. DIAGNOS was established by the EC in 1999 as a support mechanism for the ACP private sector, and its role was to undertake diagnostic studies of the constraints facing priority ACP sectors. DIAGNOS enabled the EC to rapidly assess the needs of the ACP Caribbean rum sector in late 2000. Consultants were retained, using DIAGNOS resources, to draft a financing proposal for the consideration of the Commission and the stakeholders, and eventually the EDF Committee.

Without DIAGNOS, further delays could have been experienced in this early stage of the programme design. The EC would have had to launch a time-consuming tender process for consultants to undertake this type of work. As DIAGNOS was externally managed through an EC Framework Contract, it had additional flexibility and a speed of delivery far beyond the EC's normal internal procedures. Several EC and ACP officials lamented the fact that the DIAGNOS facility was closed in April 2002, as many other ACP industries required this type of fast-tracked assistance with streamlined procedures. DIAGNOS and EBAS were seen as the only support facilities that could provide support to the ACP private sector within a defined time frame. In that context, the decision to discontinue these two private-sector support programmes for the ACP is quite difficult to understand.

New procedures are needed for time-sensitive EDF assistance to the ACP

A further conclusion relates to the speed of delivery of EDF assistance programmes. The rum experience suggests that the normal EDF criteria and timescales do not fit well with the need for rapid delivery, in a finite period, of time-sensitive programmes that involve the private sector. During the interviews for this case study, EC officials acknowledged that their procedures are 'heavy'. Even so, they believed that 'the Commission was not that slow in implementing the rum programme'. While it is true that the Commission did navigate through its own procedures relatively quickly in the case of rum, it is also true that these same procedures make the provision of time-sensitive EDF assistance practically impossible (e.g. in building ACP capacity for trade negotiations, assistance to an ACP industry in danger of collapse).

On a related issue, critical issues were expressed over the fact that the EC's new €20 million capacity-building facility to assist ACP countries in their preparations for EPAs was only established in July 2002, only two months before the new ACP–EU trade negotiations were launched. This support, while welcome, is being provided late for the ACP to take advantage of it in the preparation of initial negotiating position. In addition, questions have also been raised over the difficult access to this facility by the ACP's private sector. These experiences lead to a further important question: Is there a need for a new fast-tracked EC approach to delivering EDF assistance to the ACP countries when this support is time-sensitive?

The EU respected the political deal struck with the ACP on rum exports

One of the main conclusions of this case study was articulated by an ACP official who commented that 'it is significant that the political deal [made during the post-Lomé negotiations to support the ACP rum sector] was respected by the EC'. This should not be understated. The decision of the EDF Committee to approve the programme demonstrates that the European Commission and EU member states are prepared to support financially the process of econ-

omic transition in those ACP countries and industries where markets are liberalised. The decision also shows that the Commission is able to take risks in working with the ACP private sector if it has credible and committed partners.

Whether the EC actually does so in future will depend on whether ACP industries are able to work with their government representatives to articulate their needs clearly in Brussels. One EC official emphasised that WIRSPA was able to 'operate at a high political level when necessary'. This suggests that the rum programme may only be repeated if other ACP industries manage to generate a similar level of political momentum in the current ACP–EU trade negotiations. But how can this be achieved?

A new template for ACP private-sector diplomacy in trade negotiations

The 8th EDF rum programme has proved what government and industry working together with the same objectives can achieve. From the outset, WIRSPA recognised the value of public–private co-ordination and dialogue, both in its own region and in Brussels. The industry's close working relationship with CARICOM, CARIFORUM, the CRNM, Caribbean trade ministers and government representatives in Brussels and Geneva enabled the highest levels of co-ordination, and the delivery of a positive result.

Clearly, it is premature to promote the 8th EDF rum programme as a model worth emulating. Lessons for future EDF assistance to the ACP private sector can really only be identified once the 8th EDF rum programme has run its course in 2007. Only time will tell whether the programme's transitional support is successful in helping the industry to compete with its own rum brands in liberalised international markets.

What has been created, however, is a template for effective ACP private-sector diplomacy with government in ACP–EU trade negotiations. The main elements of such a template are:

- Public–private dialogue with government officials and trade negotiators in capitals and Brussels to forge a unified public–private position and set of common negotiating objectives.
- Be proactive and commit time and effort to the trade negotiating process to promote the industry position, including through regular visits to Brussels.
- Development of strategic alliances in Europe and the ACP.
- Ensure that industry players set aside any competing commercial interests for the greater good of the sector.
- Put in place a committed and united industry leadership that is respected by trade negotiators and officials on both sides.
- Establish a mechanism for the constant exchange of information between industry and negotiators, including through the production of written briefs and other documentation.
- Although these actions had a substantial cost, especially when sustained over a number of years, this should be weighed against what is at stake. The current ACP–EU trade negotiations for EPAs are an opportunity for other ACP industries to adapt this template to their own needs.

Annex: The history of the 8th EDF rum programme

The history of the treatment of rum from the Africa Caribbean and Pacific (ACP) group of states in Europe – including the negotiation and delivery of the 8th European Development Fund (EDF) rum programme – is complex. In the words of the Chairman of the West Indies Rum and Spirits Producers Association (WIRSPA), the story 'could fill many pages of a book that would read more like a high stakes novel than a work of historical fact'. A summary of the main events is set out below.

From the 1970s to 1996: Quotas for ACP exports to Europe

Under the Rum Protocol contained in all Lomé agreements since 1975, Caribbean ACP rum exporters received duty-free access under quota to the European market. The quotas confined Caribbean ACP producers to supplying low-value commodity rum in bulk to Europe. Once shipped, the product was then branded, bottled and distributed by major European drinks companies, who captured the value added. Throughout this period, WIRSPA argued that quotas discouraged investment in the development of locally owned Caribbean rum brands, as any increase in demand could not be met by increased supply because of the quotas imposed by the European Union (EU). The quota system was designed principally to protect domestic EU rum producers, based in the French Départements D'Outre Mer (DOM), in the European rum market.

The 1997 EU-US Agreement on Distilled Spirits ('Zero for Zero')

In November 1996, only a few months after the EU finally removed quotas on ACP rum, EU and United States (US) trade negotiators agreed to negotiate a 'Zero for Zero' Agreement on Distilled Spirits. This was proposed in the margins of the 1996 World Trade Organisation (WTO) Ministerial Conference in Singapore to facilitate the conclusion of a separate Information Technology Agreement. The ACP were not consulted on this, even though Zero for Zero would dramatically erode the value of ACP rum preferences to both the EU and US markets, under Lomé IV and the Caribbean Basin Initiative (CBI) respectively.

In early 1997, Caribbean governments protested strongly that they had not been consulted in Singapore, despite the EU's existing treaty obligations to the ACP under Lomé IV. In response, the EU and US agreed that it would be necessary for a special exception to be made in the case of rum to reflect the concerns of ACP and DOM rum producers. They therefore agreed to attach a Memorandum on Rum to the Zero for Zero Agreement allowing for special arrangements for the phasing out of tariffs.

In March 1997 the EU and US finalised the Zero for Zero Agreement. Despite the special arrangements for rum, Zero for Zero signalled. the abrupt and unexpected end of tariff preference for most ACP rums in the EU and US markets. The Memorandum on Rum set out a complex tariff elimination package that reduced the EU's and US's Most Favoured Nation (MFN) duties to zero on four of the six tariff lines for rum in annual stages by 1st January 2003. It also reduced MFN duties to low levels on the remaining two tariff lines for rum. These residual MFN duties will remain in place after 1 January, 2003, thereby preserving a small measure of preference for ACP rum exporters to the EU and US markets. The architects designed the system in such a way that this residual preference will phase out automatically over time as inflation erodes the value of the (un-indexed) price points at which the residual MFN duties are applied.

The EU Council and Commission Declaration on rum in 1997

As representations were being made to obtain a separate Memorandum on Rum, it became apparent to ACP negotiators that it would be beneficial to resolve the post-Lomé arrangements for ACP rum at that time. However, the European Commission took the position that it would not negotiate any arrangement or transitional support for an individual ACP industry outside of the post-Lomé trade negotiations. These were not due to begin until

September 1998. Instead, after sustained protests by Caribbean governments and WIRSPA, the EU General Affairs Council (GAC) approved a Declaration on 24 March, 1997. The Declaration included the following statement:

> *They [the Council and the Commission] recognise the likely impact of the EU–US agreement on the ACP exports of rum to the EU market and confirm that this will be taken fully into account in any future negotiations and arrangements related to the rum sector.*

The post-Lomé trade negotiations (1998–2000)

The ACP–EU trade negotiations for a post-Lomé Agreement began in September 1998 and concluded in February 2000. Despite the joint Council and Commission Declaration of 1997, Caribbean governments and WIRSPA had to make strenuous representations to ensure that the issue of ACP rum's early liberalisation was included in the negotiations. They argued that transitional support was needed if the industry was to survive the 2000–03 transition out of preference to free trade that the EU and US had imposed.

At the same time WIRSPA also developed a number of strategic alliances with other industry groups in Europe. Most importantly it established a dialogue with French rum producers from the DOM who had also been disadvantaged by the Zero for Zero agreement and signed with their representative association (Le Conseil Interprofessionel du Rhum Traditionnel des Départements d'Outre Mer, CIRT-DOM) a series of mutually supportive Joint Accords.

WIRSPA also began to encourage the interest of the European Parliament, particularly the Development and Budget Committees, in the ACP rum dossier. During 1999, sympathetic Members of the European Parliament (MEPs) raised the issue with the EU Presidency and the European Commission (EC) Commissioner for Development. With cross-party support, the Parliament's Budget Committee agreed to create an EU budget line to support ACP rum producers, but with no resources attached (a so-called 'budget line pm'). This signalled to the European Commission and EU member states that the Parliament was politically supportive of the rum industry's case for transitional assistance to help it cope with the effects of the Zero for Zero Agreement.

As the post-Lomé trade negotiations neared their conclusion, it became clear to the EC and EU member states that rum was an issue of principle for the ACP. The Lead ACP Ministerial Negotiator responsible for Trade, the then Jamaican Minister of Foreign Trade Anthony Hylton, and the Chief Negotiator of the Caribbean Regional Negotiating Machinery (CRNM), Sir Shridath Ramphal, continually reminded the EU through the ACP of the commitment made to the ACP by the EU Council in March 1997. As negotiations continued through the night during the penultimate ACP/EU Negotiating Council in December 1999, agreement was reached between the parties on a Joint Declaration on Rum (XXV). This was annexed to the Cotonou Agreement. Paragraph four of the Declaration identified the main elements of the programme. It states that:

- *The Community is prepared to provide sufficient funds to finance during the preparatory period, in consultation with the ACP sector concerned, an integrated sector-specific programme for the development of ACP exporters of rum, which could in particular include the following measures:*
- *Enhancing the competitiveness of existing exporters of rum;*
- *Assist in creation of rum marques or brands by ACP region or country;*
- *Enabling marketing campaigns to be designed and implemented;*
- *Assist ACP rum producers to meet environmental and waste management standards and other norms in the international markets including the Community market;*
- *Assist the ACP rum industry to move out of bulk commodity production into higher value branded rum products.*

Later that night after a review of the agreed text, WIRSPA realised that specific language was needed

on the source of the funding. Only in January 2000 when the ACP and EU met for the final time was text added that made clear that the funding for the programme would come from unallocated EDF resources:

> *This package of measures will be financed on a national and regional basis, by agreement of both parties, through specific sectoral programmes in accordance with programming rules and methods and, in the short term, through unallocated EDF resources after a decision of the Council of Ministers.*

Implementing the Cotonou Joint Declaration on rum

But that was not the end of the story. A new problem arose soon after the post-Lomé negotiations concluded. That was turning what had been agreed politically in the Joint Declaration into reality, in the form of a practical programme of transitional assistance that met the industry's needs. The pressure for early implementation increased as the looming deadline of market liberalisation on 1 January, 2003 drew nearer.

Finally, in November 2001 the EDF Committee approved a four-year package of transitional support with a grant contribution of €70m from unallocated EDF resources, in addition to a significant cost-sharing element from the industry, estimated at €78 million. A year later, in August 2002, the programme became operational. That is to say four years and five months after market liberalisation began in March 1997, or four months before market liberalisation occurred on 1 January, 2003.

Box 2: The key events between January 2000 and August 2002

Dec. 1999: Joint Declaration on Rum agreed by the EU and ACP, including an EU commitment to finance 'an integrated sector-specific programme for the development of ACP exporters of rum'.

Jan. 2000: Agreement reached to fund programme with unallocated EDF resources.

Jan.–Sept. 2000: Discussions between WIRSPA, CARIFORUM and DG Development to validate the type of programmes that were required, and to develop proposals for the EDF Committee on the measures to be financed.

Aug. 2000: DIAGNOS, an EC private-sector support instrument, undertakes a diagnostic study of the industry's needs.

Dec. 2000: DIAGNOS consultants conclude their study and report back to the Commission services. European Commission reform takes place and EuropeAid (or 'AIDCO') is established on 1 January, 2001.

Dec. 2000: A draft EDF financing proposal is produced by DIAGNOS consultants for discussion within the Commission.

Feb.–Jun. 2001: Internal discussions within the Commission and with Cariforum and WIRSPA on the financing proposal.

Sept. 2001: Financing proposal presented to the EDF Committee of EU member states by the European Commission. After negative comments the Commission withdrew the proposal.

Oct. 2001: Financing proposal re-submitted to the EDF Committee taking account of the comments of EU member states, and agreed to deal with the proposal by 'written procedure'.

Nov. 2001: EDF Committee agreed on the Financing Proposal by 'written procedure' just before November EDF meeting.

Jan. 2002: The Financing Agreement is signed by the European Commission and Cariforum in Guyana.

June 25th, 2002: The Service Contract is signed between WIRSPA and Cariforum.

August 2002: The €70 million 8th EDF rum programme becomes operational.

Endnotes

1. The West Indies Rum and Spirits Producers Association Inc. (WIRSPA) was founded in the 1960s and is an association of national associations of rum producers in the ACP Caribbean. Its aim is to promote and protect the interests of members concerned in the production, export and/or marketing of rum and other locally produced sugar-cane-based spirits. WIRSPA represents the rum industries in Antigua and Barbuda, the Bahamas, Barbados, the Dominican Republic, Guyana, Jamaica, Suriname, St. Lucia and Trinidad and Tobago.
2. From the Annex on 'Technical and Administrative Provisions for Implementation' to the Financing Agreement between the European Commission and the Member States of the Cariforum for the Integrated Development Programme for the Caribbean rum sector, January 2002.
3. Proposal for a Council Regulation on a Financial Regulation applicable to the 9th European Development Fund, COM (2002) 290 Final (OJ C 262 E/533, 29.10.2002).
4. Financial Regulation of 27 March, 2003 applicable to the 9th European Development Fund (OJ L 83, 1.4.2003). See particularly Articles 14, paragraphs 1-3 and 7, and Article 15.
5. ACP National and Regional Authorising Officers adopted the Brussels Declaration on 12 May, 2003 in which they called for an 'efficient implementation of EDF-funded projects and programmes' to address the 'slow rate of disbursement of EDF resources'. Source: ACP Secretariat Press Release, Meeting of ACP National and Regional Authorising Officers in the margins of the ACP Council of Ministers, 12 May, 2003.

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In Defence of the ACP Submission on Special and Differential Treatment in GATT Article XXIV

Bonapas Onguglo and Taisuke Ito

Rationale to the ACP submission

Negotiations between the African, Caribbean and Pacific (ACP) states and the European Union (EU) on economic partnership agreements (EPAs) pose significant challenges, and possible opportunities. The challenges are to design the contents of EPAs that would promote the opportunities agreed upon in the Cotonou Partnership Agreement (CPA), that EPAs would be instruments of development and fuller integration of ACP states into the world economy, and to strengthen their regional integration processes. Critical to this process is for ACP states to secure in concrete, explicit, operational and mandatory terms, special and differential treatment (SDT) in EPAs while ensuring their WTO-compatibility. This challenge has become important, *inter alia*, in light of the 'Stop EPAs Campaign' launched in November 2004 by some non-governmental organisations.[1] These civil society groups oppose EPAs in their current form, which includes reciprocity between ACP states and the EU. Such concerns with regional trade liberalisation are not only specific to the EU and ACP states, but to the international trading community at large, and need to be addressed in providing global legitimacy to and acceptance for regional trade agreements (RTAs) formed between developing and developed countries as instruments of both economic development and social development.

The CPA stipulates that SDT is a key principle in ACP–EU trade relations and in the international trading system generally (Article 37). It then provides that the SDT will be built into the EPAs in the form of flexibilities for ACP states in respect of: *(i) the duration of a sufficient transitional period; (ii) final product coverage, taking into account sensitive sectors; and (iii) asymmetry in terms of timetables for tariff dismantling*. Furthermore, the CPA provides that the ACP states and the EU are to 'co-operate closely and collaborate in the WTO with a view to defending the arrangements reached, in particular with regard to the degree of flexibility available'. In short, the development-oriented EPAs must contain SDT for ACP states, and both the ACP states and EU should work in the WTO to ensure that EPAs with SDT are defended (and pass the test) *vis-à-vis* compatibility with WTO rules then existing.

The need for flexibilities in EPAs is developmental in nature. SDT for ACP states under EPAs will be important to facilitate smooth and gradual transitions and adjustments of their economies towards a more open and competitive trading environment with their major trading partner, the EU. The case for SDT is very strong as many ACP states, including least-developed countries (LDCs), have small and vulnerable economies and industries. Many are commodity-dependent economies, deriving a substantial proportion of their export revenue from one or two commodities such as bananas, sugar, cotton, coffee or minerals. For example, four commodities account for over 70 per cent of the exports of Burundi, Ethiopia, Gambia, Guinea-Bissau, Malawi, Rwanda, Solomon Islands, Sudan and Uganda. For these countries, the adjustment costs that would arise from increasing liberalisation and eventually implementing full reciprocity with the EU (or other trading partners) can bring about adverse results in the form of loss of government revenue without alternatives to fill the gap; loss of

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competitiveness in already small and weak domestic industries and enterprises which, in turn, will lead to loss of industries with few alternatives to diversify into; and weak social security systems in which to cater for increasing unemployment. Instead of serving as an instrument for development of ACP states, EPAs with strict reciprocity could engender loss of local ACP industries due to competition from EU products, and even undermine their exports into the EU. Such concerns underpin the case of SDT in the CPA generally and in EPAs specifically.

Whether or not future EPAs that incorporate SDT can meet the test of WTO-compatibility depends on (i) how such SDTs are specifically defined under EPAs, and (ii) how WTO disciplines applying to RTAs treat such SDTs and most importantly, any such disciplines that may be agreed upon under the Doha Round should be in place prior to the conclusion of the EPAs. Regarding EPAs with SDTs, the actual content will depend on current ACP–EU negotiations.[2] The ACP states are currently negotiating market access conditions with the EU under the framework of reciprocal free trade agreements that would include, as a key component, SDT for ACP states. It would be important to address such SDTs in EPAs as a cross-cutting issue for all ACP regions, so as to achieve uniformity in defining the flexibilities that would be accorded to ACP states. A disaggregated, regional-based approach to SDT in EPAs should be avoided as it would result in differentiated SDTs to different regions and may weaken the SDT. The EU is committed under the CPA to provide SDTs to ACP states so there is no question about EPAs with SDT – the issue is to what extent and in what form would the SDT exist.

Regarding WTO rules on RTAs, the ACP states have taken the position that the current terms and conditions in the WTO under which RTAs (involving developed and developing countries) exist and operate should be reformed to provide developing countries with SDTs. Such WTO rules pertain primarily to GATT 1994 Article XXIV and the Uruguay Round Understanding on this article.[3] The Doha negotiations afford an avenue for the ACP states to negotiate such improvements in WTO law, as it specifically stipulates in paragraph 29 of the Doha Ministerial Declaration[4] that WTO members would negotiate to clarify and improve disciplines and procedures under existing WTO provisions applying to RTAs, and that 'the negotiations will take into account the developmental aspects of regional trade agreements'. The rules negotiations would affect the way GATT 1994 Article XXIV terms and conditions are interpreted and applied, and hence the future determination of whether or not SDTs provided under EPAs are consistent with existing GATT Article XXIV criteria. Importantly for EPAs, the negotiations should not be concluded until the reformation of GATT Article XXIV has been achieved in terms of incorporating SDTs for developing countries. This point was made in the 'AU's Ministerial Declaration on EPA Negotiations' adopted by African Union (AU) Trade Ministers in June 2005, to the effect that 'Conclusions of the market access aspects of the EPAs should take place upon completion of the amendment' (the amendment referring to the amendment of GATT Article XXIV to reflect special and differential treatment).[5]

Key aspects of the ACP submission

The ACP states submitted to the WTO on 28 April, 2004 a proposal on 'Developmental aspects of regional trade agreements and special and differential treatment in WTO rules: GATT 1994 Article XXIV and the Enabling Clause'.[6] The proposal aims to formally and explicitly incorporate SDTs in the application of terms and conditions set out in paragraphs 5–8 of GATT 1994 Article XXIV when these are applied to RTAs formed between developed and developing countries or North–South RTAs, as will be the case of future EPAs. It specifically responds to the aspect of the Doha Work Programme (DWP) in paragraph 29 that provides that the developmental aspects of RTAs will be taken into account in the negotiations to clarify and improve existing disciplines affecting RTAs.

The key objective in the ACP submission is to introduce SDT into GATT Article XXIV and, in doing so, secure legal security of future EPAs with SDTs from legal challenges as to their compatibility with WTO disciplines. Such security will enable EPAs to have a strong component of SDTs, which will enable ACP states to adjust their economies at

a pace and level consistent with their resources and ability to develop the competitiveness necessary to trade with the EU on a reciprocal basis in a distant future. There are four key aspects of the ACP submission as follows:

- Article XXIV:8(a)(i) and (b) on 'substantially all the trade' (SAT) in respect of duties and other restrictive regulations of commerce;
- Article XXIV:5(c) and paragraph 3 of the 1994 Uruguay Round Understanding on this article on the 'reasonable period of time' in respect of the transition period for RTAs;
- Article XXIV:7 and paragraphs 7–10 of the 1994 Uruguay Round Understanding on notification, reporting and review of RTAs in the Committee on Regional Trade Agreements (CRTA); and
- Paragraph 12 of the 1994 Uruguay Round Understanding on dispute settlement.

The core pillar of the ACP submission is to introduce **SDT into the SAT requirement in respect of duties.** It proposes that appropriate flexibility shall be provided to developing countries in meeting the 'substantially all the trade' requirement in respect of trade and product coverage. This can be provided through the application of a favourable methodology and/or lower (i.e. differentiated) threshold levels in the measurement of trade and product coverage of developing countries' parties to a North–South RTA in meeting the SAT requirement.

The ACP also proposes an **SDT element on the SAT requirement in respect of 'other restrictive regulations of commerce'** (ORRCs). The proposal aims, *inter alia*, to apply a flexible interpretation that allows developing countries' members of a North–South RTA to apply contingency protection measures including safeguards and non-tariff measures on intra-regional trade. While contributing to the clarification of WTO rules, this is aimed at preserving the right to apply trade defence measures in future EPAs, if needed. The interpretation of ORRCs has been a major systemic issue, as depending on its interpretation an RTA member may or may not be allowed to impose such trade remedy measures to other RTA partners.

The ACP proposal on **SDT in respect of the transition period** for RTAs is another core element, buttressed by the need for a secure and sufficient period that would facilitate smother integration and adjustment of ACP economies under EPAs. It is comprised of two aspects. First, the ACP submission seeks to clarify that the full provisions of an RTA (primarily the reciprocal free trade agreement – FTA) would become fully operational at the end of the transitional period – in other words, ACP states would not be required to liberalise fully or substantially at the start of the formation of an EPA, but towards its end date. Specifically, the substantive and procedural requirements of GATT 1994 Article XXIV:5–8 becomes applicable only after the transition period expires. Currently, there is no agreement among WTO members as to when exactly the substantive disciplines of GATT 1994 Article XXIV start to apply to an RTA – at the beginning or at the end of the transition period. Second, the ACP proposal seeks to ease the conditions under which a transition period of longer than 10 years can be authorised and thus broadening the scope of the 'exceptional circumstances' under which such extensions can be granted. It seeks to link the transition period to the trade, development and financial conditions of developing countries, so that the ACP states' need for longer transition period under EPAs, which ACP states argue should not in any case be less than 18 years, can be legally sanctioned under GATT Article XXIV. The Commission for Africa Report says that a transitional period of over 20 years if necessary should be provided.

Another aspect of the ACP submission concerns the incorporation of **SDT into the procedural requirements** for RTAs in terms of notification, reporting and review by the CRTA. It has two aspects. First, there is an exhortation to WTO members to give due consideration to 'developmental aspects' when reviewing North–South RTAs and establishing their conformity. The injunction is that the developmental aspects of a North–South RTA, which would focus mainly if not solely on developing country members, should receive primacy in the procedural aspects of notification and review of RTAs. Second, the ACP submission calls for more streamlined, efficient and less onerous transparency

and examination procedures for North–South RTAs. This is a call for a simpler examination process in the CRTA, unlike the normally long and rigorous examination of RTAs that has come to characterise the examination of RTAs by the CRTA in the post-WTO period (even if such examination has so far not led to a concrete decision on the conformity or not of an RTA). An easier examination process is being requested owing to the limited administrative, human and financial capacities of many developing countries.[7]

The ACP submission relating to **dispute settlement** aims to guarantee the legal security of North–South RTAs from possible legal challenges. It proposes that the jurisdiction of the CRTA to determine the WTO-compatibility of RTAs is not unduly overridden by dispute settlement procedures and ruling. The proposal seeks to ensure that the CRTA holds precedence over the dispute settlement body on matters relating to the WTO compatibility of RTAs.

The arguments put forward by the ACP submission, primarily on less than full reciprocity and longer transitional period, have received support from the Report of the Commission for Africa on 'Our Common Interest'.[8] The Report recommends that in the context of making special and differential treatment work better for Africa and other developing countries, a review of Article XXIV of the GATT may be useful (paragraph 77) in order to prioritise development and better meet the needs of developing countries by: allowing developing countries flexibility to protect sectors as necessary (paragraph 111); reassessing and reducing reciprocal requirements in free trade agreements (paragraph 113); reducing reciprocal demands to a minimum, and over appropriate timeframes, up to 20 years or more if necessary (page 289). In March 2005, the United Kingdom's Department for International Development (DFID) and Department for Trade and Industry (DTI) issued a joint policy statement on EPAs in which it among other things expressed that 'EPAs must be designed to deliver long-term development, economic growth and poverty reduction in ACP countries' and to this end a number of policy recommendations were made including that:

- 'EPAs must ensure that ACP regional groups have maximum flexibility over their own market opening. The EU should therefore offer all ACP regional groups a period of 20 years or more for market opening, on an unconditional basis. Each regional group should be offered this full period.'
- 'In addition, the EU should propose within the WTO that Article XXIV of the General Agreement on Tariffs and Trade should be reviewed as suggested by the Commission for Africa, in order to reduce the requirements for reciprocity and increase the focus on development priorities.'[9]

The ACP submission received further support in the various preparatory meetings of developing countries for the July 2005 'approximation' of the Doha Round and for the 6th WTO Ministerial Conference in Hong Kong, China (13–18 December 2005). This implies that a suitable solution and response to the ACP submission must be an important part of any development package that will emanate from the Doha Round. For example, the issue was discussed by the African Union Conference of Ministers of Trade 3rd Ordinary Session (5–9 June 2005, in Cairo, Egypt) and highlighted in the common political and negotiating platforms adopted by that meeting in the form of 'The Cairo Declaration and Road Map on the Doha Work Program' and the 'AU's Ministerial Declaration on EPA Negotiations'.[10] In the Cairo Declaration and Road Map, African Trade Ministers advocated the following on WTO negotiations on rules for RTAs:

- 'The development aspects are taken fully into account in the negotiations aimed at clarifying and improving disciplines and procedures relating to regional trade agreements.
- Clarification and improvement of disciplines and procedures relating to regional trade agreements as mandated under Paragraph 29 of the Doha Ministerial Declaration should not reopen the Enabling Clause under transparency or systemic issues in RTA negotiations as this would not meet Africa's developmental needs.
- Negotiations on systemic issues must address the principle of less than full reciprocity, asymmetry

in market access and the development concerns of African countries entering into regional trade agreements with developed countries under GATT 1994 Article XXIV and GATS Article V.'

In the Declaration on EPA negotiations, the AU Trade Ministers adopted the following stance:

> *'We reiterate that Article XXIV of GATT needs to be appropriately amended to allow for necessary special and differential treatment, less than full reciprocity principle, and explicit flexibilities that are consistent with the asymmetry required to make EPAs pro-development. Conclusions of the market access aspects of the EPAs should take place upon completion of the amendment.'*

The 4th meeting of Trade Ministers of LDCs in June 2005, adopted a common platform for the Doha Round in the light of the 6th WTO Ministerial Conference[11] that included the following two negotiation priorities supportive of the ACP submission:

- 'Providing LDCs adequate policy space to engage in regional trade arrangements in the pursuit of their development goals and objectives;
- The need for the negotiations on systemic issues to address the principle of less than full reciprocity, asymmetry in market access and the development concerns of LDCs entering into regional arrangements with developed countries under the GATT 1994 Article XXIV and GATS Article V'.

Reactions by the WTO membership to the ACP submission

The WTO Negotiating Group on Rules has considered the ACP submission and some WTO members have raised a number of questions and comments. Also, a written submission to the ACP states has been made by Japan.[12] These comments are useful in enabling the ACP states to better understand the concerns of WTO members regarding the ACP submission and to respond to them, as expected by the WTO membership. Many of the comments seek to dismiss the case for SDTs in GATT 1994 Article XXIV, while others raise technical questions on the substantive and procedural aspects of the ACP submission. The ACP states need to respond to these queries in order to maintain the case for explicit SDT in GATT Article XXIV, even if it means revising the original submission to reflect some of these comments.

The comments made by WTO members can be categorised in six typologies, namely that (1) It is wrong to assume GATT Article XXIV is bad for development; (2) GATT Article XXIV is already flexible; (3) SDT should be discussed later; (4) Is this a covert way to cover unilateral preferences under GATT Article XXIV?; (5) What disciplines would apply during transition period?; and (6) It is not acceptable to weaken dispute settlement. These comments are reflected in the reports of the minutes of the meetings of the Negotiating Group on Rules.[13] Each of these comments and possible responses to them are examined below.

(1) 'It is wrong to assume GATT Article XXIV is bad for development'

Comment: Comments of this nature question the underlying assumption and philosophy of the ACP submission. They assert that it is erroneous for the ACP states to assume that compliance with GATT Article XXIV hinders development – that such compliance is inherently anti-development. They argue that in fact strict adherence to the GATT Article XXIV conditions is more appropriate for the purpose of development. Such comments therefore dismiss the value of SDTs for developing countries by asserting that strict adherence to the GATT Article XXIV conditions is more appropriate for the purpose of development of RTA members, including developing countries. A common element in these comments is the view that 'flexibilities' to be provided for developing countries under North–South RTAs cannot necessarily be considered as 'development friendly'. It is thus necessary to reach a common understanding as to what is meant by 'development friendly' RTAs.

Response: Typology (1) comments are based on the simplistic assumption that reciprocal trade liberalisation would automatically lead to trade and economic growth, with the attendant development and welfare gains for all parties. This assumption does not give sufficient consideration to the specific

developmental situation of low-income developing countries, particularly LDCs.

The ACP submission does not assume that compliance with GATT Article XXIV is anti-development. It points out the eventuality that strict compliance, such as full reciprocity, can cause significant adverse socio-economic impacts on developing countries, especially for those whose imports are highly concentrated on their main trading partners, who heavily rely on tariffs for government revenue and whose domestic economy is competitively weak, undiversified and vulnerable. ACP–EU negotiations of EPAs are unique in the sense of the sheer difference in the level of development between the two parties engaged in the negotiations – few developing countries have ever (yet) concluded such extensive RTAs with developed countries. This principle is already reflected in current practice. SDT and flexibilities have been considered and agreed to be necessary for developmental purposes in existing RTAs. They include certain product and sector exclusions, or transition periods, or exemptions of LDCs. These practices testify to the need for any RTAs to incorporate certain flexibilities for policy, economic and political considerations for the benefit of members who are economically weaker *vis-à-vis* others. The ACP proposal stresses that the need for such flexibility is far greater in the case of (low-income) developing countries when operating an RTA with advanced developed country partners, as would be the case of future EPAs. It is thus not relevant for the purpose of WTO rules negotiations to consider empirically whether or not the flexibilities *per se* actually lead to economic development.

Moreover, North–South RTAs are a recent phenomenon that was unknown in during the GATT 1947 era. Thus they were not envisaged in existing GATT rules and disciplines. The advent of North–South RTAs between countries with highly asymmetric levels of development presents a major systemic challenge to the multilateral trading system in finding a solution that serves the general trade and development interests of all the membership. The ACP submission responds to this challenge in the Doha negotiations wherein WTO members agreed 'to place the needs and interests of developing countries at the centre of the work programme'.

(2) 'GATT Article XXIV is already flexible'

Comment: Comments of this type question the rationale of the ACP submission by purporting that existing WTO rules contain the necessary flexibility for RTAs. They argue that GATT Article XXIV in itself is already an exception to the most-favoured-nation (MFN) principle; existing WTO rules already provide flexibility for RTAs; and that flexibilities provided for in the Enabling Clause for South–South agreements represented one good reason for the lack of SDTs in GATT Article XXIV. They also question how the codification of existing practices on flexibilities would actually serve the general interests of the WTO.

Response: Typology (2) comments actually endorse the merit of the ACP submission and are already addressed in the submission. The ACP submission recognises that there is 'some' *de facto* flexibility under GATT Article XXIV which is available to **all** countries, developed and developing, without distinction. Such 'existing flexibility' lies in the ambiguity in the terminology used in the terms of the conditions of GATT Article XXIV and in the permissive practice over the years regarding the testing of compatibility of RTAs. However, the *de facto* flexibility is neither secure in nature nor sufficient in scope and legal validity to provide the SDT required by developing countries in North–South RTAs. The Appellate Body report on *Turkey–Textile* showed that WTO Members should not indefinitely rely on the existing flexibility in WTO rules on RTAs arising from ambiguity of languages and permissive practices.[14] Moreover, in a rules-based trading system with an enforceable dispute settlement system, *de jure*, rather than *de facto*, SDTs is important for legal security. Thus, 'additional flexibility' needs to be formally and explicitly defined and its scope extended to only developing countries as SDTs. It can be noted that GATS Article V recognises SDTs for developing countries in North–South economic integration agreements. Hence there is no *a priori* reason why SDTs should not be incorporated in GATT Article XXIV. Furthermore, SDT is an integral aspect of WTO as recognised in WTO Agreements and successive Ministerial declarations including the Doha Ministerial Declaration and thus should

be mainstreamed into WTO Agreements, including any new generation clause on GATT Article XXIV.

Regarding GATT Article XXIV as an exception clause, the question at issue in the ACP submission (and in the Negotiating Group on Rules discussion in general) is not whether WTO members can deviate from the MFN principle enshrined in GATT Article I.1 for the purpose of RTAs. Rather, it relates to what conditions (requirements) members have to meet when deviating from GATT Article I.1 (and possibly other GATT Articles) for the purpose of RTAs and, for ACP states, what form of SDT is available to developing countries.

The comment that SDT is absent from GATT Article XXIV because it is already available in the Enabling Clause is actually precisely the reason why the ACP states are requesting SDT for GATT Article XXIV. The Enabling Clause only covers South–South RTAs and cannot be applied to North–South RTAs, such as future EPAs, covered by GATT Article XXIV, which lacks explicit and legally binding SDT. As a consequence, no SDT is applicable to North–South RTAs for developing countries in the application of WTO rules. The argument that SDT should not be applied to North–South RTAs stands in contrast with GATS Article V which provides explicit SDTs for developing countries forming economic integration agreements with developed-country trading partners. This therefore is an important legal lacuna or imbalance in the architecture of the WTO in relation to RTAs that stands at odds with the particularly acute need for SDTs in North–South RTAs. The lacuna thus needs to be addressed to install balance in the WTO legal architecture and meet the Doha negotiations mandate on rule's negotiations relating to RTAs. The ACP submission thus goes beyond a simple codification of existing flexibilities and redefines the scope of flexibility for developing countries as SDT.

(3) 'SDT should be discussed later'

Comment: Comments of this form recognise the need for discussing the development aspects of RTAs as mandated by Doha Declaration, but stress that negotiations should first focus on clarifying and improving the substantive core disciplines. Some of these comments explicitly recognise that negotiations may be engaged on SDT and additional flexibilities for developing countries once systemic issues are clarified. Countries making such comments seem prepared to discuss the ACP submission on SDT in GATT 1994 Article XXIV, but only after resolving outstanding systemic and other issues. They also assert, however, that while the developmental aspects of RTAs should be taken into account, SDT should not become the overriding rule with respect to RTAs. Any flexibility provided will have to be well defined and targeted so as not to undermine the rules-based multilateral trading system. They also point out that the negotiations should result in a better functioning of the CRTA and strengthened role for the WTO *vis-à-vis* RTAs.

Response: Typology (3) comments propose to delay consideration of SDT until systemic issues are resolved and seem symptomatic of the general debate on SDT in the Doha negotiations of giving it low priority. Moreover, it is contestable as to whether the lack of SDT in GATT 1994 Article XXIV is not a systemic issue, as implicitly expressed in the suggestions to take up SDT after systemic issues have been resolved. In fact, the general question of desirability of SDT in GATT Article XXIV can only be considered as a major systemic issue in the context of rules negotiations. This is evident if one considers the apparent inconsistency and imbalance in the legal structure between GATT Article XXIV and GATS Article V. Thus, the notion of SDT cannot be dismissed off-hand. It deserves to be addressed in parallel with all systemic issues concerning RTAs. In relation to the EPAs, it is important that such systemic issues are resolved positively in integrating SDT into GATT Article XXIV and concluded prior to conclusion of the EPAs so that the future EPAs can be based on the new generation disciplines that contain SDT.

(4) 'Is this a covert way to cover unilateral preferences under GATT Article XXIV?'

Comment: Questions and comments of this kind raise concerns over the systemic implications of the ACP submission. They assert that the ACP proposal would provide for the consolidation, within

the WTO system, of existing unilateral preferences such as Lomé/Cotonou preferences. It is assumed that if flexibilities are authorised for developing countries under reciprocal North–South RTAs, there would be no distinction between reciprocal and unilateral preferences. Thus, these ask whether the adoption of the ACP submission would encourage developed countries to develop preferential arrangements with some (minimum) level of reciprocal benefits so as to avoid the WTO waiver process needed in the case of non-generalised, non-reciprocal preferential arrangements. Questions are also raised as to what would be the defining difference between those arrangements that now require a waiver and those that could be considered to be free trade agreements.

Response: Typology (4) comments and questions raise very important issues *vis-à-vis* the ACP submission. The response to them could point out that the ACP submission addresses North–South reciprocal RTAs and not unilateral preferences. The ACP submission is about instituting credible and reasonable levels of additional flexibility in respect of the SAT requirement and other GATT Article XXIV conditions. It does not seek to create legal cover for non-generalised, unilateral preferences of the type under the current Cotonou Partnership Agreement carried over from the Lomé Convention. It seeks to make available an appropriate degree of flexibility for developing countries that are greater than those (implicitly) available to developed countries under GATT Article XXIV. These flexibilities, however, may be less extensive than those available under unilateral preferences, although the exact scope of such flexibilities is of course subject to negotiations under the Doha Round. In view of the fact that GATS Article V already provides, without specific definition, flexibilities (SDT) for developing countries in forming North–South economic integration agreements, and that a number of existing RTAs provide more favourable treatment for developing country members (which are claimed to be within the scope of existing flexibilities entitled under GATT Article XXIV), it is too simplistic to assume that RTAs with SDT for developing countries would amount to non-reciprocal preferential schemes.

(5) 'What disciplines would apply during the transition period?'

Comment: Comments of this style relate to the core substantive aspects of the ACP submission. It is notable that only a few such comments are made, and the most significant relate to the transitional period for an interim arrangement leading to an FTA or customs union. Some such comments criticised the ACP proposal in seeking that no obligations would apply during the transitional period, including in relation to notification and transparency requirements.

Response: It can be noted that these comments seem to miss the underlying and more important systemic issues of what disciplines are indeed applicable during the transition period. Existing practices of some RTAs often provide longer transition periods than what the rules currently provide for, namely a 10-year transition period that can be exceeded only in exceptional circumstances. As noted earlier, the Commission for Africa Report says that a transitional period of over 20 years if necessary should be provided for African countries in EPAs. If this recommendation is to be taken on board, then it would have to be explicitly allowed under GATT Article XXIV. The point is that in North–South RTAs, there should be no limitation imposed by WTO as to the length of time for a transitional period for developing countries in case a longer than the 10-year period is required.

The applicability or otherwise of transparency requirements during the transitional period may be further studied. It may be conceded that existing transparency obligations applicable to 'interim agreements' may continue to apply during that period.

The more important point is that for an RTA with a transitional period, it is quite normal that the full SAT requirements may be achieved only at the end of the transition period when substantially all the trade is liberalised among parties. This makes sense, as this is why those agreements are called under GATT XXIV 'interim agreements' and not free trade areas or customs unions. The ACP submission seeks to codify such practices (and presumably the current interpretation of the 'interim agreements') by clarifying explicitly that SAT requirements

should be achieved at the end of the transition period, especially for developing countries. This would serve to ensure that not meeting SAT requirement during the transition period cannot be used as the basis of legal challenges of say EPAs in which the ACP states would end-load the liberalisation of trade *vis-à-vis* the EU. In this respect, it can be clarified that the reference to '18 years' in the ACP proposal as the reasonable length of a transitional period is only indicative.

(6) 'Is there a need for SDT on procedural obligations'

Comment: Comments of this type query the adequacy of instituting SDT for the transparency (notification) and examination requirements. It is argued that it is in the interest of all WTO members to identify 'more streamlined and efficient examination procedures' of RTAs, as underlined by the Doha mandate based on past experience. Also, as regards North–South RTAs, developed countries may take charge of the examination processes. Hence, there is no need for SDT in the examination process. Further comments seek clarification on specifying what constitutes 'developmental aspects' of RTAs that would need to be taken into account during the examination process as advanced in the ACP submission.

Response: Type (6) comments require further in-depth consideration regarding the procedural aspects of the ACP submission, in particular the pure transparency obligations relating to notification. The 'development aspects' referred to by the ACP states that should be carefully considered may include, *inter alia*, the effect of tariff dismantling on the domestic economy, industrialisation, competitiveness, government revenue, poverty reduction, rural development, food security and livelihood. It would also include the limited institutional and administrative capacity of developing countries. The ACP case for taking into account 'developmental aspects' is important in that even in the absence of substantive SDT in respect of SAT and other requirements, the end result in terms of WTO compatibility of a given North–South RTA would be similar to the case wherein substantive SDT had existed. Where SDT is substantively provided for, then the procedural injunction to take on board 'developmental aspects' provides additional security that SDT considerations would play an important role in assessing the compatibility of a North–South RTA.

(7) 'It is not acceptable to weaken dispute settlement'

Comment: Comments of this variety show that the ACP submission relating to the non-applicability of dispute settlement proves to be very controversial. Although there was a need to clarify the legal status of the examinations carried out by the CRTA and any possible further ruling by the dispute settlement mechanism if instituted, the point was made that recourse to dispute settlement should always be possible, irrespective of discussions and assessments made in CRTA, and that this right should not be overridden.

Response: More study is required as to the specific ways to clarify the relationship between CRTA and the dispute settlement body due to its complexity and systemic implications. It will be difficult, if not improbable, for ACP states to obtain endorsement from the WTO membership to modify WTO members' rights of recourse to dispute settlement procedures on 'any matters arising from the application of those provisions of GATT Article XXIV'.

The latest submissions by Australia and the EC

A: Australia's proposal vis-à-vis the ACP proposal

Australia made a submission dated 3 March, 2005 (TN/RL/W/173/Rev.1), and further clarified in its submission of 12 May, 2005 (TN/RL/W/180). In the latter submission, Australia proposes specific interpretation and benchmarks for the key SAT and transitional period requirements of GATT Article XXIV. It appears that Australia had the ACP submission in mind when developing proposals on these systemic issues. It expresses willingness to discuss SDT, which is a positive recognition of the ACP submission. It however contains some substan-

tive elements that are contrary to the ACP submission. For example, on the SAT and the phase-in requirements, Australia proposes the liberalisation of at least 70 per cent of products in the first year of the transition period – this can be seen as a counter proposal to the relevant ACP submission which favours flexibilities in the staging of liberalisation, including the back-loading, by developing countries.

In general, Australia's submission is very ambitious in rendering more stringent the requirements of GATT Article XXIV while putting forward a particular interpretation of 'interim arrangements'. This undermines the ACP submission for greater flexibility for developing countries. The substantive aspects of the submission are as follows:

1. To measure SAT by a rigorous benchmark of elimination of duties and ORRCs – most notably tariff rate quotas (TRQs) – on at least: (1) 70% of all tariff lines at HS (Harmonised System) six-digit level **on entry into force** of an agreement; and (2) 95% of all tariff lines at HS six-digit levels **precisely** 10 years following the enactment of the agreement.

2. To further interpret SAT as requiring no exclusion of any 'highly traded' products to be applied on entry into force of any agreement. This 'highly traded' product test should be interpreted as 'where the value of a Member's imports in any single HS six-digit line as a proportion of their total imports from the RTA partner exceeds 0.2%'.[15] Alternatively, there could be a requirement, for example, that the top 50 imports of each RTA party at the HS six-digit level that are traded between the RTA partners must be included in the trade liberalisation process.

3. Discuss how to take into account those products that would have been traded if there were no trade barriers (protection) between RTA partners. Australia proposes a methodology for this by verifying that the 'significant exports' of each party is subjected to liberalisation by the other parties even if historically they are not markets for those products. The criteria of 'significant exports' is defined as products that represent at least 2% of a party's total exports in value at six-digit HS level (on the base period of the 3 years prior to the entry into force of the RTA).[16]

4. Provide formal disciplines for the phase-in period of 10 years for those FTAs and customs unions that are not notified explicitly as 'interim agreements', so that the SAT requirement of 95% tariff line liberalisation should be met precisely at the end of 10 years. Australia submits that a transition period longer than 10 years in meeting the SAT requirement should be strictly limited to those RTAs notified explicitly as 'interim agreements'.

5. The new rules should apply to all existing RTAs that are in force (operational). Older agreements not in force at the time would be exempted from the new rules.

The proposal on SAT ((i) above) is key. Australia favours a tariff-line-based approach, as opposed to trade-volume-based approach, in the measurement of the SAT requirement, and calls for a relatively high benchmark of 95% coverage at the end of the 10-year transition period, and starting at the entry into force of the agreement with a 70% benchmark. The tariff-line approach aims to ensure comprehensive coverage of all major sectors and pre-empt the exclusion of some sectors in which little trade takes place (like agriculture where little trade may be taking place because of exclusion from an RTA and the existence of prohibitively high barriers).

Australia explicitly refers to the elimination of TRQs, in addition to duties, to meet the SAT criteria although a number of existing RTAs have maintained TRQs, particularly in agricultural products. Thus, the implication is that even though in-quota rates are reduced to zero between RTA partners, this tariff line would not be counted for the purpose of SAT requirement. This may require substantial liberalisation in the agricultural sector.

Equally important is the proposal that calls for 70% liberalisation of all tariff line at the entry into force of RTAs. This seems to be made to counter the ACP submission that no obligation should apply during the transitional period. Australia proposes to put a limit on what RTAs can do in staging the liberalisation commitments. This poses substantial

constraints to future EPA negotiations and ACP interests, and would be contrary to the ACP submission on transition period.

Australia aims to increase the rigour of the substantive requirement for SAT via the proposal to combine the tariff-based approach with a volume-based approach. It is indeed this combination of the two approaches that renders the Australian proposal particularly ambitious. This is done by requiring the coverage of major products where there is substantial trade taking place between RTA partners, i.e. highly traded products ((ii) above). Australia proposes a 0.2% share of intra-RTA trade for the interpretation/definition of 'highly traded' products. The requirement would effectively preclude the flexibility to exclude 5% tariff lines from internal liberalisation. This may mean for those countries whose imports are relatively concentrated in a few tariff lines a liberalisation of close to 100% of intra-RTA imports in terms of trade volume. There is, however, no legal basis for the notion of 'highly traded products'. This terminology is not found in GATT Article XXIV or elsewhere – it is thus not a legal requirement. This means that the appropriateness of such a concept itself has to be a matter of negotiations.

Furthermore, Australia's proposal on the potential trade between RTA parties, namely 'significant exports' ((iii) above), appears to limit significantly the scope of flexibility available under the SAT requirement. Together with the notion of 'highly traded products', the proposal would bring about greater rigor to the assessment of the SAT requirement, as both notions require inclusion of currently and potentially traded products in the coverage of RTAs. Since 'significant exports' could reasonably be expected to be those products which RTA partners would find sensitive, the proposal would limit WTO member's discretion in the design of product coverage, hence less flexibility. Thus, it would surely render the SAT requirement more stringent if applied to developing countries as well, and thus would not serve the ACP's interests.

As regards the transition period 'phase-in commitments' ((iv) above), Australia raises the issue of the lack of legal basis for WTO members' practice of providing a transition period for tariff phase-in commitment (often longer than 10 years) under those RTAs not notified as 'interim agreements', as GATT Article XXIV:5(c) authorises a transition period of 10 years only for those RTAs notified explicitly as 'interim agreements'. Australia proposes to fill this gap by endorsing and formalising the existing practice, but with the limitation that no transition period should exceed 10 years without exception, unless the agreements are notified as 'interim agreements'. This proposal is closely linked to the timing for meeting the SAT requirement however defined. FTAs and customs unions have to meet the SAT requirement in 10 year's time at the latest, while interim agreements could do so over a longer time frame.

The proposal has substantial systemic implications, particularly for flexibility that was originally intended for 'interim agreements'. Firstly, the question arises as to how to operationally define 'interim agreements' in the case of North–South RTAs. It has to be clarified whether the RTA should be notified as 'interim agreement' even in cases where only developing country parties require a longer than 10-year period for meeting SAT. Secondly, the proposal appears to require, by logical extension, extending the phase-in time period applicable for 'interim agreements' (i.e., 10 years). The proposed provision of 10 years for FTAs and customs unions would render meaningless the provision of the same time period for the 'interim agreements' (or period longer than 10 years only in 'exceptional circumstances') under GATT Article XXIV:5(c) because 'interim agreements' are by definition those agreements requiring more than 10 years in meeting SAT requirement.

Australia's proposal on the application of clarified rules ((v) above) is targeted at some previous proposals that call for the grandfathering of existing RTAs from new RTAs rules that may emerge as a result of Doha negotiations.[17] This proposal needs to be modified to say that such a proposal would be applicable to all GATT Article XXIV agreements (i.e. those involving developed countries and countries with economies in transition) and not the Enabling Clause agreements involving South–South RTAs.

The Australian submission indicates a willingness to discuss SDT elements. This is a positive consider-

ation that appears to be a direct response to the ACP proposal. At present, however, the Australian submission does not have any SDT elements. It therefore does not respond to the Doha Declaration paragraph 29 provision that the negotiations will take into account the developmental aspects of regional trade agreements. All the elements proposed by Australia should be examined under the systemic issue debate, and the ACP should ensure that whatever criteria, benchmark and rules are agreed upon, SDT should be the integral part of negotiations.

On a preliminary basis, it may be concluded that the Australian submission would lead to substantially stronger disciplines and thus less flexibility for developing countries in RTAs. The proposed reform on disciplines applicable to transitional periods would require careful assessment given its systemic implications. ACP states need to study what kind of approach to the SAT requirement (tariff line versus trade volume) and to what level (95, 80, or 70%?) is most suited to their collective interests. It is extremely important to ascertain whether the proposed method for SAT calculation in itself serves ACP interest – if the basic methodology is prejudicial to ACP, then future application of SDT may do little to compensate the initial harm that is already imbedded in the approach. Hence, the importance of a debate about systemic issues, and possible proposals by the ACP states.

B: The EC's latest submission *vis-à-vis* the ACP submission

The EC's submission of 12 May, 2005 (TN/RL/W/179) has five sections with proposals on systemic issues (Section 1), SAT (Section 2), transition period (Section 3), neutrality (Section 4) and developmental aspects (Section 5). These have to be carefully considered although generally the recognition of developmental aspects in the EC submission is supportive of the ACP submission, in some aspects.

Regarding **systemic issues** (Section 1) the EC argues that it is in the legitimate interest of all WTO members to clarify existing WTO rules on RTAs and that the development dimension needs full treatment (which is consonant with the ACP submission). Three principles are advocated by the EC to underpin the overall approach to rules negotiations on RTAs namely (a) **shared systemic interest** arising from the need to minimise the negative effects of proliferating RTAs on third parties, i.e., non-members; (b) **reasonableness** in making progress on clarifying the rules; and (c) **development dimension** relating to the developmental impact of RTAs.

Two of these principles, namely shared systemic interest and the development dimension, have also been advocated by ACP states but not for essentially the same reasoning as the EC. Regarding systemic concern, the EU underlines the need for clear and authoritative guidance from the rules, like the ACP as well, and the need to discipline the proliferation of RTAs in recent years. The ACP states pointed out that GATT Article XXIV as currently constructed is an anachronism of the 1940s era and needs updating to reflect the realities of the twenty-first century, including the rise to prominence of North–South RTAs.

The point on development is important and corollary to the systemic point – the recognition that development issues need to be treated, not as an afterthought but as integral to the negotiations on rules on RTAs and consistent with the focus, in the Doha negotiations, on the needs and interests of developing countries. However, while the EC recognises the need to give priority to development in clarifying and improving the rules, it also submits that such negotiations should also recognise that the potential impact of RTAs on third parties' trade and to the WTO at large may be different depending on their 'share of world trade and the level of development'. This may well serve the ACP's interest in that most of them, even if combined together in a regional grouping, would account for a small share of world trade. Many of them are LDCs, small islands, and landlocked states, which inhibits their development prospects. But the EC argument may imply 'differentiation' between developing country groupings and thus raising a larger systemic issue. This is not a concern of the ACP states – their simple concern is with North–South agreements under GATT Article XXIV, and not about South–South agreements under the Enabling Clause.

The principle of reasonableness needs to be clarified. The EC argues that for the clarification of

WTO rules for RTAs, there should be no *a priori* exclusion of certain subsets of RTAs. This needs clarity as to its meaning – does it mean that there should be no subsets among GATT Article XXIV agreements, and if so then this is a valid point. But if it means that developing country RTAs that would have normally been notified under the Enabling Clause should really be notified under GATT Article XXIV as they involve some with large developing countries, then this is a point that has not been raised by ACP states. It may have the effect of discriminating among developing country RTAs. This argument is somewhat related to the aspect of development dimension principle advanced by the EC relating to differences in addressing RTAs that may have a significant impact (as explained above).

With regard to **'substantially all the trade'** (Section 2), the EC provides some interesting ideas. A clear definition of SAT would be in the interest of ACP states, as it will be on the basis of such a clear definition and benchmarks that the specific provisions on SDT and explicit flexibility aspects can be elaborated for developing countries. Thus any proposal in this regard is worth careful consideration. The thrust of the EC submission in respect of the SAT requirement in tariffs is threefold:

1. **The SAT should be based on the coverage of trade, and not tariff lines as proposed by Australia.** This reflects the EC's preference to use the trade-volume- based approach, which allows for greater flexibility in excluding some sectors (like agriculture) from liberalisation. However, the EC indicates its readiness to consider a compromise option based on supplementing the coverage of trade with an assessment of trade coverage measured by number of tariff lines. An example, suggested by the EC, is a combined average threshold for trade and tariff lines. Such an approach needs to be clarified on how it would apply in practice. Whatever approach is adopted, the ACP would have to seek a favourable methodology (as proposed in the ACP submission) allowing appropriate and explicit flexibility, as with SDT.
2. The quantitative threshold level should be subject to negotiations pending agreement on the methodology to be adopted (trade-volume-based versus tariff-line-based approaches). Thus, again, the EC position is more nuanced than the Australian proposal, which explicitly call for a 95% coverage of HS 6-digit tariff lines. The EC calls for 'a reasonable balance' between the shared systemic interest (for effective disciplines) and members' interpretation to date (EC's interpretation has been on trade-volume coverage, not tariff-lines approach). The EC seems to accept the ACP call for a differentiated threshold level. It should be noted however that the ACP submission goes beyond different threshold levels and seeks the application of a favourable methodology in calculating SAT for developing countries.
3. Whatever criteria is applied for the SAT requirement in negotiations, it should form only ONE guiding element among many for determining the likely WTO-compatibility of an RTA, and not THE determining criterion. And any quantitative assessment should be done on a case-by-case basis, and should not automatically guarantee for conformity. This proposal by the EC seems to stem from its concern over the compatibility of some of its existing RTAs with SAT requirements (especially if the tariff-line-based approach is applied). Some suggested measures for clarification have been used under EU RTAs (such as TRQ, special sectoral safeguards, etc.). Thus, the EU position is that a holistic assessment on a case-by-case basis is needed to determine final WTO-compatibility of RTAs.

The EC submission on the SAT could have specified that SDT and flexibilities regarding the SAT would be provided to developing countries and that these would be elaborated during the negotiations. It is important that specific references to key aspects of GATT Article XXIV like the SAT make specific reference to SDT and flexibilities for developing countries, in addition to any generic suggestions that would be made under the development dimension proposition. The EC submission could also have added that the evolution of a 'common understanding' of the qualitative benchmark for RTAs could include an understanding on the development

aspects of RTAs in respect of developing countries.

On the **transitional periods** (Section 3), the EC is open to consider 'clarifications of the limited circumstances' where departures from the 10-year rule may be justified and that such a longer transitional period and invocation of exceptional circumstances is only for developing countries, and not for developed countries. This view is coherent with the argument that the ACP has made – that the interim period should be linked to the trade, development and financial conditions of developing countries. However, the argument that the longer transitional period should apply to only a limited number of products can be problematic as it would mean that the list of such products has to be defined and legally provided for (so more negotiations); it can affect the flexibility that developing countries would have in defining the product coverage of the tariff phase down programme; and it may be that developing countries would want to back-load the full liberalisation (rather then front-load it) and this option could be constrained.

Thus, a substantially less stringent criteria should be applied to developing countries in determining 'exceptional cases', including a presumption that where developing countries are concerned they may quasi-automatically qualify for a longer-than-10-year period (possibly under some limitation if need be). Regarding the latter, it can be important to specify or clarify an understanding, as per the ACP submission, that the full provisions of reciprocal free trade would become fully operational at the end of the transitional period. The notion that the EC can consider favourably longer transitional periods for RTAs that have adopted requirements going beyond the SAT could be fine, but it should not be used in a manner to say that RTAs should go for stringent SAT and on that basis seek longer transition period. This could lead to situations in which developing countries are encouraged to go for stringent SAT (and forego flexibilities) and in return get longer transitional periods. So ACP states need to ascertain this uncertainty.

As regards the **'neutrality'** (Section 4) of impact of RTAs on interests of third parties in respect of other regulations of commerce (ORCs), the EC has a strong interest in ensuring that any future disciplines on this aspect do not prejudice its RTAs *vis-à-vis* third countries. With the EU enlargement, it has been under pressure to provide compensatory market access for third countries and this has proved to be a contentious process. Thus, clarifying rules on no-raising of trade barriers to third parties is important for the EC. This was not a priority issue in the ACP proposal, as, being a future RTA partner under EPAs, the ACP's concern was more directed towards WTO rules in terms of internal liberalisation such as the SAT requirements in duties and ORRCs, as well as the transition period, and not external 'neutrality' of RTAs. The EC suggestion on the need for 'different approaches to neutrality for different forms of "regulations of commerce"' needs be clarified. The assumption seems to be that as far as those measures with impact on third parties fall within the existing WTO agreement, it should not be questioned in terms of the raising of barriers to third parties. This means that the extra-RTA application of safeguards, anti-dumping or countervailing duties could not be questioned for the purpose of determining WTO conformity of RTAs as long as they comply with the respective WTO rules. This, however, needs clarification. The EC position seems to prefer to retain as much flexibility as possible in this area.

Finally the 'developmental aspects: fair and equitable treatment between different forms of RTAs to which developing countries are parties' (Section 5) of the EC submission is the most relevant to the positive agenda of ACP states. It has a twofold objective. One objective emphasises that RTAs among developing countries should enter into deeper economic integration agreements and the respective substantive requirements in the Enabling Clause should not be radically different from those in GATT Article XXIV which emphasises deeper integration. This seems to be an implicit call for the Enabling Clause to be reviewed and modified. The mentioning of the Enabling Clause as part and parcel of the Doha negotiations is strictly correct. However, it raises the spectre that the EC is willing to re-open aspects of the Enabling Clause and this would be contrary to the ACP submission which explicitly states that the Enabling Clause is an *acquis* of the WTO and should not be modified.

The EC calls for developing-country groupings to embrace deeper integration is based on the claim that developing-country RTAs tend to be preferential and partial liberalisation agreements and do not entertain full tariff removal for FTA status. This is a broad generalisation. Most developing country RTAs aim at fully fledged FTAs or customs union, at least in terms of objectives and instruments set by the developing country RTAs. Take CARICOM for example; it aims to set up a common market with full liberalisation of trade and a common external tariff among members. All the African integration groupings like ECOWAS, UEMOA, COMESA and SADC aim to achieve full free trade among members. The Pacific PICTA would be a partial liberalisation scheme with the eventual aim of achieving full liberalisation. The situation is similar for many of the Latin American integration agreements. Likewise, in Asia, the ASEAN states have embraced an ambitious free trade agreement. It is the South Asian countries which still focus on partial preferential agreements under the South Asian Preferential Trade Agreement (SAPTA), and similarly in the Economic Cooperation Organisation of Central Asian countries (ECO), and many of the Arab state agreements. So, the goal is indeed deeper integration. But the problem with South–South agreements has been that progress towards deeper trade integration has been slow in many groupings, although in recent years the process has accelerated as in CARICOM, ECOWAS/UEMOA, COMESA and SADC.

A related issue, for the EC, is that 'existing rules fail to establish fair and equitable treatment between different types of RTAs based on their potential effects on third parties'. As an example, the EC notes that there is no difference between those South–South RTAs that are relatively sizeable actors in world trade, presumably RTAs involving large developing countries, as compared to those RTAs whose members' share of world trade is marginal. The EC is calling for fair treatment of those South–South RTAs that cover a larger share of world trade on the same basis as developed country RTAs. This can mean either reviewing and modifying the Enabling Clause towards more stringent requirements, or obliging those South–South RTAs to be examined and approved under GATT Article XXIV conditions. These arguments pose the risk that they work for differentiation among developing countries. While the EC compares those RTAs falling under Enabling Clause and GATT Article XXIV to draw the conclusion that the current treatment of different RTAs involving developing countries is not fair, it is logically wrong and legally incorrect to compare the treatment of Enabling Clause and GATT Article XXIV, as the subject matters are different. The comparison should rather be drawn, as was done by the ACP proposal, between GATT Article XXIV and GATS V. The Enabling Clause is about South–South RTAs, and there is no foundation to compare it with GATT Article XXIV which is about North–South and North–North agreement.

The ACP has emphasised (as noted previously) that the sanctity of the Enabling Clause should not be touched. Some developing country groups may on their own volition choose the GATT Article XXIV route; such is the case for MERCOSUR or SADC. However, it should not be a legal requirement written to the Enabling Clause or elsewhere. This proposal may also affect at some stage the future of the Global System of Trade Preferences among Developing Countries (GSTP) Agreement as it involves larger developing economies. The GSTP is presently sanctioned by the Enabling Clause. Following the differentiation principle breaks down the common development denominator binding developing countries together and this is a political issue on which ACP states need to consider. It bears repeating that the ACP concern is with the new phenomena of evolving (deeper integration) North–South agreements under GATT Article XXIV, and not about South–South agreements under the Enabling Clause.

The second objective of the EC submission is to address the ACP submission, expressing the EC's willingness to clarify the flexibilities already provided within WTO rules on RTAs to ensure that the rules facilitate the necessary adjustments required by developing countries. It specifically indicates a commitment to considering separate and differentiated, i.e. lower, thresholds for developing countries and LDCs, and for these countries to have longer

than the 10-year transition period. This is a significant support for the ACP submission. Although the EC does not use the term SDT (an acceptable terminology in the Cotonou Partnership Agreement), this is welcomed. However, the magnitude of the SAT requirement critically depends on the methodology to be used for calculating the SAT requirement. Thus, apart from differentiated threshold levels, the ACP states would need to carefully follow and examine the approaches proposed by the EC (trade-volume-based approach) and Australia (tariff-line-based approach) and ascertain which approach, or any other approach, serves their interest most. Hence the need for continued active participation of ACP states in systemic issues debate. Also, when this welcome endorsement by the EC of the ACP submission is juxtaposed against the points made above by the EC on fair and equitable treatment between RTAs, it seems to convey the sense that the EC is open to flexibilities in rules on RTAs for those developing countries with a small share of world trade like the ACP states, and not for those which are likely to have an important impact on world trade.

This second EC conclusion is the most significant in terms of supporting the ACP submission on SDT and flexibility in GATT Article XXIV for developing countries. It provides support for the ACP submission (and is consistent with the CPA on EPAs). It can be said to take up the recommendations of the Commission for Africa Report. It is an important consensus, and a step forward towards supporting regional integration processes in making an impact on trade and development of developing countries, and facilitating their contribution to the timely implementation of the Millennium Development Goals (MDGs). It could have been made more explicit, as proposed by ACP states, that WTO members agree that SDT can be formally and explicitly made available to developing countries.

The EC submission needs to be further developed and in this regard, care should be taken in a number of respects. First, the EC maintains the position that flexibilities to be negotiated relate to 'flexibilities already provided within the existing WTO rules on RTAs'. The ACP proposal called for 'additional' flexibilities, rather than just 'existing flexibilities'. It is possible that in the current negotiations that the existing flexibilities, for example in respect of the SAT or the transition period, could be tightened. Second, the EC submission to achieve such flexibilities for developing countries by way of 'the length of transition period, the level of final product coverage and the degree of asymmetry for both' under GATT Article XXIV is correctly consistent with the CPA Article 37:7. The EC expresses that it is ready to 'confirm in the negotiations these specific justifications for developing countries parties to RTAs to depart from the general rule of ten years'. This endorses the ACP submission for lowering the criteria for developing countries to have recourse to a longer-than-10-year transition period. It must be noted that the ACP submission on the transition period is much broader covering (1) the length of period, (2) the legal rights and obligations during the transition period, and (3) the conditions under which the longer-than-10-year period is allowed. Thus, all such issues need to be carefully followed up. Third, a controversial issue would be whether the SDT that the EC is now willing to discuss applies to all developing countries as a rule or only to a limited number of small developing countries on an case-by-case basis. The EC seems to go for the latter case-by-case approach to exclude some large developing countries from the SDT treatment. This leads to differentiation of developing countries, and has a larger systemic implication which requires careful consideration, especially that such a debate should not divert from the heart of the ACP submission, namely SDTs for developing countries in GATT Article XXIV.

Conclusion

The ACP states made an important submission on introducing SDT and explicit flexibilities for developing countries into GATT Article XXIV. This submission has received support from the Report of the Commission for Africa. Recent trade ministers meetings of the African Union and the LDCs have reiterated further support for the ACP submission. It is becoming apparent that the Doha Round must include in its final package some concrete elements covering the ACP submission. At this stage in the

lead-up to the Hong Kong Ministerial Conference, the ACP states need to submit their revised proposal responding to the comments made so far on its initial submission and to respond to the submissions by Australia and the EC. The ACP states need to maintain the momentum they have generated on securing explicit, operational and mandatory SDT and flexibility in GATT Article XXIV as a major development objective, linked with their negotiations of EPAs with the EC. This link between the two spheres of negotiations is now clearing terms of the timing of their conclusions – the reform of GATT Article XXIV into a new generation set of rules that include SDT at its core must take place prior to the conclusion of market access negotiations under the EPAs, so that EPAs with SDT can satisfy existing WTO rules on RTAs that would have an SDT dimension.

Endnotes

1. The civil society organisations subscribing to the campaign include the African Trade Network, Accord Mali, ActionAid International UK, Agir Ici (France), Both Ends (Netherlands) Cafod (UK), Centre for International Development CECIDE (Guinea), Christina Aid (UK), Econews Africa (Kenya), 11.11.11 Coalition of the North–South Movement (Belgium), Enda Tiers Monde (Senegal), Eurostep (Belgium), Mwenge (Zimbabwe), Oxfam International, Southern & Eastern African Trade Information and Negotiation Institute – SEATINI (Zimbabwe), Traidcraft (UK), Third World Network (TWN) Africa (Ghana) and the Zambian Trade Network. www.stop epa.org
2. Various articles have been written on this issue. See, for example, Bonapas Onguglo and Taisuke Ito, 'How to make EPAs WTO compatible?: Reforming the rules on regional trade agreements', *ECDPM Discussion Paper No. 40*, July 2003. www.ecdpm.org/dp40
3. The ACP states have also clarified that the WTO rules affecting RTAs among developing countries, namely the Enabling Clause of 1979, should be considered as an *acquis* of the multilateral trading system and hence should not be reformed in any way whatsoever.
4. WT/MIN(01)/DEC/1, www.wto.org
5. Available at www.acp-eu-trade.org
6. TN/RL/W/155 (Communication by the Mission of Botswana on behalf of the ACP Group of States), www.wto.org
7. It can be noted that under the Enabling Clause, the notification and examination process by the WTO Committee on Trade and Development is fairly simple and straightforward. The Committee normally accepts the notification submitted by parties to a South–South RTA and endorses them without a major examination of their features nor their compatibility with the Enabling Clause provisions.
8. www.commissionforafrica.org
9. DFIF and DTI, 'Economic Partnership Agreements: Making EPAs Deliver for Development', March 2005, www.dti.gov.uk/ewt/epas.pdf
10. www.uneca.org/eca_programmes/trade_and_regional_integration/meetings/cairo/cairo_declaration.pdf and www.acp-eu-trade.org, respectively.
11. 'Livingstone Declaration', Fourth LDC Trade Ministers' Meeting, Livingstone, Zambia, 25-26 June, 2005.
12. TN/RL/W/165, 8 October, 2004.
13. TN/RL/M/16, 12 July, 2004, TN/RL/M/15, 15 June, 2004, and TN/RL/W/165, 8 October, 2004 (submission by Japan).
14. WT/DS34/AB/R. The case pertained to the quantitative restrictions introduced by Turkey, as of 1 January, 1996, on imports from India on 19 categories of textile and clothing products. Turkey considered that the measure was necessary to adopt 'substantially the same commercial policy' as the EC in the textile sector including the agreement on trade in textile and clothing by virtue of its association agreement with the EC aimed at the establishment of customs union. India complained that the quantitative restrictions were inconsistent with Articles XI and XIII of the GATT 1994, and Article 2.4 of the Agreement on Textiles and Clothing (ATC), and not justified under GATT Article XXIV. Turkey argued that quantitative restrictions were necessary for the formation of a customs union with the EC, particularly in adopting 'substantially the same commercial policy', thus justified under GATT Article XXIV. The panel and Appellate Body have concluded that GATT Article XXIV does not authorise Turkey to adopt, upon the formation of a customs union with the EC, quantitative restrictions that were inconsistent with Articles XI and XIII of the GATT 1994 and ATC Article 2.4.
15. This figure would be the average over the three-year base period (which is the three years before the entry into force of the agreement).
16. The required information could be obtained from the UN Commodity Trade Statistics Database (Comtrade).
17. See, for example, the submission by Turkey (TN/RL/W/32).

IV
Market Access

15

Rules of Origin under EPAs: Key Issues and New Directions

Eckart Naumann

Introduction

Rules of origin (ROO) form a critical component of any trade agreement or preferential trade area. They describe the conditions used for the determination of a product's origin, thus setting the parameters for preferential access to a given trade partner's domestic market. Rules of origin can thus promote or curb trade, depending on their restrictiveness.

For the 78 ACP countries, all of which have a long association with the European Union, the latter forms an important market for their exports, especially in certain product categories. Preferential trade has been governed mainly by the provisions of successive Lomé Conventions, which offered ACP countries non-reciprocal market preference. In 2000, the 4th Lomé Convention was replaced by the Cotonou Agreement; its ROO, however, remaining largely unchanged from those contained in its predecessors. By being non-reciprocal in nature rather than the result of bilateral negotiations, they contained provisions which in the view of ACP stakeholders were often overly restrictive if not protectionist. The Cotonou Agreement sets the stage for a re-negotiation of the formal trading relationship between the EU and ACP countries, specifically its ROO, to form part of new Economic Partnership Agreements (EPAs) which are to be concluded by 2008. ROO negotiations are set to begin at the end of 2005 or by early 2006 at the latest.

Rules of origin: Their role in international trade

Rules of origin play an important role in the implementation of trade policy. They are used to determine the 'economic nationality' rather than merely the geographic nationality of goods, a distinction that is important especially where a product is made up of materials sourced from more than one country.

Since trade policy often requires that market preferences be made available only to certain countries, for example the parties to a trade agreement, an absence of origin rules would lead to problems with transhipment and render preferential trade provisions meaningless. Known as trade deflection, products exported to a specific country could then be channelled through third countries that have more favourable market access to a given export market (that of the final destination), without any economic value-adding and associated benefits taking place in these preference-receiving third countries.

In the determination of origin, the distinction between economic and geographic source is important since the proliferation of global trade has meant that products are their produced in one location alone. Regional and country-specific competitive advantage, say in the manufacture of textiles, has meant that clothing production worldwide is increasingly using materials produced by a small number of highly competitive countries. ROO define the minimum processing that must be undertaken locally (in the preference-receiving country) in order for a product to be deemed to be of the economic nationality of that country. Geographic nationality, being the country from which the final product is shipped to its destination, does not qualify in this determination of origin.

While the prevention of trade deflection is the original and probably only legitimate purpose of origin rules, especially from a development perspective, many ROO regimes have evolved to become instruments and guardians of protectionism. Strict origin rules make compliance onerous, if not indeed impossible, especially for many developing countries with

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less-developed infrastructure or domestic production capabilities. Likewise, with international trade and associated supporting logistics having developed rapidly in recent years, it is no longer sufficient for a country to be able to merely *produce* a given input. These have to be produced within a given competitive framework, incorporating efficient and competitive lead times, pricing, quantitative, qualitative and other characteristics. Notwithstanding this, ROO are often still used to protect 'sensitive sectors', and political economy elements remain present in most ROO regimes.

Technical aspects of rules of origin regimes

There has been a proliferation of preferential trade arrangements in recent years, especially between developed and developing countries. While all preferential-trade rules are governed by a set of origin rules, the technical composition of these rules differs across trade regimes. Common among them is the fact that unless goods are wholly produced in the exporting country, they must be 'substantially transformed' in order to benefit from given trade preferences. It is however in the application of the 'substantial transformation' principle that ROO differ from each other.

Rules of origin methodology

As described earlier, ROO set the conditions for determining the economic nationality of a product. In order to be deemed the manufacture of an exporting country, a product must be either 'wholly produced' (the EU uses the term 'wholly obtained') or 'substantially transformed' in the exporting country. Substantial transformation is measured according to three key principles, each of which is described below. It should be noted that these criteria always apply only to the non-originating components of a product; materials wholly sourced from within a country or specific regional grouping (where applicable) are not required to undergo further processing.

Value added (or *'ad valorem'*) (VA)

The 'value added' methodology is the most easily understood conceptually as it confers origin based on a specific proportion of production value that must be added locally. However, some challenges are associated with the technical aspects of this methodology, especially with regard to the principal-cost basis to be used in the determination of sufficient local value added. An alternative way of using this methodology is by setting maximum foreign content thresholds instead.

Specific processing (SP)

Specific processing provides an alternative means of setting criteria for substantial (local) transformation. Specific processing rules require a non-originating material or product to have complied with a predefined set of local operations or processes, for example the fabric used in garments must be woven locally.

Change in tariff heading (CTH)

This methodology is usually based on the internationally recognised and used Harmonised System nomenclature (HS), and requires that a product must be classified under a different heading than that of any non-originating input materials used in its manufacture. As the HS uses different levels of classification, CTH criteria are usually set at the 4-digit level of disaggregation.

While some ROO regimes make use of a single methodology for determining origin, others use a combination of criteria or even provide the option of complying with alternate methodologies. In general, the VA methodology is seldom used as the sole test for determining origin. An example is the African Growth and Opportunity Act (AGOA), the United States preference programme geared at qualifying countries from Sub-Saharan Africa, which uses a VA rule for determining local (or in this case regional) origin. Products must comply with a 35% threshold level of local value added, with specific rules applicable to the garment sector (essentially a range of SP rules). Another example is Canada's 2003 Market Access Initiative, which offers least-developed countries a 25% VA threshold in order to qualify for duty- and quota-free market access.

The VA rule, while being conceptually concise and thus easy to understand, suffers from the fact that its application is subject to a number of poten-

tially complicating variables. Foremost among these is the methodology used in determining a product's base cost, as this plays a critical role not only in this methodology's ease of use from an administrative perspective, but also in terms of compliance. Different cost calculations, which are beyond the scope of this report, include ex-works price, free on board price (FOB), cost plus insurance and freight (CIF) and so forth. Depending on which method is required, and what cost components are included and excluded, the outcomes can be vastly different

A further criticism of the VA method is that depending on the cost components included or excluded in the value calculation, this can place a high administrative burden on the exporter and customs authorities. Many are not equipped to sufficiently deal with these matters without unnecessarily holding up the export process, especially in some developing countries. Likewise, the relatively significant movements in the exchange rate experienced by some countries *vis-à-vis* that of its trade partners may mean that a slight devaluation of the local exchange rate may suddenly disqualify a product from benefiting under a preference programme. As there is movement in a country's exchange rate, so does the ratio of local against foreign value added change.

More widely used are CTH and SP criteria. The EU's origin regime, which shows a high measure of consistency across preferential trade agreements that it is a party to, makes widespread use of CTH and SP criteria, and to a lesser extent VA principles (sometimes as an alternative or secondary rule).

While many origin regimes employing the CTH principle recognise a tariff shift at the 4-digit level as sufficient to confer origin, there is still much inconsistency in the use of this methodology. Efforts by the World Customs Organisation (WCO) to harmonise the application of ROO methodologies are still focusing on those found in non-preferential regimes, although there appears to be a favoured emphasis on the CTH methodology. The weakness of the CTH lies in its use of the HS classification system, which as mentioned earlier was not designed with this role in mind. As a result, CTH at the 4-digit level is sometimes an insufficient requirement for sufficient local transformation having taken place, while with other products the 4-digit level would represent an overly onerous origin requirement. Despite this, the CTH methodology is relatively easy to understand and implement.

The SP methodology sets the processing operations that a product must undergo locally in order to qualify as originating in the home country. Associated with this methodology, although often broadly applied to all products covered by a trade agreement, are 'insufficient operations'. These define the processes that, on their own, are insufficient to confer origin. Like the VA and CTH methodology, this system has its own set of advantages and disadvantages. A clearly positive aspect is the fact that this methodology does not suffer from any ambiguity, since the necessary processing requirements are clearly defined and described. The disadvantage, of course, is the fact that they make ROO more cumbersome, as each product has its own set of requirements. This is burdensome for exporters (especially where these are not the same as producers), and customs authorities. Similarly, the SP methodology is subject to political economy elements, as home industry concerns may (and are known to) influence specific rules.

Cumulation of origin

Cumulation is important in expanding the scope of preferential trade. Cumulation provisions essentially describe the extent to which production may be shared between countries without forfeiting preferences under a given trade agreement. In other words, cumulation permits countries to use inputs produced in specific third countries without having to comply with the usual origin requirements, provided that such inputs are further processed in the exporting country claiming preferences.

Various forms of cumulation exist. These are bilateral, diagonal and full cumulation. Bilateral cumulation, being the simplest and most common form of cumulation, permits the unrestricted use of one another's inputs between parties to a preferential trade agreement. In other words, bilateral cumulation allows cumulation between the preference-giving and preference-receiving country. Where cumulation is permitted between certain preference-receiving countries, for example the SACU countries with respect to South Africa's trade agreement

with the EU, this is referred to as regional diagonal cumulation. Diagonal cumulation almost always has a regional component, and can substantially expand the scope of a trade agreement in that it implicitly recognises that different countries within a defined geographic area may have different industrial and productive capabilities and efficiencies. Diagonal cumulation can thus play an important supporting role in fostering regional economic integration.

Full cumulation can perhaps be described as an extended form of diagonal cumulation without the geographic or regional limitations. Full cumulation permits production to be shared among all members of a preferential trade regime, without the processing of an individual country having to be sufficient to confer origin on its own. In other words, the sum of all processing is seen in its totality. The main benefit of cumulation lies in the flexibility it gives to manufacturers and exporters, for example allowing certain processes or material requirements to be outsourced to more competitive beneficiary countries without jeopardising the final product's originating status.

Rules of origin in the EU–ACP Cotonou Agreement

Being a non-reciprocal agreement, Cotonou's ROO are not the result of a negotiated process, but rather a unilateral offer of preferential market access on the part of the EU. Cotonou's origin rules are based on those found in earlier Lomé Conventions, and are likewise largely consistent with other preferential trade agreements that the EU has entered into. They employ a mixture of wholly obtained, CTH, VA and SP methodologies for the determination of origin.

For example, the origin requirements for many agricultural categories are based on the wholly obtained criteria, that is, products must be wholly produced in the exporting country. In practice this means that livestock must be born and raised within the exporting country to be deemed to have originated there, fruit and vegetables must be grown there, fish caught within a country's inland or territorial waters, and so on.

Most resource-based and manufactured products are required to comply with a combination of CTH and SP criteria, and in some instances have an alternative option of a VA rule. For example, articles of apparel must be made up from yarn (which entails the local conversion of yarn to fabric to garment), or alternatively from fabric that is further subject to specific beneficiation requirements.

While an analysis of the Cotonou ROO shows that many of its origin provisions are not unreasonable or excessively onerous, it is both the overall package as well as the rules applying to certain key sectors that have made them the target of much criticism among ACP countries. Administrative requirements associated with exporting under Cotonou, such as the burden of demonstrating compliance with the rules, are relatively onerous, although this is an issue that often lies equally with the customs authorities in exporting countries.

Specific sectors where Cotonou's origin requirements are deemed to be particularly restrictive are those applying to the fisheries and textile and clothing sectors. The latter, as shown above, typically requires two distinct stages of transformation to be undertaken by the exporting country. This requirement implicitly fails to recognise that dynamics within the global textile and clothing production pipeline have shifted substantially since the 1970s when these rules were originally determined, making them excessively restrictive in today's environment. In practice they prevent ACP countries from availing themselves of the benefits of sourcing input materials (such as textiles) from low-cost countries in South-East Asia, for example as is permitted under the AGOA ROO which permit virtually unconstrained fabric inputs from third countries. Making matters worse is the fact that textile and more importantly garment production are relatively important manufacturing sectors in many ACP countries, and are often seen as an important step as developing countries diversify their economies away from a complete reliance on, say, a single agricultural product.

The fisheries sector is a further example of Cotonou's ROO shortcomings, showing unambiguous protectionist elements on the part of the EU (fish products constitute one of the largest export categories from the ACP). These restrictions extend beyond the product-specific ROO (so-called 'list rules') but also reach into the core definition of the 'wholly obtained' principle. Besides describing what

product categories are deemed to be wholly obtained in the exporting country (livestock born and raised there, fruit and vegetable products grown and harvested there, fish caught in the territorial waters, etc.), they impose further restrictions on the vessels used to harvest a country's fish stocks.

Specifically, any fish caught outside of a country's territorial waters,[1] but still within its 200-mile exclusive economic zone (EEZ), is subject to stringent fishing vessel, crew, registration (flag), and ownership nationality requirements. Essentially, all fish must be caught by a country's own vessels, or those owned by EU stakeholders. To be considered a domestic fishing vessel, the ship must be registered in and sail under the flag of an ACP state or the EU, be at least half-owned by nationals of the ACP (subject to further conditions pertaining to head office, the Board of Directors and capital), and must use the services of a crew that are at least half nationals of the ACP. While these conditions are consistent across most EU preference regimes, Cotonou provides some minor concessions: under certain conditions, leased or chartered vessels may be used, although even this concession is subject to prior approval by a so-called 'ACP–EC Customs Cooperation Committee'. But the concessions continue to prescribe that at least 50% of crew are ACP nationals, this being a slight concession from the usual 75% crew requirement.

Other provisions in Cotonou describe conditions for cumulation, so-called value tolerance, drawback and other requirements. Provisions for cumulation are broad, including bilateral, diagonal and full cumulation. It should be noted that full cumulation among all ACP countries is possible for the simple reason that ACP countries are subject to, and may benefit from, the same set of origin rules under Cotonou. Differentiated origin rules and full cumulation are mutually exclusive, since it would merely open up the possibility of transhipment and thus severely undermine a trade regime having more restrictive origin rules.

Cotonou does however contain a number of limiting provisions with respect to the principle of cumulation. These relate mainly to cumulation with South Africa, and to neighbouring developing countries (a concept whereby cumulation is extended to a small number of pre-defined non-ACP countries). Specifically, materials originating in South Africa – itself an ACP country but not benefiting from Cotonou's trade provisions – may be used without further processing, but the value added in the ACP country must exceed the value added in South Africa. This cumulation only applies after three to six years following the conclusion of the TDCA and does not apply to all products (as listed in Annex XIII). Also, this cumulation is only possible after the lifting of tariffs on these products agreed between the EU and South Africa, and following publication in the *Official Journal of the European Communities* of the date on which these conditions have been met. South African materials must also have obtained originating status by application of ROO identical to those set out in the Cotonou Agreement.

Cumulation with materials originating in 'neighbouring developing countries, other than an ACP state, belonging to a coherent geographical entity' is possible, but requires the prior conclusion of administrative agreements between the ACP countries, the EU and the affected neighbouring countries. For products listed in HS50-63 (textiles and clothing), CTH processing must also subsequently take place in the ACP country, while a further Annex prescribes the working or processing required on *certain* of the textile and clothing products listed in HS50-63. It would appear that these provisions restrict rather than enhance cumulation options for ACP countries.

Drawback provisions describe a scenario whereby non-originating (i.e. imported) materials used in the manufacture of final goods having originating status (and subsequently exported) receive an exemption from or remission of import duties. In many origin regimes, including the majority that the EU is party to, drawback is expressly prohibited as it is seen as a form of subsidy, and incentive to use foreign-produced inputs. In the Cotonou Agreement, however, drawback is not prohibited; in fact, no mention is made of drawback in its ROO.

Finally, value tolerance provisions are a feature in Cotonou's origin rules, and are set at a 15% threshold. Value tolerance is in effect a derogation from normal origin rules, and provides producers and

exporters with an additional measure of processing flexibility. Value tolerance essentially describes the proportion of materials, expressed as a percentage value, which are exempt from complying with usual origin requirements. For example, a garment could use certain foreign materials, such as interlinings, buttons and zips, so long as the combined value of these materials does not exceed either the 15% value tolerance threshold or any other threshold specifically indicated in the product-specific rules. Besides a similar value tolerance threshold contained in the EU–South Africa Agreement, no other EU Agreement contains a value tolerance provision higher than 10%.

A fresh approach to rules of origin: Recent proposals by the EU

Over the past two years there have been a number of proposals on the part of the EU with a view to revising its general ROO framework. While its policy is for overall consistency across its preferential trade regimes, and specifically ROO contained therein, the current rules are largely based on a system that has already been in operation for some decades. Considering that industrial configurations globally have changed considerably in recent years, while industrial tariffs between WTO member states are being gradually reduced or dismantled, the current ROO regime had become somewhat outdated. Likewise, experience had shown that onerous ROO and their associated administrative requirements were a key burden to the natural development of export trade in many ACP countries, as the current non-reciprocal framework still contained too many protectionist elements.

Green Paper on the future of rules of origin

In December 2003 the European Commission (EC) published a *Green Paper* on the future of ROO in preferential trade arrangements. In response to the changing nature of international trade, and objectives of preferential trade arrangements, the *Green Paper* was to aid the EC in a process that was to culminate in the formulation of revised origin guidelines and compliance procedures. Up to that point, evidence from trade flows and the uptake of preferences (specifically the GSP and Cotonou Agreements) had shown that a significant proportion of imports eligible for preferences failed to use them (see also UNCTADT, 2003).

The *Green Paper* recognised the need for 'new equilibria' in (a) the criteria for determining ROO as well as the framework for their implementation, (b) in the mechanisms for safeguarding the economic interests of the contracting parties (countries) bearing in mind the objective of promoting legitimate preferential trade, and (c) in the responsibilities of those involved in the procedures for declaring, certifying, and checking preferential origin. However, it eventually failed to place much emphasis on the substantive issues that were preventing beneficiary countries from using EU preferences, despite point (a) above. In particular, the document failed to address key concerns by stakeholders that the current rules were too restrictive.

A subsequent summary report on the *Green Paper* consultative process was published in 2004, and concluded that:

- the present origin rules do not fit current economic reality;
- current ROO are seen as being too complex, restrictive and lacking transparency; and
- the current origin rules should be rationalised and simplified.

EC communication on rules of origin

In March of 2005 the EC published a formal communication titled *The rules of origin in preferential trade arrangements: Orientations for the future*. It represented the next stage in the process of revising the EU's ROO requirements, and outlined a number of concrete proposals. The Communication also indicated that this document would inform the position to be adopted by the EC in the negotiation of EPAs. While EPAs are likely to feature a form of reciprocity and will be *negotiated* agreements, the reality on the ground is that the EC's position is frequently seen as the *de facto* outcome of any negotiations. Negotiators for ACP countries will have to be alert to this.

Two broad issues are dealt with by the EC's communication:

- the conditions for a product to be considered as originating (i.e. the ROO); and
- issues around the implementation and control of trade preferences, and the development of instruments to ensure compliance with the obligations governing preferential trade.

The first issue represents a substantial departure on the part of the EU from current ROO methodology in that it proposes the use of a single methodology for products or materials that are not already wholly obtained in the beneficiary country. In other words, the proposal does away with the CTH and SP tests, and proposes an across-the-range VA methodology. Differentiation is envisaged between different product sectors, rather than a single percentage threshold for all sectors.

The communication outlines the envisaged basis on which the determination of costs, being production cost and local content, should be based. It departs from the *ex-works*[2] methodology contained in the Cotonou Agreement and introduces 'local value content' (LVC) against 'net production cost' (NPC). NPC would include any direct materials used, originating and non-originating, as well as direct labour costs and expenses that can be directly attributed to the production of a good. Indirect materials such as fuels, energy, plant and equipment also count towards NPC (and of course where applicable to the LVC component). But the EC's definition of cost departs from other methodologies in that it envisages specifically excluding a number of other cost elements, including marketing and administrative costs, profit mark-up, packaging, and other overheads not directly attributable to or contained in the product (or used in the production of the product). As emphasised earlier, the basis used in the determination of costs has an important bearing on the restrictiveness of the VA threshold defined in the ROO. The result of these specific exclusions would in direct comparison correspond to a relatively lower VA threshold, if all other variables were set equal.

The EC communication also specifically touches on three sectors, at least two of which are frequently seen as key sticking points with regard to Cotonou's current ROO. These are the fisheries and textile sectors, while mention is also made of the agricultural sector in general. The essence of the Communication is that these three sectoral areas require specific analysis with respect to the applicability of a VA criterion in future ROO

The fisheries sector, as outlined earlier, is subject to very onerous origin requirements for fish caught outside a country's territorial waters yet still within its EEZ. Rules regarding ownership and flag of vessel, and the nationality of crew and captain, are just some of the many conditions affixed to this sector. The current origin regime for fish is thus often perceived to be excessively restrictive by ACP countries, with the result that ACP countries have been unable to use this export sector to the extent that they would have were ROO more liberal.

Despite these criticisms, the communication fails to address the key issues relating to fisheries ROO. The solitary suggestion pertains to the current requirement regarding the nationality of the crew engaged in fishing within the EEZ, and proposes to remove this condition.

With respect to the textile sector, the communication makes no real proposals except for a general acknowledgement that future ROO in this sector will require special analysis. Explicit reference is made to the EC's 2003 communication 'on the future of the textile and clothing sector in the enlarged European Union'.

Issues around the implementation and control of trade preferences, and the development of instruments to ensure compliance with the obligations governing preferential trade, are dealt with more extensively. The EC proposes changes to the administrative systems currently in use to govern origin provisions, including an elaborate pre-registration system whereby any exporter must be registered with the home country's customs authorities before being permitted to receive preferential market access to the EU. While the proposals speak about self-certification by exporters, the ultimate responsibility (financial and otherwise) of such claims would lie with customs authorities of the home country. Failure to comply with these regulations, for example declarations by exporters which subsequently prove to be false, could result in the suspension of preferences for the beneficiary country. Further, the systems required for registration, including the process

by which customs authorities should conduct assessments into the affairs of its exporters, would be prescribed by the EU, thereby effectively removing a degree of autonomy that currently prevails under Cotonou.

EC defence of the choice of value added as the preferred ROO methodology

Shortly after (and based on) the publication of the March 2005 communication, the EC published a working paper titled 'Justification of the choice of value added method for the determination of the origin of processed products'. It seeks to entrench and justify the EC's earlier proposals regarding a new and uniform ROO methodology. It also provides a rebuttal to some of the criticism that had earlier been levelled against this shift to a new (or rather single) methodology.

The working paper makes strong statements to highlight the fact that current origin rules contained in EU trade regimes are in need of an overhaul. Specifically, the paper argues, current rules 'are too numerous and different', are 'complex', and furthermore are 'opaque, unequal and rigid'. It goes on to substantiate these statements, while illustrating the variation in current origin requirements by means of a table. This is replicated in Table 1.

A number of arguments are presented in favour of value-added. Some of these, presented below, have been drawn from the EC's communication:

- (the) value-added method would provide both a single criterion to be applied (...) and flexibility in defining the thresholds to reach (...);
- such a method would (...) allow determining with a common tool for all kinds of products the real 'local content' that a product has obtained during its manufacturing process (or a 'regional content' in the event of cumulation);
- (the value-added methodology) is particularly relevant for an assessment of the impact of a processing on development;
- (the) value-added method would be an incentive to source originating materials (even if more expensive than (sourcing from) non-originating countries) from the exporting country or from a country belonging to the same cumulation zone (...) (or to utilise) other local regional production factors; and
- (the) value-added method is the only (methodology) which would allow real simplification by (...) (removing variables such as) minimal operations, value tolerances, alternative rules and most of the introductory notes to list rules, (as well as) covering (...) the identification of sufficient processing on non-originating materials.

Judging by developments over the past two years it is increasingly evident that the EU acknowledges that its current ROO regime is in need of an overhaul. The choice of VA as a departure point for new origin rules, with special rules for the agricultural, fisheries and textile sectors, represents a significant departure from the *status quo* but with as yet unknown consequences. No single methodology is flawless, and considering the many administrative issues associated with this methodology (and systems of control

Table 1. Breakdown of use of ROO criteria in EU preferential trade agreements

Method	WO	CTH	SP	VA	WO + CTH	WO + VA
Number of rules	29	98	150	128	4	4
% of total	5.3%	18%	27.5%	23.5%	0.7%	0.7%
Method	**CTH + VA**	**SP + VA**	**WO + CTH + VA**	**Sets + VA**	**NR**	**Total**
Number of rules	94	28	2	2	6	545
% of total	17.2%	5.1%	0.4%	0.4%	1.1%	100%

Key: WO = wholly obtained; CTH = Change in tariff heading; SP = Specific processing; NR = No rule (manufacture from any heading
Source: EC (2005b)

proposed by the EU) it is not clear whether a VA methodology will actually enhance access to the European market.

Key ROO-related challenges in EPA negotiations

With ROO negotiations between ACP countries and the EU due to start by the end of 2005, there is little time left to prepare. However, the outcome of these negotiations will be of key significance for ACP countries, as the ROO contained in future Economic Partnership Agreements (EPAs) will define many of the conditions of EU market access (and in terms of proposed reciprocity, also vice versa). Further, as long as import tariffs and especially tariff spikes remain globally, ROO will be relevant and important. But ROO are not the only determinants of market access, with trade barriers (such as technical standards, sanitary and phytosanitary measures, labelling requirements), issues around trade facilitation (many of which are affected by recent EU proposals) and a host of other issues also play an important role.

A number of issues are of particular relevance in the context of EPA ROO negotiations. Key among these was whether ROO negotiations should be conducted at the all-ACP level or individually by the six EPA configurations, being SADC (Southern Africa), ESA (East Africa), ECOWAS (West Africa), CEMAC (Central Africa), CARIFORM/CARICOM (Caribbean) and the Pacific Forum (Pacific countries). At an ACP Council of Ministers session held in Botswana in May 2004, the decision[3] was taken to include ROO in the list of issues that was to be negotiated at the all-ACP–EC level (others included for joint negotiations were trade-related issues and dispute settlement). Despite this, officials at both the ACP Secretariat and the EC indicated mid-2005 that there was still scope to conduct ROO negotiations at the regional level.

There are both advantages and disadvantages to negotiating ROO at the regional level, and they can be summarised as follows. Disadvantages include a loss in regional flexibility, considering different levels of development and commercial interests *vis-à-vis* EU market access. Advantages include the fact that all-ACP negotiations will benefit from a stronger bargaining position, greater availability of negotiation expertise, and importantly, the possibility of ensuring full-cumulation between all ACP countries by way of a single and consistent ROO framework. As emphasised earlier, the mutual exclusivity between dissimilar origin rules and full cumulation means that negotiating parties face a choice between conducting ROO negotiations independently, or prioritising the need for full cumulation but within the context of less regional flexibility and differentiation.

Experience in the past has also shown that not all ROO provisions contained in the Cotonou Agreement pose difficulties for ACP exporters. In fact, the majority are seen as being reasonable by stakeholders, who instead cite other trade barriers as posing even greater challenges. However, ROO in a number of key sectors are nevertheless seen as being overly restrictive, especially in fisheries and textiles, as well as the burden of proving compliance.

A strong thread in recent EC communications is a proposed tightening of the administrative controls associated with preferential trade. This system foresees the introduction of elaborate systems, many of them electronic or based on detailed company assessments by local customs authorities. While in theory these proposals appear entirely sound, the reality on the ground is that a surge in procedural formalities will do little to enhance market access for ACP countries. Instead, stakeholders in some ACP countries have expressed the view that an escalation of these procedures, many of which are to be dictated by the EU, will merely serve to hold up the trade process or indeed promote a climate of corruption. In any case, what is required are home-grown systems and if anything a reduction in unnecessary bureaucracy, an issue that calls for high levels of vigilance from ACP negotiators.

Sectoral issues, particularly around the textiles and fisheries sectors, would involve a substantial lessening of current restrictions. The two-stage transformation requirement that prevails in the textile sector, and which requires two distinct stages of production to be undertaken locally, is completely out of tune with current dynamics in this important sector. In fact, the implicit classification into 'stages of

transformation' is outdated and a remnant from early EU origin regimes of the 1970s, particularly the GSP and early Lomé Conventions. It fails to recognise, both explicitly and implicitly, that first of all beneficiation activities are today far more diverse in this sector than they were three decades ago (for example, a simple fabric can undergo various stages of beneficiation that make it a product with unique technical, design and aesthetic characteristics without changing its classification or general product description), and that global dynamics have changed with regard to geographical centres having distinct price competitiveness. AGOA, which has proved a resounding success mainly in its more liberal approach to ROO in the clothing sector, permits fabric to be sourced from any third country, thus allowing beneficiary ACP countries to utilise competitive inputs and remain competitive in their exports. As a result, there has been a resurgence of the sector (and exports) in a number of African countries.

As indicated earlier, the fisheries sector is subject to stringent rules with regard to vessels, crew and ownership when exporting fish caught in the EEZ. A relatively simple solution, and one that has been endorsed informally by every EPA region, would be to extend the definition of 'wholly obtained fish' beyond the 12-mile territorial waters up to the 200-mile EEZ. Stringent conditions similar to the present ones could instead apply to fish caught outside the EEZ, to prevent the abuse of trade preferences by third countries undertaking fishing activities 'on the high seas'.

The issue of cumulation remains important, despite the fact that there is relatively little evidence suggesting that intra-ACP cumulation has indeed been of substantial benefit. It is likely though, that as regional economic integration advances over the years, that cross-border trade will also grow, thus making the issue of full cumulation potentially critical. But the same applies to cumulation with neighbouring countries that are not ACP countries but nevertheless part of an existing regional integration initiative; on this matter the EC has expressed a willingness (in its March 2005 communication on the future of ROO) to consider additional cumulation where there is a demonstrable need for it, and where the necessary administrative procedures are in place. A lack of such a provision could potentially undermine existing or future regional integration initiatives.

On the EC's preference for a VA methodology, this matter requires further analysis. In the absence of clear analysis, it is impossible to predict whether specific thresholds will benefit or disadvantage ACP exporters, particularly where their products already qualify under current rules. Likewise, the choice of net production cost (NPC), with its numerous cost exclusions, would significantly increase the burden of proving compliance in most categories, and possibly also 'raise the bar' where the threshold is set at too high a level. It must be borne in mind that a, say, 35% ex-works VA threshold would equate to a far higher NPC equivalent threshold. Perhaps maintaining current rules but adding an additional uniform VA rule may be a solution, as it is then a given that at least no sector would be worse off.

Related to VA are the issues of currency movements, and maximum foreign content (FC) versus minimum local content (LC) equivalent, and the inherent disincentive of the VA methodology's approach to increase local production and sourcing efficiencies. Movements in the value of a local currency can from one day to the next push a local product made up partly with imported materials below the local content requirement, despite all manufacturing processes remaining equal.

To alleviate the administrative burden associated with the local content calculation, a switch to requiring FC (in place of LC) as a component of the final cost calculation for ROO purposes may be an option. For example, *minimum* 35% LC would equate to *maximum* 65% FC. Exporters could use the invoiced cost of imported materials as a proportion of final cost to verify compliance with ROO, rather than the administratively more burdensome calculation using local costs. The sometimes-used argument about the danger of under-invoicing holds little weight in the context that ROO should not be burdened with this administrative function, which is after all the responsibility of customs authorities and the like. But even with this method complications arise if the outcome to trade negotiations is a ROO regime that has a high number of cost variable

exclusions in the determination of a baseline product cost.

Another issue inherent in the VA approach is its implicit bias against increasing local production efficiencies. This is due to the fact that over time greater local efficiencies will in turn lower the value of local content, which in certain cases may push a product's local value added below the minimum threshold required by the applicable ACP–EC ROO. This methodology may likewise provide an incentive to source material that are of a higher cost (made in a less efficient way?) than foreign equivalents, which despite its potential developmental dimension (of sourcing locally or within the region) may in effect price the final good 'out of the market'. On the issue of using inputs from higher cost sources the EC's recent working paper on its defence of the choice of a VA methodology even states:

> *'(the) value-added method would be an incentive to source originating materials (even if more expensive than the non-originating ones) from the exporting country or from a country belonging to the same cumulation zone and to use other local/regional production factors'.*

It remains questionable whether 'institutionalised' incentives to source at higher cost will indeed enhance ACP country's market access to the EU. In fact, anecdotal evidence suggests that poor countries without sufficient upstream capabilities have, as a rule, never succeeded in remedying these shortcomings based solely on the requirement of restrictive origin rules (a recent example is AGOA, where despite the looming end of the 'third country provisions' for garment exports, little or no investment was undertaken in upstream textile production). Whatever the case, unless positive progress is made on the key issues it is unlikely that a new ACP–EC ROO regime will provide exporters (especially in ACP countries) with more favourable market access to the EU than is the case at present.

Conclusion

Despite the pending start of ACP–EC ROO negotiations, it is clear that there is little assurance that future ROO will in fact enhance the ACP's trade relationship with the EU. Many factors and uncertainties contribute to this uncertainty, not least of all the apparent lack of a coherent strategy containing the ACP's offensive interests. In its defence, a number of recent initiatives have sought to formulate negotiating positions, even if time constraints do not permit a rigorous analysis of the potential impact that any one ROO methodology may have – especially the EC's preference in this respect.

As with all trade negotiations, real challenges are often hidden away in the detail. Issues such as the EC's proposed net production cost (NPC) basis for valuing goods seeking preferential market access are a case in point, as not only does it form a significant departure from previous practice, but also it may be that the exclusion of specific cost components have the potential to substantially alter the qualifying status of current exports.

Full cumulation has long been an issue perceived as 'non-negotiable' within a future EPA framework, both in the context of seeking improved ROO based on the current '*acquis*', but also from a political level. As a consequence, the decision was taken to negotiate future ROO as a bloc, thus preventing a potential conflict between different ROO regimes and maintaining provisions for cumulation. But the real benefit of this approach, it is submitted, lies in the fact that as a coherent negotiating bloc the ACP group will inevitably have greater negotiating expertise and leverage.

Since ROO potentially play such a vital role of enhancing (or denying) market access among preferential trade partners, an apparent lack of awareness of important ROO issues among stakeholders – including some policymakers and economic agents such as producers and exporters – emphasises the need for ongoing capacity building in this area. Even among the various EPA configurations and regional secretariats, and by extension their constituencies, significant differences in the overall level of awareness regarding ROO continue to prevail. As long as import tariffs and related measures continue to form part of trade policy, preferential ROO will be an important variable for countries wishing to benefit from preferential market access. In that context, the

benefits from a revision of ACP–EU ROO under proposed EPAs will continue to be measured against the margin of preference that compliance with relevant origin rules would entail.

Endnotes

1 International law (the UN Convention on the Law of the Sea) defines the territorial sea as extending up to 12 miles from the coast, while the exclusive economic zone (EEZ) refers to the area between 12 miles and 200 miles from a country's coastline (or less where applicable, for example where island states are closer than 400 miles apart).

2. 'Ex-works' refers to 'the price paid for the product ex works to the manufacturer in whose undertaking the last working or processing is carried out, provided the price includes the value of all the materials used, minus any internal taxes which are, or may be, repaid when the product obtained is exported' (Protocol I, Article 1 of the Cotonou Agreement).

3. Decision No. 5/LXXIX/04.

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WTO/EPA Negotiations: For a Better Co-ordination of ACP Positions on Agriculture

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Introduction

The African, Caribbean and Pacific (ACP) countries are participating in two parallel rounds of negotiations that are of crucial importance for their trade and agricultural policies. Most of them, as member states of the World Trade Organization (WTO),[1] have been participating in the renegotiation since 2000 of the agricultural agreement, implemented in 1995. After the failure of the Cancun Conference in September 2003 to finalise a document on trade modalities, the document on which the member states reached a consensus in July 2004, the so-called July framework agreement, is today used as the blueprint for the agricultural negotiations. In accordance with the timetable set out in Article 20 of the agricultural agreement, the renegotiation is scheduled to be completed by the end of 2005, on the occasion of the Sixth WTO Ministerial Conference in Hong Kong. This sixth conference is intended to put an end to the negotiation round launched at the fourth conference in Doha (Qatar) in November 2001, and described as the 'development round'. The issues of the multilateral agricultural negotiations involve in particular the three pillars of the agricultural agreement: improving market access by reducing tariff and non-tariff barriers; the disciplines concerning the use of domestic supports so that aids granted to farmers do not distort markets; and the disciplines relative to export supports (export subsidies and other measures having equivalent effects).

Moreover, the ACP countries have been negotiating since September 2002 with the European Union (EU) to put in place Economic Partnership Agreements (EPAs) on 1 January, 2008 between the ACP regions and the EU. These agreements constitute the commercial part of the Cotonou Accord, signed in 2000, which replaces the various Lomé Conventions applied since 1975. The trade regime under Lomé between the ACP countries and the EU was based on non-reciprocal trade preferences; the EU granted preferential access to exports from the ACP countries in comparison to other countries, while the ACP countries were not obliged in exchange to grant the same preferential access to the EU in comparison to their other partners. This regime was heavily criticised on numerous occasion in the 1990s because it did not respect the WTO rules[2] and because its effectiveness in integrating ACP countries into world trade was contested. The EU therefore undertook to change its trade regime with the ACP countries to comply with the WTO rules, after having obtained an initial dispensation under Lomé IV-bis (1995–2000), followed by a second dispensation under Cotonou (2000–07) on condition that it would request no more dispensations and that the second dispensation was only provisional pending total compliance by the EU–ACP trade regime with the WTO rules. The EPAs, as free trade areas between an ACP region and the EU, would thus introduce for the first time the principle of reciprocity in trade relations between ACP countries and the EU; such reciprocity could be asymmetric with less trade liberalisation by the ACP countries. The negotiating issues concern the products which can be excluded from the EPAs, the implementation timetable, as well as the development part of the EPAs.

The two rounds of negotiations are being carried out at the same time in separate frameworks, the

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multilateral WTO forum for the agricultural agreement and the framework of bilateral relations between the EU and the ACP countries organised according to their regional integration areas for the EPAs. However, other than the fact that they require sufficient human and technical capacities to be carried out head-on, the difficulty of the exercise for the ACP countries lies in the interaction between the two rounds of negotiations. The EPA negotiations must ensure that the results produced comply with the WTO rules (since it was the non-compliance of the preceding trade regime with those rules which in part led to the reform). However, these negotiations are being carried out at the same time as the negotiations on the actual WTO rules. The WTO negotiation timetable is in addition fairly flexible and tends to become more elastic in line with the difficulties encountered in the negotiations, while the deadline of 1 January, 2008 for the EPA negotiations seems firmer since it is the result of the second dispensation granted to the EU on the basis of the latter's commitment not to seek another dispensation. In this context, the EPA negotiations may progress more quickly and influence considerably the position of the ACP countries with regard to the multilateral negotiations.

In addition, the two rounds of negotiations are taking place against a backdrop marked by important changes in the EU's agricultural and trade policies, as well as other bilateral or regional rounds of negotiations involving the ACP countries. The reform of the European Union's Common Agricultural Policy (CAP) and its Generalised System of Preferences (GSP) with regard to all developing countries, which includes the Everything But Arms (EBA) initiative for the least-developed countries (LDCs), undoubtedly have an influence on the WTO and EPA negotiations. The ACP countries must also take into consideration the parallel negotiations that they are conducting in the framework, for example of their regional integration.

Finally, the ACP countries constitute a very heterogeneous group of countries. However, the problems as regards agricultural trade are different (while some countries are geared to exporting agricultural products, others, on the contrary, are net importers of agricultural products), levels of development and therefore 'statuses' also differ (more than half of the ACP countries have LDC status). The interests of the ACP countries in both rounds of negotiations may therefore diverge and make it difficult to establish a global ACP negotiating strategy.

In the light of these complexities, a certain number of questions need to be addressed by the ACP countries: how to approach the two rounds of negotiations? What negotiating strategy should they adopt, bearing in mind the potential interaction between the negotiations? To which round of negotiations should they give priority, in which round should they proposes the most ambitious commitments and with regard to which negotiating points?

The aim of this chapter is to discuss potential responses to those questions, while showing to what extent the WTO and EPA negotiations interact and can be linked. The issue for the ACP countries is to define a negotiating strategy that co-ordinates the two rounds of negotiations with a view to obtaining results which are in their best interests in the area of trade and agricultural policy.

In this chapter, we present first of all the main objectives and issues for the agricultural trade of the ACP countries. The paper then sets out the contextual background of the WTO and EPA negotiations to be taken into consideration, and which can influence the interests, objectives and negotiating strategies of the ACP countries. After having identified the main lessons to be learned from the free trade agreements previously concluded between the EU and developing countries, endeavours to analyse, for each of the objectives and issues regarding agricultural trade previously identified, how the two rounds of negotiations are linked and, accordingly, to identify the appropriate negotiating strategies to be adopted. We draw conclusions, on the one hand regarding the speed and timing of the negotiations, and on the other regarding needs in terms of technical assistance, capacity building and support in the negotiations.

Main objectives and issues of the agricultural trade of the ACP countries

Agriculture is a vital sector for the ACP countries. It is the main source of foreign currency for most of the

ACP countries and the majority of the population (between 40 and 90%) depend directly on it for their subsistence. In addition, the EU is the main trading partner for the majority of the ACP countries, especially in Africa. That is why the current reforms of agricultural policies, such as the regional integration processes and now the EPA negotiations and agricultural negotiations within the WTO, are crucially important for the ACP countries.

Two major problems can be distinguished concerning the agricultural trade of the ACP countries, which are also the main issues at stake in the agricultural negotiations: (i) access to markets in developed countries and the EU in particular; and (ii) the competition of imports from developed countries on national markets as well as the dynamics of regional trade. Substantial progress has already been achieved on access to markets in developed countries through successive tariff reductions. The residual tariff barriers that are an obstacle to ACP exports are now far more limited, however non-tariff bariers have increased (sanitary and phytosantiray standards, rules of origin), and strcutural supply constraints also limit very strongly the capacities of the ACP countries to position themselves on export markets. The problem of competition from imports from developed countries, and in particular EU countries, on the markets of the ACP countries is particulalry acute. It concerns the conditions of access to markets in the ACP countries and therefore the measures that those countries can put in place to protect their markets from competition.

A. Access to the markets of developed countries

Residual tariff barriers

Tariffs are still high despite the generalised reduction in customs duties

Globally, the markets of developed countries are open to exports from ACP countries. In markets other than those of the EU, the ACP countries can benefit from the Generalised System of Preferences (GSP) put in place by most of the major developed countries (United States, Japan, Canada, etc.) to offer preferential, non-reciprocal access to all developing countries. They also benefit from the generalised reduction in customs duties applied in particular since the entry into force of the WTO agricultural agreement in 1995 and the disciplines that it imposes in the area of tariff reductions.

Customs duties, however, remain high on products that are very important for the ACP countries, despite the generalised reduction in customs duties (see Table 1). The GSPs of developed countries exclude moreover the products that they consider to be sensitive and that are also key products for the ACP countries. Thus the GSP of Canada excludes, among agricultural products, poultry, prepared meat and fish, vegetables, fruit and juices, wine, etc. or imposes tariff quotas on products such as bovine meat, dairy products, cereals. The Japanese GSP is even more restrictive from the agricultural point of view: it excludes sugar, bovine meat, dairy products, etc. The improvement of access to the markets of

Table 1. Customs duties in certain developed countries before and after the implementation of the Uruguay Round Agreements

	EU before	EU after	Japan before	Japan after	USA before	USA after
Green coffee	5	0	0	0	0	0
Cacao beans	3	0	0	0	0	0
Fresh tropical products	9	5	17	4	7	5
Sugar	297	152	126	58	197	91
Wheat	170	82	240	152	6	4
Dairy products	289	178	489	326	144	93

Source: OECD. MFN duties

developed countries other than the EU is therefore a key issue for the ACP countries.

A European market which in theory is very open

In the European market in particular, overall the residual tariff barriers are lower than on markets in other developed countries. The EU claims as proof that it is the world's leading importer of food products. It alone imports more agricultural products from developing countries than the United States, Canada, Japan, Australia and New Zealand combined.[3] Since the creation of the WTO, the growth rate of agricultural exports from LDCs to the EU has doubled. It is important however to make a distinction between LDCs and non-LDC ACP countries.

For LDCs, the question of improved access to the European market through the removal of residual tariff barriers is no longer an issue, since the adoption by the EU of the Everything But Arms (EBA) initiative in 2001 offers duty-free and quota-free access (except for sugar, rice and bananas which are subject to the phased elimination of quotas). Therefore, there are no longer any residual tariff barriers for LDC exports, including for products that are sensitive for the EU and are covered by specific protocols (see below). That does not mean that there are no more obstacles to LDC exports, and impact studies have shown the limited effect of the initiative because of numerous limits such as rules of origin, sanitary and phytosanitary standards, and safeguard measures, as well as the unilateral character of the initiative.

The non-LDC ACP countries also benefit from preferential access to the European market in the framework of the Cotonou Accord, in relation to non-ACP LDCs. In fact, the vast majority of agricultural exports to the European market enter free of customs duties. Only about 7% of agricultural exports are still taxed under the Cotonou regime which has been in force since 2000. However, there are residual tariff barriers that can be divided broadly into two types: *ad valorem* duties (a percentage of the product's price) and specific duties (amount in euros per unit of measure, for example per 100kg, tonne, number of parts, etc.). While certain products can benefit from a 100% reduction in *ad valorem* duties, they can still be subject to variable specific duties.[4] In 2000, 46% of agricultural tariffs were expressed in specific amounts for imports under the Most Favoured Nation (MFN) regime, and 31% for imports benefiting from a preferential system (ACP, including LDCs and GSPs).[5]

In general, residual tariff barriers apply to ACP agricultural products that are considered by the EU to be particularly sensitive, that is to say that could compete with EU products. For those products, the principle of a duty-free and quota-free European market, in the framework of the Lomé Conventions,

Box 1. Rice (Guyana, Surinam) and grapes (Namibia), examples of residual trade barriers for non-LDC ACP countries

For rice, access to reduced duties is authorised via two quotas:

- a quota of 125,000 tonnes for exports of rice in the husk
- a quota of 20,000 tonnes for exports of broken rice

A 65% reduction in duties is granted on these quotas, in relation to MFN duties; in other words, rice exports from ACP countries are subject to 35% of MFN duties, up to the quota limits. Guyana and Surinam, major exporters of non-LDC rice, are particularly affected by the existence of these residual tariff barriers.

Namibian grapes are subject to residual tariff barriers (quota of 800 tonnes duty-free) when they enter the European market at a period when they are not competing with any production of similar quality in the EU. The dismantling of residual tariff barriers would, on the contrary, enable Namibia to achieve large-scale gains in terms of employment and income.

Source: Agritrade.

is limited. The Cotonou Accord includes (Declaration XXII of Annexe V) provisions such as tax-free quotas, import 'ceilings', and seasonal duties for agricultural exports of the ACP countries. It also allows the ACP countries to request the registration of new agricultural products under the principle of tax and quota exemption. Applications must, however, be justified and registration is far from easy to obtain.

Moreover, the Cotonou Accord has reaffirmed the product protocols existing under Lomé for sugar, bovine meat and bananas (Protocols 3, 4 and 5 respectively of the Cotonou Accord).[6] For the non-LDC ACP countries these protocols represent quantitative restrictions accompanied sometimes by residual duties. They authorise a certain quota of exports from ACP countries with reduced or zero customs duties, for sugar and beef, enabling the ACP countries to benefit from the European domestic price (higher than the world price and stable).

Product protocols		
Sugar	**Bovine meat**	**Bananas**
Duty-free up to the quota limit	Specific duties of 8% up to the quota limit	Duty-free up to the quota limit
European domestic market price	European domestic market price	

Customs duties are thus applied to, among other things, dairy products, eggs, fresh and frozen vegetables, oleaginous fruit, bananas (above the tariff quotas), other fresh and dried fruits, cereals, starches, animal fats, sugar (except for cane sugar, covered by a protocol), chocolate, fruit juices, albumin and animal food. By way of example, among dairy products, milk (non-condensed unsweetened milk) from ACP countries is taxed at €11.5/100kg (compared with €13.8/100kg MFN duty); yoghurts (whether or not flavoured) are not subject to *ad valorem* duties (in comparison to MFN duties and the GSP), but are still subject to the same specific duties as for other countries, which range from €12.4/100kg to €168.8/kg depending on the product. In the same way, *ad valorem* customs duties on chocolate are zero but specific duties vary.

The average level of residual tariff barriers applied to agricultural exports from the ACP group (including LDCs) on the European market has been estimated at 5.3% on 98.1% of imports receiving preferential treatment.[7] This estimate must be compared with that of countries under GSP (17.9% of protection on average on 19.8% of imports covered by the preferences system) and MFN (average protection rate of 20.7%) regimes. Although the residual tariff barriers for non-LDC ACP countries are therefore far lower than for other countries,[8] the issue is still important for certain ACP products for which access to the European market could be improved considerably.

Table 2. Escalating MFN and GSP customs duties for coffee and cocoa in Japan and the EU

	Japan		EU	
	MFN duty	**GSP duty**	**MFN duty**	**GSP duty**
Unroasted coffee	0%		0%	0%
Roasted coffee	12%		7.5%	2.6%
Cocoa beans	0%	0%	0%	0%
Non-defatted cocoa paste	5%	3.5%	9.6%	6.1%
Defatted cocoa paste	10%	7.0%	9.6%	6.1%
Unsweetened cocoa powder	12.9%	10.5%	8%	2.8%
Sweetened cocoa powder	15%	12.5%	8%	2.8–4.5%
Chocolate	21.3%	12.5%	8.3%	4.8%

Source: Japanese Ministry for Foreign Affairs, in Gret (to be published in 2005), Impact on agriculture of the CEMAC+STP of an EPA with the EU; European Commission Export Help Desk.

Escalating customs duties

Customs duties applied to agricultural products from the ACP countries are generally applied to high added-value products, while primary products or semi-processed products are subject to zero duties. Customs duties escalation, that is to say increasingly higher levels depending on the degree of processing of products, is evident on markets in certain developed countries concerning MFN and GSP duties (see Table 2).

On the European market, exports of processed products from non-LDC ACP countries (those classified as LDCs are not concerned) are not subject to tax in the same way owing to trade preferences granted to them (see the example of cocoa in Table 3).

However, certain high added-value products may be taxed when they include in their composition products that are sensitive for the EU, such as sugar. Thus fresh and dried mangoes exported from ACP countries to the EU are admitted duty-free, whereas they are taxed at €15/100 kg when they are conserved with sugar and mango juice is taxed at €12.9/100 kg.[9] Likewise tinned pineapples are subject to prohibitive import duties, including for LDCs in the framework of access restrictions on sugar exports.

For countries that are heavily dependent on trade with the EU, which is the case of African countries in general (but not of Caribbean and Pacific countries), this tariff structure can contribute to continuing primary specialisation, at a time when the emphasis is on the need to create added value for agricultural products.

The erosion of trade preferences

In the framework of the Lomé Conventions since 1975, and even today under the Cotonou Accord up to December 2007, the ACP countries benefit from non-reciprocal trade preferences on the European market in comparison to their non-ACP LDC competitors. The effectiveness of these trade preferences is contested to the extent that they have not made it possible to halt the overall marginalisation of ACP countries in world trade and even on the European market. While the ACP group has been enlarged, the share of its exports on world markets has gone from 3% at the beginning of the 1970s to 1.5% today; and the share of ACP countries in European imports has fallen over twenty years from 8% to 3%, mainly in favour of Asian countries which do not benefit from trade preferences. However, certain ACP export sectors have undoubtedly benefited from the advantage that this system gave them. Although ACP agricultural exports (excluding

Table 3. Customs duties on cocoa-based products entering the EU

	Cocoa beans (SH 18010000)	Cocoa paste (SH 18031000)	Cocoa butter (SH 18040000)	Cocoa powder not containing added sugar (SH 18050000)
ACP (Ivory Coast, Ghana, CEMAC + STP, Nigeria)	0%	0%	0%	0%
Brazil	0%		7.7%	8%
Equator – GSP +	0%	9.6% or 0%	4.2% or 0%	
Indonesia – GSP	0%		4.2%	2.8%
Malaysia – GSP	0%		4.2%	
Peru – GSP +	0%		4.2% or 0%	
Singapore	0%		7.7%	
Thailand	0%		7.7%	
Turkey	0%		0%	

Source: Gret (to be published in 2005), Impact on the agriculture of the CEMAC+STP of an EPA with the EU.

Protocols) grew by 43% during the period from 1988 to 2000, the sectors benefiting from a preferential margin of more than 3% increased their exports by 60%. Growth rates are particularly strong for the following non-traditional products: flowers (+230%), vegetables (+132%), prepared fish (+110%), tobacco (+83%), and prepared vegetables and fruits (+70%).

However, over the years, the preferences of the ACP countries in comparison to their non-ACP competitors have declined for several reasons, including:

- the multilateral liberalisation process promoted by the WTO with a generalised reduction in tariffs (Most Favoured Nation principle);
- the signature between the EU and other trading partners of bilateral free trade agreements (FTA) introducing tariff reductions;
- the CAP reform decided in June 2003;
- the EBA initiative in 2001; and
- the new Generalised System of Preferences (GSP) put in place in July 2005 (including the EBA initiative).

The impact of these different processes varies from one product to another and therefore from one country to the next. The multilateral trade liberalisation process leads inevitably to a reduction in the preferential margins of the ACP countries. However, the other processes are at least as important and the generalised reduction in tariffs reinforces the erosion resulting from the CAP reform (which reduces European prices to world levels – sugar and beef being the most significant examples of that) and the multiplication of FTAs signed by the EU which offer preferences to a growing number of regions and countries.[10]

The main effect of the decline in preferences has been to reinforce competition between ACP countries and non-ACP LDCs for access to the European market, resulting in lost market share and a drop in export revenues for the ACP countries.

Non-tariff barriers

Rules of origin

The rules of origin applied by the EU to exports from developing countries are particularly strict. This question affects specifically LDCs since the rules of origin of the EBA initiative are those of the GSP.[11] These rules, which include aggregation rules and sufficient processing criteria, are stricter than those applying in the framework of the Cotonou Accord. Thus, a recent study carried out by IDS (University of Sussex) indicates that the rules of origin which are applied can impose on LDCs up to 60% of local added value as an eligibility criterion.

Although the wish to avoid risks of re-exportation[12] seems to be a legitimate concern, the rules of origin imposed on products from LDCs seem too rigid to enable those countries to benefit properly from the EBA initiative. For example, LDC food exports, where the import packaging represents an important element in the cost of the finished product, may be considered as not respecting the rules of origin and be taxed accordingly. The issue for LDCs in particular is therefore to obtain a revision of the EU rules of origin applied to their exports with a view to achieving greater flexibility, thereby enabling them to benefit fully from preferences.

Quality standards and SPS

The reduction in tariff barriers introduced in the multilateral framework of the WTO as well as in the bilateral framework of free trade agreements has facilitated access to the markets of developed countries for the ACP countries. However, at the same time, non-tariff barriers have developed and are becoming today the real obstacles to access to markets in developed countries, in particular for fresh products. Notifications of technical measure (different types of standards, technical obstacles to trade) as conditions of access to markets increased from 300 in 1980 to 3,000 twenty years later, while at the same time customs duties were reduced regularly.[13]

For the ACP countries, the adoption and implementation of European SPS standards, which in general tend to be stricter than international standards,[14] are an additional difficulty and a major challenge. In this regard, a recent study commissioned

by the CTA in 2003 has revealed that 'some 17 ACP countries represented approximately 83% of the ACP exports in the areas of products likely to be the most affected by the SPS measures', horticultural products and fisheries being the most at risk. One of the main conditions of access to the European market is that agricultural exports should not exceed the Maximum Residual Limits (MRL) for pesticides fixed by the European Commission.[15] Moreover, there is a risk that access to the European market will become even more difficult with effect from 1 January, 2006, the date of the application of the new European regulation on the control of foodstuffs. This new regulation is above all an internal European Union regulation, but the Commission has stressed that it also applies to third countries wanting to export to the European market. The basic principle is that any product entering the European market must satisfy or be equivalent to EU standards. The new generalised regulation makes it compulsory for food companies to apply the HACCP (hazard analysis critical control points) principles. The EU also requires, in the framework of the new regulation, the competent authorities of exporting countries to ensure that products exported to the European market satisfy the standards in force on that market. That means in theory that even if an ACP food unit satisfies European standards, it can only export its products to the European market if the competent authority of the country where the unit in question is established is recognised by the Commission's services, in this case the Food and Veterinary Office (FVO). This raises important questions for the public institutions of the ACP countries, with potentially very high costs imposed on the private sector because of a lack of resources and capacities at public sector level.

If the new European regulation creates a certain number of important constraints for ACP exporting countries, the codes of conduct adopted for the future by the large food retail chains in Europe (e.g. Eurepgap) very often go further than the Community legislative texts and are a major problem for SMEs/SMIs (small and medium-sized entrepries and/or industries) of the ACP, and African in particular, food industry.[16]

The lack of competitiveness of ACP countries in comparison to non-ACP LDC competitors

The lack of competitiveness of the ACP countries results from their high production costs and more generally their production constraints. Competition from non-ACP LDCS on European markets is particularly strong from Asian and Latin American countries, and in the area of traditional tropical type products such as coffee and cocoa. The example of processed mangoes (see Table 4) illustrates the lack of competitiveness of the West African ACP countries.

Even if improvements have been and can still be made in terms of ACP access to the markets of developed countries, the difficulty for ACP countries is to be able to take full advantage of these opportunities owing to the structural constraints that affect trade potential, in particular for the least-developed African countries. These structural constraints also affect production capacities (unfavourable climatic conditions, problems of access to land, productivity, etc.), as well as processing capacities (unsuitable

Table 4. Competitiveness of processed mangoes

	Interest rate	Labour costs (US$)	Price of fresh mangoes (FOB US$)
Mexico	10	244,65	513.05
Brazil 17	245.9	490.83	
India 11	42.07	463.55	
Philippines	11	137.76	861.40
South Africa	11	859.48	378.24
West Africa	19	304.10	609.97

Source: Laborstat and Fernch Ministry of External Trade; in SIA West Africa, phase II.

equipment and technologies) and commercialisation.

Public infrastructure weaknesses (the poor state of roads and rail networks) result in high transport costs and can be bad for the quality of fresh products (fruit and fresh vegetables for example), including hygiene problems (frozen meat without suitable means of transport). Likewise, the shortcomings in public utility services, such as water and electricity, are a handicap to the competitiveness of products. The absence or lack of reliability of information systems, the lack of financing and capital (weakness of financial services, levels of investment) and the low productivity of labour (because of the poor quality of human resources due to the state of the health and education systems) are also negative factors. Finally, institutional shortcomings can be a source of corruption, fluctuating exchange rates and high levels of inflation. They also undermine the capacity to carry out the necessary checks and certification with regard to compliance with European sanitary and safety standards.

The challenge for the ACP countries is therefore to reinforce their production, processing and commercialisation capacities by addressing all these aspects in order to improve their competitiveness and be able to compete with non-ACP LDCs, such as Brazil, in accessing the markets of developed countries. This challenge concerns in particular the possibility of putting in place agricultural policies that are sufficiently strong and effective.

Competition from imports on domestic and regional markets in the ACP countries

Competition from imports on domestic markets

Competition which is even stronger because it is unfair

Numerous ACP countries suffer from the competition of imports with their local production and in consequence the dynamics of the development of their local and regional markets. The competition from imports may be due to the strong competitiveness of the products imported, based on levels of productivity and comparative advantages superior to those of the ACP countries. It may also be due to the absence of a consumer market for by-products (e.g. cuts of poultry not used in Europe and exported at low cost to West and Central Africa).

However, the competitiveness of imported products is sometimes distorted when it is maintained by aids to producers and exporters enabling them to sell their products at dumping prices, that is to say at less than their cost of production (as in the case of wheat from the United States and the EU); competition is then unfair. The ACP countries cannot use such aids, since neither structural adjustment programmes (SAPs) and WTO rules allow them to, nor do they have sufficient budgetary resources. For example, no ACP country has notified export subsidies. There is in fact a tendency for exports, in particular from the African ACP countries, to be taxed. It is important to emphasise that the production and export-support measures used in Northern countries contribute to the destabilisation of world markets by encouraging over-production, lower prices, and price volatility.[17]

Low protection possibilities

Moreoever, the tariff protection of the ACP countries *vis-à-vis* imports has proved to be insufficient. It must be borne in mind that in the SAP's framework the conditions include converting non-tariff barriers into customs duties (tariff rates) and heavily reducing tariffs. A number of ACP countries therefore had very low tariffs at the time of the 1995 agricultural agreement. That agricultural agreement provided for reductions in tariffs for developing countries (except the LDCs) on the basis of the tariff lists determined at the end of the Uruguay Round. However, most of the ACP countries that had not consolidated their tariffs before the Uruguay Round chose the option of ceiling rates. In Africa, tariffs were consolidated in a relatively standard way at high levels. That option was the one that gave them the greatest flexibility; as most of the tariffs were at low levels because of the SAPs, the possibility of consolidating their tariffs at ceiling rates gave them the option, if necessary, to increase their tariffs subject to those limits. However, the tariffs as generally applied remain below the tariff ceilings; in other words developing countries do not use their option to increase their tariffs (see Table 5). Moreover, certain ACP countries, such as those of the Union

Table 5. Customs duties consolidated at the WTO by certain ACP countries for agricultural products

Countries	Consolidated customs duties (%)	Additional consolidated customs duties (%)	Total consolidated tariffs (%)	Rates effectively applied (%)
Benin	60	18	78	
Burkina Faso	100	50	150	
Cameroon	80	230	310	24.5
Ivory Coast	15	200	215	20
Ghana	98	0.2	98.2	22
Kenya 100	0	100	44	
Mauritius	120	17	137	52
Mozambique	100	300	400	

Source: WTO

Economique et Monétaire Ouest Africaine (West African Economic and Monetary Union –UEMOA), implemented important tariff decommissioning when they applied the common external tariff (CET) determined in the framework of their regional integration process.

A major fear for the ACP countries is that they will be obliged to reduce further their customs duties, as is provided for in particular in the introduction of reciprocal trade preferences in the framework of the EPAs. One of the consequences would be to make imported European products more competitive than local ACP products, which would have negative effects for emerging industries, notably as regards subsidised products such as beef, dairy products, cereals. This risk is particularly high in the case of tomato purée in the CEMAC zone, beef and tomato purée in West Africa, dairy products in the Caribbean countries, and cereals in East and South Africa. These potential risks explain the current discussions of the ACP countries at both multilateral and bilateral levels on the need to use two types of protection: on the one hand the designation of special/sensitive products to be excluded from the liberalisation process, and on the other hand putting in place safeguard systems.

Competition from EU imports with regional trade

Certain ACP regional integration areas have adopted a CET that protects them from imports, all sources combined. In the UEMOA area, however, the CET, as defined, is today increasingly disputed since it is considered to be too low to limit imports, with the resulting harmful consequences for domestic and regional markets. The signature of an EPA abolishing customs duties imposed on EU imports would potentially accentuate the phenomena of competition with regional markets. Certain countries would prefer to import European products that have become cheaper with zero customs duties, rather than continue to obtain them from their regional partners (diverting trade).

Contextual elements to be taken into consideration and which may affect the interests, objectives and negotiating strategies of the ACP countries: CAP reform, the EBA initiative

Impact of the CAP reform

The CAP reform of 26 June 2003 follows the first wave of reforms, which started in 1992, and consists chiefly in decoupling supports to producers with the introduction of a single payment per farm. This approach is intended to reduce the domestic price of EU agricultural products, without threatening agricultural income. This reform, which marks the gradual abandonment of intervention prices guaranteeing a Community price far higher than the world market price, thus enables the EU to comply with the WTO disciplines. Sectoral reforms, including those with regard to cereals (initiated in 1992), rice,

bovine meat, dairy products, and oleaginous crops have also been decided. The main objective of the reform is above all to reinforce the competitiveness of the European food sector on export markets.

By reducing the difference between the EU market price and world market prices, this reform process helps to reduce the need for the EU to use protective customs duties and export refunds. It is an important element in the proposals made by the EU to the WTO with regard to reducing export refund expenditure and customs duties. The CAP reform can therefore be seen as the mainspring of the EU position in agricultural negotiations at the WTO and not the opposite.

For the ACP countries this reform has several types of consequences:

- a reduction in the domestic European price on which they could rely in the framework of the sugar and bovine meat product protocols, and therefore a reduction in their export revenues (see Box 2 on the reform of the common market organisation for sugar).
- an additional erosion of the preferential margins granted to the ACP countries in relation to non-ACP countries. As shown above, by reducing the guaranteed prices to European producers to bring such prices more into line with world prices, the EU has less need of high customs duties to protect its market. It is therefore more willing to reduce its customs duties. A direct consequence of this reduction of European customs duties is an erosion of the preferential margins of the ACP countries. The erosion of preferences is already significant in the beef sector following the 1999 reform. The same applies as regards ACP rice following the June 2003 reform, which implies a 50% reduction in the Community intervention price.
- Increased competition from EU imports on ACP markets given the reduction of European prices to world levels. That is the case for example of the cereals sector. By reducing prices and therefore the difference between European and world prices, European producers and processors will find it easier to export processed agricultural products. Once the reform has been completed, it should reinforce the price competitiveness of European agricultural products and boost the competitiveness of these exports on ACP markets. But it is important to emphasise that changes in the €/$ exchange rate in recent years have strongly influenced the price competitiveness of European products and are therefore a key element of the analysis.

Table 6. ACP countries benefiting from product protocols

	Bananas	**Bovine meat and veal**	**Sugar**	
Africa	Cameroon	Botswana	Congo	Swaziland
	Cape Verde	Kenya	Ivory Coast	**Tanzania**
	Ivory Coast	Madagascar	Kenya	**Uganda**
	Madagascar	Namibia	**Malawi**	**Zambia**
	Somalia	Swaziland	Mauritius	Zimbabwe
		Zimbabwe	**Madagascar**	
Caribbean	Belize		Barbados	
	Dominica		Belize	
	Grenada		Guyana	
	Jamaica		Jamaica	
	St. Lucia		St. Christophe & Nevis	
	St. Vincent		Surinam	
	Surinam		Trinidad & Tobago	
Pacific			Fiji	

Note: the countries in bold are LDCs.
Source: Dunlop, 'What future for Lome's commodity Protocols', ECDPM Discussion Paper No.5, June 1999.

Box 2. The reform of the Common Market Organisations (CMO) for sugar and bananas

Case of sugar: The sugar reforms follow the condemnation by the WTO of the European sugar regime. Discussions on the reform started in 2002, and on 22 June, 2005 the European Commission presented a revised proposal. The European support price would be reduced considerably (by 39%, from €632/tonne to €385.5/tonne) and the sugar intervention price (currently €632/tonne, i.e. more than three times higher than the world price) would be replaced by a reference price to be used in particular to trigger private storage systems and to determine border protections and the guaranteed price for preferential imports. The reform maintains the ACP sugar protocol (purchase of quotas of sugar from ACP countries on a duty-free basis)but the European domestic price from which they benefit will be reduced to the Community reference price and refining aid will be abolished. Moreover, the Commission has proposed a specific 'Action Plan' to help ACP countries to adapt to the new market conditions (improvement of the competitiveness of sugar production where it is still viable, support for diversification). For LDCs in particular, the EBA initiative provides for imports with zero duties with effect from October 2009 (no quota) and the Commission has undertaken to ensure that the price at which sugar will be bought from LDCs will not be less than that guaranteed to ACP countries in the framework of the protocol. The Commission considers that if the European inter-vention price for sugar was reduced by 25%, ACP sugar-exporting countries would lose some €300 million a year in revenues; however, the proposed Commission reduction in June 2005 is 39%.

Case of bananas: The CMO for bananas has been reformed on several occasions following complaints filed by Latin American countries with the WTO dispute settlement body. Today, the ACP banana-exporting countries still have duty-free access to the European market up to the limit of their tariff quotas, while bananas from other sources ('dollar bananas' from Latin America) are taxed, which is relatively low up to the limit of their quota and very high above that limit. With effect from 1 January, 2006, a purely tariff-based system will replace the current system of tariff quotas by zones of origin (including for LDCs in the framework of the EBA initiative). The idea is to enable ACP bananas to continue to benefit from a preferential margin by applying a single customs duty for banana imports from non-ACP third countries, with ACP imports continuing to be duty-free. The overall objective is to prevent banana-producing ACP countries from losing market share to the major Latin American producers. However, the level of tariffs to be applied has give rise to heated discussions. The customs duty notified at the beginning of 2005 by the EU to the WTO to enter into force in 2006 is €230/tonne. The Latin American countries consider that this tariff is too high and have asked that it should not exceed the current €75 tariff quota for dollar bananas. Conversely, the two principal African exporting countries, Cameroon and the Ivory Coast, have asked that the future customs duty should not be less than €275 per tonne. The tariff of €230/tonne proposed by the EU was formally rejected on 1 August, 2005 by the arbitrator appointed by the WTO. Following that decision, the EU published on 12 September, 2005 a press release announcing an MFN tariff of €187/tonne. Although the Commission considers that its new proposal meets the criticism set out in the WTO decision, the Latin American spokespersons have declared that they are not satisfied. The ACP representatives are also dismayed by the new proposals. On 27 October, 2005, a second decision of the WTO arbitrators rejected the EU proposal of an MFN tariff of €187/tonne, considering that such a level would not lead to total access to the European market being maintained for Latin American producers.

What is at stake is the differences in competitiveness of dollar bananas and ACP bananas (mainly African since it is very unlikely that Caribbean-produced bananas can support the competition) which are based on production costs but also the relative efficiency of the internal commercialisation channels and the cost of international freight.

Source: GRET (to be published in 2005), CTA – Agritrade

In conclusion, over the short and medium term, the CAP reform is a key element in trade relations between the EU and the ACP countries. Its effects for the ACP countries are important, in terms of reduced export revenues for the ACP products covered by protocols, heightened competition in ACP markets (via an expected improvement in the price competitiveness of European products), and an erosion of ACP preferential margins (via the decline in MFN and GSP duties made possible by the reduction in domestic prices).

The 'Everything but Arms' (EBA) initiative

This initiative, signed in February 2001, entered into force in March and grants duty-free access for all ACP exports, without any quantitative restrictions, to the European market, except for arms and munitions. For certain products, the implementation is gradual, up to 2006 for bananas and 2006 for rice and sugar (see Box 3).

This EBA initiative has three types of consequences as regards trade preferences for the ACP countries:

- An erosion of preferences for LDC ACP countries (40 countries in total[18]) in comparison to the non-ACP LDCs. The advantages from which only ACP countries benefited in terms of access to the European market have now been extended to non-ACP LDCs.
- Improved preferences for LDC ACP countries in comparison to non-LDC ACP countries, in particular when the initiative will apply to products covered by protocols. From 2009 for sugar, the LDC ACP countries that were limited in the same way as non-LDC ACP countries by quotas in the framework of the sugar protocol, will be able to have free access to the EU market. For rice also (which is not covered by a protocol), LDC ACP countries will have quota-free access, and will therefore be at an advantage compared with non-LDC ACP countries from 2009. Banana exports from LDC ACP countries will have duty-free and quota-free access from 2006, while those of the other ACP countries will be taxed, although at a level (not yet determined) below that applied to non-ACP exports.
- In the case of an EPA signed between the EU and regional blocs combining LDCs and non-LDCs, these two ACP sub-groups will have the same conditions of access to the European market. That will mean for the LDC ACP countries an erosion of current preferences in comparison to non-LDC ACP countries.

The new Generalised System of Preferences (GSP)

The Generalised System of Preferences (GSP) of the EU offers reduced customs duties – even totally duty-free access – to imports from 178 developing countries and territories to the European market. A new GSP entered into force on 1 July, 2005 and applies up to 31 December, 2008.[19] This GSP provides for:

- a general system;
- a special system to encourage developing countries to adopt sustainable development and good governance measures (GSP+); and
- a special system in favour of LDCs (Everything but Arms initiative – EBA).

The general system provides for a suspension of customs duties for so-called 'non-sensitive' products and a reduction in customs duties of 3.5% or 20% for sensitive products (the list of sensitive products is determined by the Commission). The special system (GSP+), provides for a suspension of customs duties for almost all products, sensitive and non-sensitive products alike. It is accessible to a specific list of countries, subject to ratification and the implementation of certain international conventions governing human rights, workers rights, the environment and principles of good governance. LDCs continue to benefit from the EBA initiative (see previous section).

Other bilateral or multilateral trade negotiations in which the ACP countries are involved

Other than the contextual elements referred to above, most of the ACP regions are involved in parallel negotiations concerning their regional integration area or sometimes the signature of free trade

Box 3. The impact of the EBA initiative

The EBA initiative concerns 49 LDCs. Except for arms and munitions, only bananas, sugar and rice imports were not totally liberalised when the initiative was implemented in March 2001. During the transitional period rice and sugar imports will be free of customs duties up to the quota limit and tariffs on exports outside the quota will be reduced progressively. For bananas, the intention is to abolish quotas and introduce a single tariff system in 2006. For the three products, free access will be implemented in several stages:

Rice: duties reduced by 20% on 1 September, 2006, by 50% on 1 September, 2007. and by 80% on 1 September, 2009. Total suspension on 1 September, 2009.

Bananas: total suspension on 1 January, 2006.

Sugar: Duties reduced by 20% on 1 July, 2006, by 50% on 1 July, 2007 and by 80% on 1 July, 2008. Total suspension on 1 July, 2009.

Several studies have endeavoured to assess the interest and real impact of such an initiative for LDCs as well as the effects for non-LDC ACP countries. They highlight the following elements, which tend to reduce both the interest and its impact:

- Unlike the Cotonou Accord, the EBA initiative is not a negotiated agreement and can therefore be amended at any time unilaterally by the EU.
- The initiative includes a safeguard clause which authorises the EU to withdraw its preferences in the event of an increase of LDC exports to 'unusual levels'.
- Supply constraints may prevent LDCs from benefiting fully from the initiative, which will therefore not necessarily be able to halt the trend towards marginalisation of LDC imports on the European market.
- Only those products for which LDCs pay import taxes will be affected (for example beef, cheese, maize, bananas, rice, sugar). Those products are strongly protected under the protocols for bananas, sugar and bovine meat, and by quota systems for the others.
- The most significant improvements in terms of market access will concern the non-ACP LDCs in comparison to the LDC ACP countries to the extent that the former receive fewer preferences than the latter. Thus, Bangladesh (for rice, sugar, molasses), Myanmar (for rice and sugar) and Cambodia (for rice) should benefit from considerably improved access to the European market. However, the LDC ACP countries are potentially important beneficiaries to the extent that their imports are approximately €95 million compared with €361,000 for non-ACP LDCs.
- The non-LDC ACP countries may face increased competition from LDCs in gaining access to the European market. That may be the case for Mauritius with regard to molasses and Zimbabwe as regards bovine meat.
- Certain LDCs may be able to take advantage of the initiative to refocus their exports on European markets. That may be the case for the Sudan (beef and maize), Uganda (maize) and Malawi (rice).

Source: CTA – Agritrade. Among the studies carried out on the impact of the EBA initiative, the following study in particular is noteworthy: *The impact of the EU's Everything but Arms' proposal: A report to Oxfam: Final Report*, Oxfam, Christopher Stevens and Jane Kennan, January 2001, Institute of Development Studies.

agreements with third countries. That is the case for example of the Caribbean region, which must reinforce its regional integration process with the creation of the CARICOM Single Market and Economy, CSME, at the same time as negotiating the Trade Area of the Americas agreement, FTAA, which includes different agreements: the free trade agreement with Mexico, the GSP for the Andean and Central American countries, the United States and Canadian MFN regimes. The difficulty is obviously reconciling and co-ordinating all these agreements. The timetable and issues of these parallel negotia-

tions certainly have an impact on the EPA and WTO negotiations.

Principal lessons from previous free trade agreements concluded between the European Union and developing countries

The European Union's trade in agricultural products in the framework of free trade agreements (FTA) is far from being totally liberalised. The EU and its trading partners maintain a certain number of tariff barriers which limit market access. This is linked to the fact that the agricultural parts of the FTAs signed by the EU must take into account, on the one hand, the potentially negative effects of the liberalisation of trade and, on the other hand, national interests and pressures to limit access to the European market.

On the basis of the FTAs signed with the seven Mediterranean countries (Euro–Med) and the FTAs signed with South Africa, Mexico and Chile, the EU uses six instruments to liberalise agricultural trade so that countries can have more advantageous access to the market than that granted to countries with MFN status:

- Complete and/or partial tariff reductions for products subject to *ad valorem* rates or specific taxes. It is to be noted that for the EU, tariff reductions are often linked to MFN duties whereas for its trading partners, the reduction applies to tariffs actually in force, and not to WTO consolidated tariffs (higher). Certain FTAs do not specify the tariff reduction, but a final tax which will be applied to imports from the EU.
- Tariff quotas for products exempt from total tariff reductions. These quotas are tariff reductions for defined quantities of imported products. The quotas are determined according to the needs of the different parties: depending on seasonal limits and necessary quantity adjustments. These adjustments are made by applying a fixed annual rate, or determined every year when the agreement is revised.
- Safeguard clauses, either common to all products or special clauses. These clauses are intended to provide protection against increases in volumes of imports or against a fall in prices of imported products.
- The origin of agricultural products rule.
- Flexible adjustments for access to the market of the trading partners, made possible via two clauses:
  - The revision clause by which the partners undertake to examine the possibilities of deepening the liberalisation of agricultural products, taking into account the sensitivity of agricultural trade and domestic internal agricultural policies.
  - The flexibility clause which allows the partners to modify the agreement if one of the parties modifies its domestic agricultural policies.
- Other specific duties can also exist, but they are not common to all the FTAs.

Moreover, there are two different approaches to the liberalisation of agricultural trade via the FTAs signed by the European Union:

- First of all, it is possible to specify the products benefiting from preferential access (EURO–MED). This positive list type of approach limits the general scope of the FTA and limits it to certain products. It defines the first stages in the liberalisation process, but does not set any guidelines for the process as a whole. Flexibility as regards adopting new increased trade liberalisation measures is ensured by a revision clause.
- The other approach consists in fixing the timetable for the liberalisation process as a whole (South Africa, Mexico, Chile and Lebanon for imports into the EU). In this approach certain products are excluded from the liberalisation process and benefit from preferential access, essentially up to the limit of tariff quotas. The adoption of different timetables or exemptions for various groups of agricultural products, and the restriction of access to markets via tariff restrictions, make it easier to control the liberalisation process. The revision clauses provide additional flexibility for products exempted (for the time being) from trade liberalisation.

Consequently, although trade liberalisation is the main objective of these agreements, it appears that a certain number of products remain excluded from this process, owing to the implementation of various market protection measures, in particular the application of tariff quotas for certain products.

In all the FTAs in which the EU participates, it can moreover be seen that the choice of products subject to quotas or a total tariff reduction reflects the level of domestic protection given to the products in question and the existence of surpluses for the respective products. It can in fact be said that:

- High domestic protection leads to a limited willingness to reduce customs duties, since that could undermine high domestic.
- High domestic protection for certain products, together with a production surplus, implies stronger import restrictions, for example by not extending tariff quotas.
- Surpluses produced by the EU thanks to domestic protection, and which then need to be sold, encourage the EU to improve its access to the markets of its trading partners.

An analysis of the various FTAs signed by the EU therefore shows that the EU excludes a certain number of important products from the free trade principle. The protection and aids from which certain agricultural products benefit at national level within the EU are undoubtedly the decisive factor in the choice of the exceptions. In the case of the so-called sensitive products, important tariff reductions are made by putting in place preferential access, but up to the limit of the quotas. On the other hand, imports above that quota are heavily taxed. Accordingly, imports of sensitive products are limited, via the introduction of tariff quotas. This example shows once again that the CAP reform is the driving force which influences the position of the EU in its agricultural trade negotiations, with all concessions by the EU being linked to the progress of the reform.

Discussion on the issues involved in the WTO and EPA negotiations, the best options and links between the two rounds of negotiations, for each of the agricultural trade issues of the ACP countries

After having identified the key issues for the agricultural trade of the ACP countries and the other factors that could influence the agricultural negotiations conducted by the ACP countries, this section presents the way in which both the WTO and EPA negotiations may respond to those challenges, and above all how the two rounds of negotiations are linked in this regard. The resultant proposed negotiating strategies therefore address the negotiations a whole. In this regard, it is important to emphasise that the commitments entered into by the trading partners in the framework of bilateral negotiations for a free trade area are generally more far-reaching than in a multilateral framework. The MFN principle that prevails at the WTO obliges the member states to be more prudent in multilateral negotiations than in a bilateral framework.

Moreover, the timetable for the EPA and WTO negotiations is crucial in the negotiating strategy. It was originally intended that the Doha Round negotiations would be completed at the Sixth WTO Ministerial Conference in December 2005 in Hong Kong. The EPA negotiations must of necessity be completed by 31 December, 2007 since it is very difficult to see how the EU could obtain a third dispensation within the WTO for its non-reciprocal system of trade preferences. In theory, this difference in deadlines is an incentive to give priority to the WTO negotiations and negotiate in that forum the maximum room for manœuvre to ensure a favourable framework for the EPA negotiations whose results must respect the multilateral WTO framework.[20] However, the WTO deadline seems to be somewhat flexible as a result of the difficulties in making progress in the negotiations, and it may be relevant on certain subjects to give priority to the EPA negotiations.

Finally, it must be borne in mind that at the WTO, the definition of a negotiating strategy depends in particular on the creation of coalitions

between countries with common interests in order to carry more weight in the negotiations. The scope of these coalitions can vary according to the subjects involved. The ACP countries can constitute a group as such in the WTO negotiations. However, certain ACP countries are also members of diverse groups, even several groups at the same time: the G33, G90, G10 (see Box 4). Finally, it must be borne in mind that the LDCs are the only group of countries recognised by the WTO. Those countries are not subject to any reduction commitment.

Modification of coalitions as discussion progresses

The **European Union** and the **United States**, even if there is still a tendency to highlight their divergences, continue to defend certain common interests, such as the option to continue to support their agriculture and improved access to expanding markets.

The **Cairns Group** is a coalition that has declined in importance since the last ministerial conference in Cancun. Several developing countries that were members of the Cairns Groups[22] have joined the G20 or the G33 (see below). Australia and Canada, which were among the driving forces behind the Group, speak with increasing frequency in their own name.

Moreover, the last ministerial conference in Cancun saw the emergence of new country groupings.

First of all, the most-developed developing countries, such as Brazil, India, China and South Africa, as well as 15 other developing countries, have created the **G20**,[23] whose main objective is the abolition of export subsidies used by developed countries. The influence of this group has increased in recent months. Its knowledge of the negotiation issues is very solid and it has put forward astute proposals and counterproposals.

The LDCs, the African Union and the ACP countries are grouped together in the G90 in order to defend the right to protect their agriculture and to support fully the Cotton Initiative. Even if there is a real convergence of interest between these countries, they sometimes find it hard to adopt common positions. The various sub-groups prefer to speak in their own name.

More recently, at the time of the approval of the July 2004 framework agreement, two new coalitions emerged, the G10 and the G33.

The **G10**[24] brings together countries that are net importers of agricultural products and which protect strongly their agriculture. These countries have formed this coalition to defend the right to continue to protect their agriculture, in particular by highlighting its role in terms of 'multifunctionality'.

The **G33** brings together countries, notably Indonesia, and including developing countries such as Cuba, Kenya, Nigeria, Turkey, Pakistan and the Philippines. The G33 is notably committed to defending the concept of special products for which they want special treatment in relation to the tariff reduction requirements, in order to be able to satisfy their needs for food security, guaranteed means of existence, and rural development.

It is to be noted that there are cross-groupings,

Box 4. The various negotiating groups at the WTO

The first is that of the major agricultural exporting countries, including notably the United States and Europe. These countries give very strong support to their agriculture and want to continue to do so, while competing to conquer expanding markets.

The second group is that of agricultural exporting countries that give little support to their agriculture. They are grouped together in the Cairns Group.[21] They consider that agricultural supports lead to unfair competition on world markets and prevent them from capitalising on their comparative advantages. They are calling for the total liberalisation of agriculture.

The third group of countries is far more heterogeneous and brings together a large proportion of developing countries. They agree on the need for greater discipline in the area of agricultural policy in developed countries, better access to their markets, and for developing countries, greater flexibility as regards agricultural policy.

with certain countries belonging to several groups, and expressing themselves within such and such a group depending on the items discussed. If the groups themselves seem stable, their composition is subject to change.

A) Access to the markets of developed countries

Reducing or eliminating residual tariff barriers

In the WTO negotiations, the question of the reduction or elimination of the residual tariff barriers with which the ACP countries are confronted in the markets of developed countries concerns the market access part of the agricultural agreement. The issues involved in the negotiations are the tariff reduction formula to be used, the possibility of increasing tariff quotas[25] and the way in which the WTO member states can protect a certain number of products that they consider to be sensitive.

In July 2004, the framework agreement on which the WTO member states had reached an agreement provides that developed countries (but also developing countries) should open their markets further using a phased tariff reduction formula (Annexe A of the agreement). Such a reduction is likely to reduce or even eliminate tariff peaks and customs duty escalation. The ACP countries that are likely to profit from this new opportunity with regard to access to the markets of developed countries are essentially those that have an export structure that is relatively diversified in terms of products and export markets (that is the case of East and Southern Africa for example).

However, the opportunities to substantially improve access to the markets of developed countries must be qualified by the fact that, according to the framework agreement, those countries have the option, like all member states, to designate a certain number of 'sensitive' products, for which there can be some 'flexibility' as regards tariff reductions. The framework agreement also provides, in addition to tariff reductions, for an increase in tariff quotas, but for the ACP countries – the majority of whose exports are to the EU – this increase does not provide better access to the European market since they benefit from the existence of product protocols and preference systems in relation to non-ACP countries.

The EPA negotiations rightly seek to eliminate the residual tariff barriers on the European market for the ACP countries that are subject to them, that is to say the non-LDCs. In other words, a possible EPA scenario is the 100% liberalisation of the European market. Thus, the European Commission submitted to Committee 133[26] a proposal intended to grant – at the time of the entry into force of an EPA – the ACP countries access to the EU market equivalent to that granted to an LDC under the EBA initiative; which seems to indicate that the Commission is willing to dismantle all residual tariff barriers on non-LDC ACP exports in the framework of an EPA. However, as was noted above, the residual agricultural tariff barriers concern sensitive products in the framework of the CAP. Even if the EPA scenario of complete liberalisation by the EU is often advanced, the negotiations for the liberalisation of sensitive agricultural products are likely to be difficult and there is no reason to believe that this scenario will effectively be the one chosen. In addition, based on the experience of previous free trade agreements signed between the EU and developing countries, liberalisation by the EU is never total.

If the non-LDC ACP countries decide not to sign an EPA, the Cotonou Accord provides for access to the European market to be governed by an alternative system, to be determined. As the only alternative to free trade agreements authorised at the present time by the WTO is the Generalised System of Preferences granted to all developing countries, it is very likely that the latter system will be the only option. This system is in principle less favourable for ACP countries in terms of access to the European market than an EPA, which can offer totally duty-free and quota-free access. That is, however, the subject of numerous discussions following the publication of an article by IDS (University of Sussex) tending to show that the inclusion of the ACP countries in the GSP+ could lead to more important economic gains than an EPA, on condition that the EU is also willing to extend to the rules of origin of the GSP the Cotonou-type arrangements in the area of consolidation. The erosion of preferences that would result from such inclusion would not in any event be

as significant as all that (it requires a detailed analysis, country by country and product by product to be able to measure it). However, even if a status different from that of the EBA initiative (other developed countries have a GSP, which is not the case of EBA), the GSP is not the result of negotiations with developing countries, unlike the EPA negotiations; moreover, the EU unilaterally modified its GSP in July 2005. In addition, as the GSP concerns all developing countries, the ACP countries would lose the trade preferences that they currently have in comparison to non-ACP LDCs if they opted for the GSP rather than an EPA.[27] However, the conditions of the GSP+ tend to be close to free access since almost all products are covered, including sensitive products. The erosion of margins for non-LDC ACP countries is therefore already a reality with the GSP+, provided that the countries listed respect the eligibility criteria to benefit from this system.

For the LDC ACP countries, as access to the European market is already duty-free and soon to be quota-free (EBA initiative), the signature of an EPA would not seem to add anything. On the contrary, an EPA could result for those countries in an erosion of preferences in relation to non-LDC ACP countries since, as was noted above, the latter will in the future benefit from the same conditions regarding access to the European market. In addition, the LDC ACP countries will be obliged to open their markets to imports from the EU, which they are not obliged to do under the EBA initiative. This therefore raises the question of what would be the point for the LDC ACP countries in withdrawing from an EPA negotiated regionally. However, as regards tariff barriers, it must be borne in mind that this initiative is unilateral and can therefore in theory be called into question at any time by the EU; the signature of an EPA would from this point of view be a better guarantee of free access to the European market and could as such favour longer term investments.

In terms of negotiating strategy, it would be a double-edged sword for the ACP countries to adopt an aggressive position on the reduction of tariffs in the WTO forum. By pushing the developed countries to apply a tariff reduction formula which eliminates residual tariff peaks as well as tariff escalation, the ACP countries would obviously have better access to the markets of developed countries. That implies in particular that the tariffs included in the upper band of the phased formula are not too heterogeneous and that the rate of reduction applied to that band is sufficiently high to avoid the risk that, even when reduced, certain tariffs would still be too high. However, *vis-à-vis* the EU market which is the main trading partner of the African region compared with the Caribbean and Pacific regions, such a strategy has perverse effects. Any additional reduction of the tariffs of developed countries in a multilateral framework leads in fact to an erosion of the trade preferences of the ACP countries in relation to non-ACP countries on the European market. The negotiating strategy of the ACP countries at multilateral level must therefore ensure that the planned generalised reduction of customs duties does not result in an additional erosion of their trade preferences, which would negate the potentially positive effects of better access to the markets of developed countries.

In addition, it follows from the above that the question of sensitive products as a means of lifting in part the liberalisation effort can play a part in both the WTO and EPA negotiations. It is a kind of ultimate residual tariff barrier for exports of the ACP countries to markets in developed countries (and of the non-LDCs on the European market in particular) despite the reduction of tariffs. The ACP countries must ensure that the flexibility authorised in the application of the tariff reduction formula at the WTO does not destroy the efforts made by developed countries to open markets. For the non-LDC ACP countries, as for LDCs *vis-à-vis* markets other than the EU, the designation of sensitive products in the framework of the WTO negotiations is an important issue. The EU proposals to the WTO regarding sensitive products are particularly important for the EPA negotiations since they can foreshadow the exclusion of sensitive products in the framework of EPAs by the EU. The attention of the ACP countries must focus in particular on:

- The definition of sensitive products. That may be a certain percentage of tariff lines (G10 proposal, United States proposal – 1%, October 2005), or alternatively a number of tariff lines (EU proposals on 160 sensitive products out of 2000 registered with the WTO).

- Their treatment: reduction of lower customs duties (United States, EU proposal), exclusion of the formula of phased reductions and integration in a separate box, longer reduction implementation period (G10 proposal).
- Offsetting this flexibility by increased tariff quotas in order to ensure improved market access, even for sensitive products (EU proposal). The lessons drawn from the free trade agreements (FTAs) previously signed between the EU and other trading blocs show in this regard that the exclusion of sensitive products from these FTAs is achieved by granting preferential access to the EU market up to the limits of the tariff quotas granted for excluded products.

Avoiding escalating customs duties

The WTO framework agreement of July 2004 provides for the question of escalating customs duties to be treated using a formula to be agreed. Negotiations should therefore focus on the definition of this formula so that this question can be dealt with in operational terms. For the European market in particular, the signature of an EPA would facilitate, as for residual tariff barriers, the elimination of tariffs on all ACP products, whether or not they are processed, and avoid tariffs being applied to high added value products incorporating sensitive products such as sugar. However, this will depend on the way in which the sugar protocol is treated in the EPA negotiations (integrated into each EPA or in the form of a *stand alone agreement*). There is also the question of designating sensitive products by the EU in the WTO and EPA negotiations which would reduce the progress achieved as regards market access.

Avoiding the erosion of trade preferences

At the WTO, the demand of the G90 countries to treat this subject was integrated into the July 2004 framework agreement. The agreement recognised in the Special and Differential Treatment (SDT) section relating to market access the importance of long-standing trade preferences and states that the 'erosion of preferences will be treated on conditions to be agreed'. The negotiations must therefore in the future focus on the implementation in concrete terms of this provision. The agreement refers for that to an article in the first modalities proposal of March 2003.[28] The article stipulates that 'in the implementation of their tariff reduction commitments, the participants undertake to maintain, as far as is technically feasible, the nominal tariff preference margins (...) that they grant to their developing country trade partners'. It is proposed that for products exported by the ACP countries, and which are of vital importance, the reduction of tariffs affecting non-ACP countries should be spread over a longer period. In addition, all quota duties for these products will be eliminated.

In the EPA negotiations with the EU, maintaining trade preferences is also a key issue and is linked to the reform of the CAP, as well as to the EPA alternatives, namely the EBA initiative and the GSP. If the LDC ACP countries decide to remain with the EBA initiative, while the non-LDC ACP countries sign an EPA, they will lose their trade preferences in relation to the latter (that is if the EPA negotiations culminate in the total liberalisation of the European market). If they decide to sign an EPA with the non-LDC ACP countries, the common issue is to maintain trade preferences in relation to non-ACP countries. The EPA negotiations must then take into account the reform of the CMOs for sugar and bananas which is likely to favour countries such as Brazil to the detriment of the ACP countries. The consequences would be particularly harmful for the ACP countries that are strongly dependent on these products: Mauritius for sugar in Africa, the Caribbean countries for sugar and bananas, and Fiji for sugar in the Pacific. The EPA negotiations must also take into consideration the GSP+ reform.

As regards negotiating strategy, it can be seen that an aggressive position on the reduction of customs duties in the WTO negotiations contradicts a position seeking, on the contrary, to maintain preferences, and possibly to improve them for non-LDC ACP countries in the framework of the EPA negotiations. That implies for the ACP countries that they should not promote a generalised reduction of duties at the WTO, or at least that they should designate the products for which preferences are important (products covered by a protocol for example), but

also that they should be more aggressive in the EPA negotiations. The question of offsetting the losses linked to the CMO reform leading directly to an erosion of preferences could, for example, be part of the negotiations.

Contending with non-tariff barriers

Rules of origin

In the framework of the WTO, this question is treated in the agreement on rules of origin, which aims to harmonise the rules of origin and ensure that the rules do not create in themselves unnecessary obstacles to trade. Used in an abusive way, the rules of origin can in effect be trade policy instruments. However, the EPA negotiations seem to be a far more appropriate forum for addressing this issue. The rules of origin are particularly strict for the GSP and therefore for the EBA initiative. Since the signature of an EPA is not obligatory for the LDC ACP countries, the EPA negotiations must address the alternatives, namely the GSP, including the EBA initiative for the LDC ACP countries. It is important, in order for these provisions to be true alternatives comparable to the EPA with regard to access to the European market, that the rules of origin should be revised and made less restrictive.[29] For the LDC ACP countries in particular, the question of a dispensation to these rules could be raised in order to take into account their structural supply constraints.

Quality and SPS standards

At the level of the WTO, the agreement on sanitary and phytosanitary measures (SPS agreement) concerns all the rules that govern the formulation and implementation of the SPS measures applying to international trade. The agreement specifies that although WTO members have the right to fix the standards that they consider appropriate for the protection of their citizens, such standards limit as far as possible any constraints on trade. Its aim therefore is to regulate the use of standards in order to avoid protectionist excesses. However, it does not define the content of such measures and refers to international standards established by specialised institutions. The definition of the content of the SPS standards is for the Codex Alimentarius Commission in the case of human health, the International Office for Epizootics for animal health, and the International Convention for the Protection of Plants. WTO members are also authorised to put in place stricter national standards than these international standards, but they must justify such on scientific grounds.

Concerning quality standards, the agreement of technical barriers to trade (TBT agreement) covers all the specific characteristics of a product, such as size, appearance, functions, performance; the way in which it is packed or labelled. In this case, it might be more appropriate to draw up technical regulations on production methods rather than on the product's intrinsic characteristics (in the case of biological products for example).

The SPS and TBT agreements impose *de facto* very strong constraints on countries exporting agricultural products. First, the ACP countries do not have the technical, financial and human resources to apply increasingly complex standards. Secondly, they participate only to a limited extent in drawing up such standards. Their interests and specific characteristics are rarely taken into consideration. Recognising the difficulties developing countries have in complying with the SPS and TBT measures put in place by developed countries, the WTO provides in the framework of the special and differential treatment arrangements for technical assistance to be made available to developing countries. In the event that the implementation of new measures by a developed country has the effect of reducing substantially access to its market, the developed country in question must provide technical assistance. In addition, when new measures are decided, developing countries have a longer period to put them in place.

In the EPA negotiations, the question of standards is explicitly included in the roadmap of the EPA negotiations between the ACP regions and the EU. The question of standards is extremely sensitive in Europe since it concerns the increasing demands of consumers. It is therefore very difficult to imagine that the EU could revert to less restrictive standards.

The negotiating strategies[30] for the ACP countries at international and European levels appear to be very complementary. At international level, the issue for the ACP countries is above all within the

international organisations that determine the content of standards, by trying to be more closely involved to draw attention to their interests and concerns, than within the WTO concerning the SPS and TBT agreements. In the EPA negotiations, the negotiating strategy must focus on capacity building to comply with standards as well as with regard to administrative procedures for SPS certification; this concerns the development part of the EPAs. To date, little progress has been achieved on this aspect and the ACP countries should adopt a more proactive approach in order to benefit in the framework of an EPA or its alternatives from adequate technical assistance. The advantage for the ACP countries of giving priority to the EPA negotiations on this question is also to be able to benefit from assistance for the standards of their main trading partner, which overall are stricter than those of their other partners.

Improving the competitiveness of ACP countries in the face of competition from non-ACP developing countries

At the WTO, the negotiations on domestic agricultural supports can represent an opportunity for the ACP countries to be able to put in place policies to overcome their structural supply constraints and thus improve their agricultural competitiveness. It must be borne in mind that agricultural support in these countries has been considerably reduced following the liberalisation measures implemented in the framework of the structural adjustment programmes (reduction of customs duties, elimination of price controls, etc.). Today, the ACP countries have little room for manœuvre to be able to re-use internal supports. The only supports that they can use are those of the green box, or those based on a strong budgetary capacity, which are not available to ACP countries. Concerning amber box supports, although developing countries have fewer reduction commitments and longer implementation periods in the framework of the special and differential treatment (SDT) arrangements, most ACP countries have already strongly reduced or even eliminated the use of such supports and they can no longer re-introduce them. Although LDCs are exempted from reductions by the SDT, they are not in a position to increase the use of such supports because of their budgetary constraints. It is to be noted that these budgetary constraints will be even stronger with the signature

Box 5. The classification of internal supports in the WTO agricultural agreement

The agricultural agreement classifies the various types of support in 'boxes' depending on the degree to which they distort trade. The only supports that can be increased are green box supports, considered as causing the least distortion to trade. They are mainly supports that are not linked to production volumes or prices (research, training, popularisation, plant protection, animal welfare, food security stocks, protection of the environment, etc.). Amber box supports are deemed to cause particular distortion to trade and are subject to reduction. These supports involve mainly price-support measures intended to maintain domestic prices at a higher level than on international markets in order to guarantee a certain level of income for producers (stabilisation and equalisation funds for example). Blue box supports correspond to measures to limit supplies (for example letting land lie fallow).

The framework agreement of July 2004 stipulates that the global level of domestic supports causing distortion[31] must be reduced substantially, using a phased formula, and that the reductions should be made on the basis of consolidated levels. Most domestic supports that have been notified[32] are below consolidated commitment levels. For the ACP countries, the application of a phased formula would limit their room for action. However, to the extent that once again the agreement states that developing countries are treated in the framework of the SDT, the issue for negotiation by the ACP countries could be, for example, to be authorised not to reduce the aggregate level of support or, on the contrary, even to increase it.

of an EPA, if no far-reaching tax reforms are implemented to offset the elimination of customs duties (development of internal taxation, improvement of tax collection, etc.). It is important to emphasise in this regard that, unlike the SPS and TBT agreements, the SDT of the agricultural agreement contains no provisions relative to technical and financial assistance for developing countries, except solely for the Marrakech Decision, which has never been applied. It should be more closely linked to the development objectives of developing countries.

The other negotiating point on domestic supports concerns the *de minimis* clause. This clause allows member states for the time being to avoid the obligation to reduce amber box supports up to a limit of 5% of the value of agricultural production for developed countries, and 10% for developing countries. The July 2004 framework agreement provides for this percentage to be reduced. The negotiating issue for the ACP countries is therefore to be authorised not to reduce the *de minimis* limit on the grounds that in their case producers have limited resources and are involved in subsistence farming.

The EPA negotiations are a forum that is particularly suited to aggressive negotiating strategies by the ACP countries on this subject. The development part of the EPAs is in fact supposed to focus on capacity-building for the ACP countries to help them improve their competitiveness.

B) Competition from imports on domestic and regional markets in the ACP countries

Limiting competition from imports on domestic and regional markets

Limiting access to the markets of ACP countries

In the WTO and EPA negotiations, the ACP countries must undertake to reduce their customs barriers with a view to liberalising trade. However, at the same time they have the option to exclude a certain number of products from the liberalisation process through, on the one hand, the Special and Differential Treatment (SDT) granted to developing countries at the WTO and, on the other hand, through the asymmetric reciprocity – authorised at the WTO by article XXIV– in the EPAs.

Applying a specific tariff reduction formula

The WTO framework agreement of July 2004 provides for new tariff reductions for all member states, but developing countries have smaller reduction commitments in the framework of the SDT. The issue for non-LDC ACP countries – LDCs being exempt from reduction commitments – is more precisely to be able to apply a specific tariff reduction formula. Relying on the July agreement which stipulates that the tariff reduction formula must take into account the diversity of the tariff structures of the various developed countries and developing countries, the G33 declared on 11 October, 2005 that in this regard any formula establishing common thresholds for developed countries and developing countries would be unacceptable. Countries that have used tariffs consolidated at ceiling rates, as well as those that apply customs duties consolidated at a low level, must propose specific tariff reduction modalities.

Designating special products

In addition to sensitive products that concern all the WTO member states, developing countries have 'flexibility' under the SDT to designate an 'appropriate number' of 'special products', based on reasons of food security and rural development. The concrete arrangements for the implementation of this flexibility (exclusion from the tariff reduction formula, lower tariff reductions, etc.) have still to be determined. For the ACP countries – once again non-LDC ACP countries – it is important that the criteria or indicators used to determine the treatment applied to the special products designated are different from those of sensitive products; otherwise the distinction made between the two types of products would be meaningless. The notion of special products calls for a more ambitious treatment than that of sensitive products having regard to the reasons used to justify them. The ACP countries have several options based on existing practices in some of these countries: exclusion of special products from all tariff reductions (in comparison to a smaller tariff reduction for sensitive products), possible tariff rearmament, the possibility of import quotas, more or less long quota periods, etc.

Having special safeguard measures

The WTO authorises the use of special safeguard measures by countries to protect themselves against massive imports or an important reduction in the price of imports by applying additional customs duties on the products concerned ('temporary tariff rearmament'). However, the safeguard measures which exist at the current time are too burdensome and difficult to implement in developing countries. They are therefore *de facto* more or less reserved for developed countries. Only three members of the SADC (Botswana, Namibia and Swaziland) have reserved the right to apply the special safeguard measure in their notification for certain specific products.

The July 2004 framework agreement also provides that a special safeguard mechanism (SSM) may be used by developing countries. The negotiating strategy of the ACP countries should be to promote a simplification of the safeguard mechanism, which implies adopting a position on the following points: trigger criteria (price and/or volume threshold), triggering mechanism (automatic or specific procedure), duration, eligible products and in particular the link with sensitive and special products and finally the content (additional customs duties or other possibilities, such as quantitative restrictions). The possibility of limiting imports by seasonal quotas for example, even by way of temporary bans, appears particularly necessary when the implementation of additional customs duties proves to be insufficient to halt the harmful effects of imports on local production. That is the case, for example, with cuts of poultry imported into West Africa and Central Africa where only tariff peaks of 400% would suffice to limit the effects of competition.

Excluding products from the EPA

The signature of an EPA between the ACP countries organised in regional integration areas and the EU can potentially accentuate the effects of competition from EU imports on ACP markets. It implies in effect that the ACP countries open further their frontiers to European imports by reducing substantially the customs duties that they apply to such imports. It is to be noted that the non-signature of an EPA by ACP countries, having decided to remain within the scope of the EBA initiative for LDCs or to switch to another regime for non-LDCs (probably the GSP), would not protect them from the competition of EU imports. They can be subject to such competition via the phenomena of re-exportation at regional level: ACP countries from the same regional integration area having signed an EPA can import European products at zero duty rates then export them to neighbouring countries without those products being taxed in the framework of a regional free trade area.

However, the EPA negotiations also concern the possibility for ACP countries to reduce their customs duties to a lower level than that of the EU by excluding from the liberalisation process a certain volume of trade with the EU. This possible asymmetry in the degree of liberalisation is based on article XXIV of the GATT, concerning customs unions and free trade areas. This article derogates to the Most Favoured Nation (MFN) principle, that is to say non-discrimination. It stipulates that a country or a group of countries can grant preferential trade treatment to another country or group of countries, when the relations between those countries or groups of countries are governed by a free trade agreement or a customs union, therefore when there is reciprocity of trade preferences.

The problem of article XXIV is that it remains very vague on the definition of a free trade agreement or a customs union, and indicates simply that this agreement must concern a substantial part of the trade and be implemented over a reasonable period. The two terms, namely a 'substantial share' of trade and a 'reasonable period', are open to interpretation.

The interpretation given to this article by the EU and which it has used in the previous free trade agreements signed with developing countries is as follows:

- 'Substantially all the trade' is understood to mean 90% of all trade between the FTA partners (including industrial goods and services). In other words, there is an FTA when the sum of all trade flows free of customs duties and non-tariff barriers represents 90% of all the trade flows, without being able to exclude whole sectors. Thus, the FTA signed between the EU and South Africa in 1999 covered 90% of the trade flows between the

Box 6. Article XXIV

The GATT agreement recognises, in article XXIV, that the setting up of customs unions or free trade areas facilitates free trade and that it is therefore desirable to develop such trade agreements. In particular the MFN rule is not infringed by a free trade or customs union agreement.

Paragraph 8.a) specifies the definition of a customs union or a free trade area. A free trade area 'shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated on **substantially** (author's emphasis) all the trade between the constituent territories in products originating in such territories'.

parties, with the EU market being opened to 94% of South African imports and a liberalisation of the South African market to 86% of imports from the EU. This interpretation of article XXIV has not been contested at the WTO.

- 'Reasonable period' for the implementation of the FTA implies a period not exceeding 12 years.

According to Davenport (2002), by using this interpretation, the EU retains the option to maintain protected sectors in FTAs, which are for example sensitive agricultural products and processed food products. Table 7 shows the final level of liberalisation decided in several previous bilateral agreements.

On that basis, one of the conclusions drawn by Davenport is that if the ACP countries succeed in negotiating EPAs so that the liberalisation covers 90% of all six-digit products in the chapters of the customs classification (SH-2), the liberalisation will then be broader and include 'protected' sectors.

One of the most frequently evoked EPA scenarios corresponds to an asymmetric liberalisation of 100% by the EU and 80% by the ACP countries (i.e. approximately 90% of the total trade flows between the two parties). That would amount for the ACP countries to excluding 20% of their trade flows with the EU, bearing in mind that it is impossible for them to put all the agricultural trade flows in that 20%. The challenge for the ACP countries is to obtain overall the greatest asymmetry possible in the EPAs, with effectively 100% liberalisation by the EU and the lowest possible liberalisation by them, as well as the longest possible implementation period. An EPA is only interesting for the non-LDC ACP countries if they can achieve the same level of preferences as LDCs in the framework of an EBA initiative, which implies duty-free and quota-free access, including on sensitive products, for the EU. In addition, the fact that the degree of asymmetry in the liberalisation is in favour of the ACP countries, does not imply a lesser liberalisation effort by them than the EU. On the contrary, it must be remembered that only 7% of non-LDC ACP products are still taxed by the EU – even if it concerns sensitive products for which it will not be easy to eliminate taxes – while most EU products are taxed by the ACP

Table 7: Share of liberalised trade (not subject to tariff and non-tariff barriers) as a percentage

	Imports from the EU		Partner		Total trade	
	1998	1999	1998	1999	1998	1999
EU–Tunisia Mediterranean Agreement	95.2	92.9	95.4	96.7	95.3	95.0
EC–Egypt Cooperation Agreement	85.7	84.5	100.0	100.0	96.4	96.4
EC–Turkey Customs Union	86.4	86.9	97.6	97.6	93.3	93.1
EC–Hungary Europe Agreement	92.7	93.5	98.5	98.8	95.8	96.3
EU–South Africa Trade, development and co-operation agreement	90.2	91.1	91.1	90.3	90.7	90.7

Source: Davenport, 2002

countries. To protect their interests and ensure that the compromise that will result from the EPA negotiations complies with WTO rules, it is indispensable for the ACP countries to clarify the content of article XXIV. In this context, the EPA negotiations depend on the negotiations that will be conducted at the WTO on article XXIV. However, any progress achieved in the EPA negotiations on the redefinition of this article may also be a negotiating position at the WTO.

Redefining article XXIV of the GATT

The negotiating strategy of the ACP countries in order to avoid the risk linked to an EPA of an increase in competition from EU imports on their markets, could therefore be to make as much headway as possible in the EPA negotiations so as to take a negotiating position to the WTO on article XXIV. That position could be supported by the ACP group as a whole, and possibly jointly with the EU. It should be borne in mind that at the WTO ministerial conference in Cancun in 2003 the ACP countries had already requested a more flexible interpretation of article XXIV, in the event that a free trade area is concluded between countries having very different levels of development, which is the case with the EPAs.[33] That request was reiterated in the framework of the preparations for the Sixth WTO Conference which is due to be held in Hong Kong in December 2005.

Moreover, the designation of sensitive products and special products in each of the ACP countries that are members of the WTO may conversely influence the EPA negotiations as regards the identification of products considered as 'sensitive'[34] by the ACP countries and which may be excluded from the EPA. The WTO negotiations on special products seem to be relatively advanced in relation to the EPA negotiations on this subject. The G33 in particular put forward a specific proposal on special products in October 2005.[35] In addition, the designation of sensitive products in the framework of the EPA negotiations is a particularly difficult exercise to the extent that it must be accomplished in each of the regional integration areas defined to negotiate an EPA with the EU. That implies for the ACP countries negotiating first of all at regional level to reach a consensus on a list of products to be excluded from the EPA and to advance a common position *vis-à-vis* the EU, while these countries may have divergent interest. It must, however, be emphasised that the setting up customs unions in the framework of the regional integration process involves in any event determining a common external tariff (CET). This CET will concern imports from the EU for the products that will be excluded from the EPA, but also imports from the rest of the world. The definition of tariff structures must thus take into account the notion of sensitive and special products at the WTO as well as the products excluded from the EPA.[36]

Finally, it is also possible to envisage a specific safeguard mechanism for imports from the EU in the framework of the EPA, in order to limit the consequences related to an increase in imports from the EU after the introduction of reciprocal preferences. The definition of a special safeguard mechanism at the WTO may prefigure the development of a mechanism at the level of the EPA negotiations.

Combating the unfair character of competition from imports

The problem of the unfair competition of imports with regard to local production in the ACP countries concerns the various supports from which producers and exporters benefit, mainly in developed countries. To the extent that the EPA negotiations do not deal with agricultural supports, the WTO is the most appropriate negotiating forum to discuss this issue. The WTO negotiations on domestic supports and exports supports can nevertheless affect indirectly the EPA negotiations on the identification by the ACP countries of the products that they want to be excluded from the EPAs; the strongly subsidised character of certain products can be used as a criterion for selecting such products.[37]

Avoiding transfers between domestic support boxes

In accordance with the phased reduction formula for domestic supports that distort trade and are provided for in the July 2004 framework agreement, developed countries must reduce by at least 20% their aggregate level of domestic support. In addition, with a view

to harmonising the reductions, the countries with the highest levels of trade distorting domestic supports must make proportionally higher reductions. More precisely, the amber box supports (comprising the aggregate measure of support, AMS) must be reduced according to the same phased formula; with an AMS per product capped at a certain level (to be determined) to prevent transfers of supports between boxes. It has also been agreed that the limit indicated in the *de minimis* clause[38] should be lowered. While protecting themselves from a reduction in this clause as far as they are concerned (by way of the SDT), the ACP countries can have an aggressive negotiating strategy *vis-à-vis* developed countries on this subject.

Moreover, the renegotiation of the agricultural agreement provides for the enlargement of the eligibility criteria of blue box supports, which is currently restricted to product limitation programmes, to include supports decoupled from production, such as contra-cyclical payments used in the United States.[39] In reality, the redefinition of the blue box provides a form of protection to this country which is strongly dependent on it; especially since the ceiling planned for that box (5% of the value of the total agricultural production of the country) is in practise not really restrictive and that a degree of 'flexibility' will be accepted for countries exceeding exceptionally the limit. The redefinition of the green box will also be part of the negotiations in order to limit it effectively to the supports that cause the least possible distortion to trade and to take account of other considerations, such as the social and environmental dimensions of agriculture.

In terms of negotiating strategy, the positions that the ACP countries could adopt concerning the redefinition of the blue box would tend to target those supports used by the United States, which have little influence on the EPA negotiations. On the other hand, positions relating to the disciplines of the amber and green boxes may target the so-called decoupled supports which are increasingly used by the EU. It is important to emphasise that if the EU has accepted the principle of an additional reduction of the amber box supports, it is because it depends less and less on them, following the successive reforms of the CAP intended to reduce these supports in favour of decoupled supports. Experience shows however that decoupled payments made directly to producers to guarantee a certain level of income, are in reality not neutral on production (that is the intended effect) and therefore on markets. That does not means that it is necessary to condemn all forms of agricultural supports – as the ACP countries themselves can support negotiating positions in favour of the use of agricultural supports, while giving consideration to other forms of disciplines over and above the classification between boxes; such as for example limiting supports to products traded on domestic markets but not on international markets.

Eliminating export support measures

Since the July 2004 framework agreement, the principle of the elimination of direct export subsidies has been accepted. The framework agreement also provides that the negotiations should focus not only on export subsidies, but should also take into consideration **all export measures having an equivalent effect**, namely export credits and credit guarantees,[40] state trading enterprises, and food aid. The commitment of developed countries to dismantle their export imports on production of ACP countries will no doubt lead to a reduction in the effects of their unfair competition on ACP production.

The ACP countries can adopt an aggressive negotiating strategy on this aspect so as to ensure that the definition of these rules ensures that the commitments of the developed countries are fulfilled. For export credits and credit guarantees, this involves introducing disciplines concerning repayment periods, the payment of interest, and premiums. For state trading enterprises, the discipline should concern the export subsidies that are granted to them and which they grant, their financing by the public authorities, and the guarantee against losses from which they benefit. The question of the future use of the monopoly powers of such enterprises is trickier. Their monopoly is at the same time a means of stimulating export that leads to unfair trade. However, for certain developing countries and LDCs, granting a monopoly for the marketing of agricultural products to a state enterprise enables them to regulate the domestic market and therefore to stabilise domestic

consumer prices, which helps food security. As regards food aid, the challenge is to avoid it becoming a means of clearing surpluses and opening up new markets.

Moreover, it is important for the ACP countries to pay particular attention to the links between domestic support measures and export support measures. Developed countries are inclined to eliminate their export supports when they no longer need them, that is to say when their competitiveness is assured in another way, in particular by domestic supports. Thus, the EU has no difficulty in eliminating its export subsidies when, via the CAP reform on domestic supports, it has less need of export supports. In effect export refunds that are supposed to cover the difference between the world price and the domestic price become pointless when that difference is almost zero. In this regard the importance of the influence exchange rates must be noted since they can undermine that argument. That was recently the case in the cereals sector, where the EU had to increase its export refunds because of the unfavourable €/$ exchange rate that had a negative effect on European competitiveness.

However, the ACP countries do not necessarily have the same interests as regards export subsidies. Certain ACP countries, in particular developing countries that are net importers of food products, may suffer from the elimination of export subsidies if they result in an increase in world prices for basic products such as wheat, bovine meat, maize, dairy products and sugar. One of the issues of the negotiations could be to put in place mechanisms to help countries that are net importers of food to accompany the elimination of export subsidies. Their legitimate concern should not be used as a pretext by exporting countries to maintain unfair competitive export practices under the guise of SDT.

Discussions on the speed and timing of the WTO and EPA negotiations and the potential impact on negotiating strategies

The previous section attempted, for each issue of the agricultural trade of the ACP countries, to analyse the negotiating strategies possible for those countries, by identifying whether priority should be given to the WTO or EPA negotiations, and in which cases an aggressive negotiating approach should be adopted. The aim here is to discuss the linkage between the two rounds of negotiations and the negotiating priorities in the light of the timetable and speed of the negotiations.

It must be borne in mind that the WTO negotiations relative to the Doha Round are supposed to be completed on the occasion of the Sixth WTO Ministerial Conference in December 2005 in Hong Kong. Certain negotiating points are relatively advanced and the EPA negotiations can rely on that progress, but it is also necessary to stress that there are strong uncertainties regarding the outcome of the conference and the experience of previous ministerial conferences suggests that we should be circumspect regarding the initial timetable. The EPA negotiations are supposed to be completed by 31 December, 2007, to be implemented with effect from 1 January, 2008 over a 12-year period. If the deadline for the implementation of the EPA seems difficult to modify given the dispensation already obtained by the EU from the WTO, the length of the implementation period and above all the liberalisation modalities may be more revised or clarified during the negotiations.

Based on the experience of the previous free trade agreements concluded by the EU with developing countries, some flexibility is conceivable at several levels:

- Different timetables for the start date of the implementation of an EPA depending on groups of agricultural products that are more or less sensitive.
- Different timetables also for the duration of the implementation period depending on those groups of products. The liberalisation could be made progressive: customs duties would thus be reduced in phases for specific groups of products after a preliminary evaluation of the competitiveness of each of the groups. If such an evaluation shows that certain sectors are not yet sufficiently competitive to support the competition of EU imports and that such a reduction would have very negative socio-economic consequences, deferment of the liberalisation could be envisaged until the next evaluation.[41]

- Revision clauses could also be fixed so as to provide additional flexibility for the products exempted (for a certain time) from the trade liberalisation.

On the above basis, and taking account of the degree of progress of the negotiations (on the basis of proposals made), Table 8 presents and summarises each of the main agricultural trade issues for the ACP countries, and describes which negotiating forum is the most appropriate, the WTO or EPA. The choices regarding the preferred negotiating forum proposed below are however not definitive. The negotiating strategies may be modified on an ongoing basis in line with developments in each round of negotiations.

Table 8. Choice of negotiations between the WTO and the EPA

Negotiating forum	First choice	Second choice
Access to the markets of developed countries (including the EU)		
1. Reduction or elimination of residual tariff barriers	**EPA** The EU is the main export market for the ACP countries, in particular African countries The EU reduction commitments can be more ambitious – and include sensitive products in the framework of the CAP	**WTO** Any generalised reduction of customs duties at the WTO leads to an additional erosion of the long-standing trade preferences of the ACP countries with the EU in comparison to non-ACP countries
2. Customs duties escalation	**EPA** The EU is the main trading partner of the African countries (Caribbean and Pacific countries have closer relations with, respectively, North America and Australia and New Zealand The EPA must reduce EU tariffs on all products, including sensitive products and agricultural products containing sensitive products	**WTO** The elimination of the escalation of customs duties applied by trading partners other than the EU to ACP products must be accomplished in the framework of the SDT and enable a revision of the GSPs) Little progress has made on producing a formula which takes account of this question
3. Maintaining preferences	**WTO** The issue for the ACP countries is to specify the products for which their trade preferences are strong, so that the generalised reduction of customs duties is either lower or slower in respect of those products. That must be linked with the negotiations on sensitive and special products. Thus, the ACP proposal on long-term preferences is that the products benefiting from these preferences should be declared sensitive products by the countries that grant the said preferences (in this case the EU for the preferences granted to the ACP countries).	**EPA** The elimination of customs duties on the EU's sensitive products exported by non-LDC ACP countries, accentuates their preferences in relation to non-ACP countries But it leads to an erosion of those of the LDC ACP countries that already benefit from zero-rate duties (EBA initiative) in relation to non-LDC ACP countries The consequences in terms of erosion of preferences for the ACP countries in relation to non-ACP countries of the CAP reform (Product protocols in the framework of the sugar and bananas CMOs) must be taken into account in a compensation mechanism
4. Rules of origin	**EPA** The rules of origin must be made more flexible in the framework of the GSP, including for the EBA initiative, so as to enable LDCs to benefit truly from them	**WTO** The EPA negotiations can facilitate progress in the negotiations on the agreement on the rules of origin

Table 8 (continued)

Negotiating forum	First choice	Second choice
Access to the markets of developed countries (including the EU)		
5. SPS standards and TBT	**EPA** It is difficult to make the standards more flexible, unlike the rules of origin But the development part of the EPA could provide the ACP countries with opportunities if they can obtain firm commitments from the EU in terms of technical assistance	**WTO** Better participation of the ACP countries in the international bodies that elaborate the standards
6. Improving competitiveness (removing supply constraints)	**EPA** The negotiations on the development part of the EPAs, which have not really started, could help to achieve this objective	**WTO** The issues of development and technical assistance are part of the negotiations in several ways: the current round of negotiations has been described as a development round; technical assistance is provided for in the framework of the SDT, in particular to help LDCs to be in a position to comply with the new SPS standards But in practice these provisions are still very weak
Competition on ACP markets		
7. The integration of the SDT in tariff reductions	**WTO** The tariff reduction formula for developing countries cannot be the same as that used for developed countries (ACP and G33 proposal)	**EPA** The tariff reduction formula must be defined in a way that is consistent with the designation of the products to be protected (sensitive and special products to be excluded from an EPA)
8. Products to be protected (sensitive products, special products to be excluded from an EPA)	**WTO** The multilateral negotiations are particularly advanced on the question of special products (G33 proposal) The designation of special products must however be linked with the list of sensitive products that can be excluded from an EPA and to be defined at regional level	
9. Safeguard measures	**WTO** The multilateral negotiations are very advanced also – on this point (G33 proposal)	**EPA** The definition of a mechanism specific to EU imports can be based on that drawn up at multilateral level
11. Redefinition of Article XXIV	**EPA** It is important to reach an agreement first of all between the ACP countries and the EU to clarify certain terms (how far to go on asymmetry and the length of the implementation period), in order to be able to table a sufficiently technical and detailed proposal at the WTO It is urgent that this proposal should be made before the Hong Kong conference so that the framework of the EPA negotiations is clearer	**WTO** Support a proposal to modify Article XXIV in agreement with the compromise found in the EPA negotiations, in order to ensure the stability of the compromise

Table 8 (continued)

Negotiating forum	First choice	Second choice
Competition on ACP markets		
12. Domestic supports of developed countries	**WTO** The WTO is the appropriate forum to deal with the question of the unfair competition of imports. Of note is the G33 proposal on special products stating that all products benefiting from amber and blue box export supports should be considered as special products	
13. Export supports of developed countries	**WTO** Same	

Consequences for technical assistance, aid, capacity-building, support in negotiations

The different types of development aid that the developed countries can offer to the ACP countries should aim to help:

- the various parties involved in the agricultural sector to define negotiating positions that enable them to defend their interests; and
- the countries to improve their agricultural competitiveness, whether for access to the markets of developed countries North country markets *vis-à-vis* their competitors, or to compete with imports.

Capacity-building must be aimed at the various parties concerned by the WTO negotiations and in the framework of the EPA negotiations on agriculture. This involves developing human resources and the expertise of the ACP negotiators, representatives of civil society, including producer organisations, and the private sector. These parties must be able to define their own negotiating positions in agreement with their objectives and development priorities, and then be able to defend them *vis-à-vis* the EU in the framework of the EPA negotiations and in the WTO multilateral forum. That implies first of all defining a clear agricultural development strategy at both national and regional levels for the EPA negotiations, if necessary through an institutional reinforcement of the various parties concerned.

Technical assistance appears to be indispensable, in particular as regards standards. The previous chapters have emphasised the increasing importance that standards will acquire as obstacles facing ACP country exports as regards access to the markets of developed countries. It is difficult to reduce the level of standards, in particular in the EU, and even if the ACP countries can participate more closely in the definition of international standards, they will continue to be confronted with higher standards imposed individually by countries (as is the case in the EU), as well as with the multiplication of private standards imposed notably by retailers (e.g. Eurepgap). It would appear therefore to be essential to be fully aware of the standards so as to be able to respect them and have the ability to prove that the standards have been fully respected; which does not preclude efforts to combat what may be considered as an abusive development of private standards. It is also important to emphasise that over and above standards, technical assistance should be provided to help the ACP countries meet the requirements of their 'customers' in the North (compliance with delivery times, stability with regard to product quality, etc.). In general the technical assistance proposed in the framework of the WTO (SPS and TBT agreements) is insufficient. It is important in the EPA negotiations to ensure that the issue of standards is taken into account in such a way as to ensure that the technical assistance provided is sufficient and effective.

The technical assistance must moreover help the ACP countries to diversify their exports and trading partners; that is provided for by the WTO in its paragraph in the July 2004 framework agreement on the erosion of preferences:[42] *'The Members granting preferences will undertake technical assistance programmes and other measures, as appropriate, to support the countries receiving preferences in the efforts that they make to diversify their economies and their exports'.*

Support in negotiations should take the form of:

- impact studies on the various options under consideration in the WTO and EPA negotiations (impact of different degrees of reciprocity, the erosion of trade preferences linked to reforms of the product protocols in the framework of the CAP, greater flexibility in the rules of origin, the competitive effects of an increase in imports from the EU and, moreover, in order to define the special products excluded from the EPAs, etc.); and
- the organisation of information/training sessions and above all a consultation between the various parties concerned from the agricultural sector.

Aid is envisaged in particular in the framework of the EPA negotiations, the latter being presented as being not only trade agreements but also development instruments. During Phase I of the EPA negotiations, the ACP countries undoubtedly made the mistake of asking for important amounts of aid without any precise 'justification'. The European Commission responded and has reiterated that no additional resources will be released specifically for the EPAs, as the funds of the 9th EDF are more than sufficient. Even if there should not in theory be any link between the signature of an EPA and the aid granted to ACP countries, the latter must be vigilant regarding the risk of conditions being attached to aid and that such does not influence the negotiations. It must be emphasised in this regard that it is not easy for the ACP countries to negotiate with trade partners such as the EU, which is also their leading backer, an agreement that combines trade and development. It is very likely that the request of the ACP countries for important funding will be reiterated, justifying such funding by the need for them to offset the potentially negative consequences of the EPAs (the main argument being the loss of budgetary revenue). It is very likely that the question of funding will be a very important issue in drawing up the 10th EDF.

Conclusion

The EPA and WTO negotiations are crucially important for the agriculture of the ACP countries since they provide major changes in their environment. The preparation of the ACP countries is therefore also crucial and it is important for the ACP countries to take the initiative in proposing negotiating positions so that their interests are better defended and taken into consideration. If the two negotiations seem at first sight to be very distinct, one taking place in a multilateral context and the other in the framework of bilateral ACP–EU relations, they are in fact very closely linked; what is decided in one negotiating forum may have consequences on the other. The ACP countries must pay particular attention to this linkage between the two negotiations if they want to defend fully their agricultural interests, taking care not to reduce their room for manœuvre in one round of negotiations on account of positions adopted in the other negotiating forum.

Endnotes

1. That is not the case for all the Pacific countries – see Annex 1.
2. First, it introduced discrimination between countries contrary to the Most Favoured Nation (MFN) principle of the WTO which stipulates that all trade advantages granted by one country to another country or group of countries must automatically be extended to all WTO Member States. The only discrimination authorised by the WTO concerns the least-developed group of countries, or all developing countries, which does not cover the ACP countries. Secondly, it did not respect the derogation to the MFN principle which authorises trade preferences to one country or a group of countries only when they are reciprocal, in the framework of a free trade area.
3. Source: French Ministry for Foreign Affairs.
4. Certain tariffs can be particularly complex, with both an *ad valorem* part and specific duties (Gallezot, 2003).
5. Gallezot, 2003.
6. The rum protocol has been cancelled. Some other products (dairy products, fresh vegetables such as carrots and lettuces, and fruit juices, for example) were moreover subject to customs duties under the Lomé Conventions.
7. vA study carried out by the INRA emphasises the difficulty of the exercise and indicates that estimates differ considerably between studies according to the type of data used, in particular between the WTO customs bindings and the actual customs duties applied (Gallezot, 2003).

8. The preferential tariff for ACP countries is even more important for products subject to tariff peaks (11% on average versus more than 40% for the MFN). Gallezot (2003).
9. PwC/GRET/Forum for Africa: Sustainability Impact Assessment (SIA) of the EU-ACP Economic Partnership Agreements. Phase 2. July 2005.
10. That is the case for example of the FTA concluded on trade in fruits and vegetables with the Mediterranean countries. The EU has also reinforced its relations with the Mercosur countries (Brazil, Argentine, Uruguay and Paraguay), Mexico, Chile and, to a lesser extent, Asian countries. See CTA-ECDPM *In*Brief 'Comparing EU FTAs – Agriculture', Bettina Rudloff and Johannes Simons.
11. As the initiative is part of the GSP, the EBA has no specific rules. Europa Internet site.
12. This risk provoked strong resistance in the preparation of the EBA initiative, in particular among sugar and rice manufacturers. They feared that LDCs would import untreated rice, process it and export all their production to the EU relying on the rules of origin, while at the same time importing sufficient volumes for their domestic consumption needs.
13. In Gret (to be published in 2005), Impact on agriculture of the CEMAC+STP of an EPA with the EU.
14. See CTA-ECDPM InBrief on 'EPAs and SPS issues', Martin Doherty. See also Le Bigot and Ribier (2004) who present a comparison product by product of the EU regulation on MRL and that of the Codex Alimentarius.
15. MRL are the maximum authorised residual concentrations of pesticides, that is to say considered as acceptable in foodstuffs in terms of human health.
16. By way of example, the new European regulation does not impose total traceability for third countries (including ACP countries), whereas the Eurepgap code makes such traceability compulsory.
17. These policies are not solely responsible for the phenomena of falling and volatile prices of agricultural raw materials on world markets. These phenomena can also be observed in the markets for tropical products such as coffee and cocoa, where it is the supply policies of the producing countries themselves that are called into question and not the policies of Northern countries.
18. Burkina Faso, Sudan, Senegal, Mauritania, Mali, Niger, Chad, Cape Verde, Gambia, Guinea-Bissau, Guinea, Sierra Leone, Liberia, Togo, Benin, Central African Republic, Equatorial Guinea, Sao Tomé and Principe, Democratic Republic of the Congo, Rwanda, Burundi, Angola, Ethiopia, Eritrea, Djibouti, Somalia, Uganda, Tanzania, Mozambique, Madagascar, the Comoros, Zambia, Malawi, Lesotho, Haiti, the Salomon Islands, Tuvalu, Kiribati, Vanuatu and Samoa.
19. Regulation (EC) n° 980/2005 of 27 June, 2005, published in the Official Journal of the EU L169 of 30 June, 2005.
20. Alex Bridges, April 2003.
21. Cairns Group: South Africa, Argentine, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Fiji, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, Philippines, Thailand, Uruguay.
22. The countries are: Argentine, Bolivia, Brazil, Chile, Guatemala, Indonesia, Paraguay, Philippines, Thailand.
23. G20: Argentine, Bolivia, Brazil, Chile, China, Cuba, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Philippines, South Africa, Tanzania, Thailand, Venezuela, Zimbabwe.
24. G10: Switzerland, Bulgaria, Taiwan, Iceland, South Korea, Japan,, Israel, Liechtenstein, Mauritius and Norway.
25. The principle of tariff quotas consists in granting an exemption from customs duties, or lower customs duties, on certain import quota. Products that are imported in a quantity higher than that quota are subject to higher customs duties.
26. Committee 133 is the main EU committee charged with trade issues (CTA–Agritrade).
27. The current ACP preferences differ according to the products and it is difficult to estimate the average level of tariffs linked to those preferences in relation to that with the GSP. Such an estimate would require a very in-depth study. Table 3 on cocoa shows however the difference between European tariffs applied to ACP exports in relation to exports under GSP, GSP+ and MFN status.
28. Paragraph 16 of the document TN/AG/W/1/Rev.1.
29. See on this subject the article by Dr Chris Stevens: 'Le SPG: une solution au problème de Cotonou et des APE', Eclairage sur les Négociation Vol.4 No.4, July–August 2005; see also C. Stevens and J. Kennan (2005) GSP *Reform: a longer-term strategy (with special reference to the ACP) – Report prepared for the UK Department for International Development (DIFD)*. IDS, Brighton (http://www.ids.ac.uk.ids/global/pdfs/CS_GSPrs05.pdf).
30. See CTA-ECDPM InBrief on 'EPAs and SPS issues', Martin Doherty, not yet published.
31. This represents the total level of support of the consolidated amber box (all the supports of this box are measured by the 'total consolidated final aggregate measure of support (AMS), plus the authorised *de minimis* level and the blue box).
32. That is to say the supports that a given country uses and that it must report to the committee on agriculture.
33. ACP declaration relative to the fifth WTO ministerial conference, Brussels, 1 August, 2003. Document ACP/61/082/03 [FINAL]
34. The term 'sensitive products' is commonly used in the EPA negotiations but does not refer directly to the expression of sensitive products adopted at the WTO in the July agreement, even if it corresponds to the same problem of limiting market access.
35. The proposal consists in facilitating the task of identifying special products by proposing a non-exhaustive list of indicators for each of the three criteria adopted to characterise special products: food security, combating poverty and rural development.
36, In West Africa the countries belonging to the West African Economic and Monetary Union (UEMOA) have a CET which must be extended to the CEDEAO (Community of West African States) area. However, as the CET levels are considered too low and are sometimes not applied by the UEMOA countries, it is possible that these levels may be revised for certain lines ('tariff rearmament'). In this context, the designation of sensitive and special products in the WTO negotiations may also contribute to a revision of the CET.
37. This criterion is one of those proposed by the G33 to determine special products.
38. This clause is currently set at 5% of the total value of the agricultural production of developed, and 10% for developing countries.
39. They are intended, in the event of low prices or a poor harvest, to compensate American producers by paying them the difference between the market price and the target price set by the government. They are widely used by the United States, in particular for its cotton producers.
40. Export credits consist, for the exporter, in guaranteeing payment facilities to the importer. Export credit guarantees consist, for the exporter's State of origin, in guaranteeing the repayment of the loan granted to the importer, if the latter defaults.
41. See on this subject the proposal: 'The EPAs and sustainable development: Benchmarks for pro-development monitoring of the negotiations', APRODEV & ICTSD, Brussels and Geneva, May 2005
42. The agreement refers to the article of the first modalities document (March 2003).

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ACP–EU Economic Partnership Agreements: Sanitary and Phytosanitary Measures

Martin Doherty

Introduction

The scope and requirements of food safety (sanitary and phytosanitary – SPS) measures are increasingly replacing tariff barriers as the main concern of African, Caribbean and Pacific (ACP) countries seeking to export to the European Union (EU). The ACP countries are beneficiaries of preferential access to the EU market under the Cotonou Agreement and the Generalised System of Preferences (GSP), in particular the Everything But Arms (EBA) initiative for least-developed countries (LDCs). However, they find the increasing coverage and sophistication of many of these SPS measures are preventing them from gaining maximum advantage from such arrangements. The primary reason for this is the inadequate level of human, financial and technical resources that ACP countries can provide to satisfy EU importers that all food exported meets the level of safety required by these SPS measures.

The increased presence of SPS on the international trade scene has been driven by the increasing awareness and concern for food safety among European consumers, particularly about the presence of chemicals and various food additives in their food. This has been exacerbated by several food alarms (e.g. BSE, Avian flu, etc.) and to a certain extent by the resultant European Commission's (EC's) actions to tighten up and harmonise an EU food-safety regime that had developed in a piecemeal fashion over 40 years.

SPS is consequently not a passing issue but one that needs to be recognised as presenting new twenty-first-century challenges to the twentieth-century regulatory mechanism of the World Trade Organization (WTO) generally and its related SPS Agreement specifically. SPS is a fundamental element of the negotiations on economic partnership agreements (EPAs) foreseen under the Cotonou Agreement between the ACP groupings and the EU, as it directly affects ACP exporters' ability to avail themselves of any opportunities that may arise.

This chapter looks at the challenges to be faced in changing the parameters within which SPS measures are introduced and managed in the context of the EPA negotiations, and suggests several strategies that might be useful in achieving mutually beneficial EPAs between the ACP regions and the EU. Maintenance of the *status quo* in relation to SPS and the current trading environment runs the risk that ACP–EU trade may not be able to benefit as intended from any new arrangements.

International trade negotiations on SPS

WTO and Doha issues

SPS measures deal with food safety and animal and plant health standards. The WTO does not set the standards. The WTO SPS Agreement encourages member countries to use standards set by international organisations (e.g. Codex Alimentarius; International Office of Epizooties – OIE; and International Plant Protection Convention – IPPC), but also allows members to set their own standards. These standards can be higher than the scientifically agreed ones, but the Agreement says that they should be based on scientific evidence, should not discriminate between countries, and should not be a disguised restriction to trade.

The provisions strike a balance between two equally important objectives: helping governments

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protect consumers and animal and plant health against known dangers and potential hazards; and avoiding the use of health and safety as protectionism in disguise. Considerable discussion has taken place over the years as to whether the SPS Agreement is in practice comprehensive enough in its coverage to achieve its stated objectives and the extent to which its wording allows the major issuers of SPS standards, such as the EU, to exceed internationally accepted norms.

The following issues are among those raised in the lead up to the 2001 Ministerial Conference in Doha. Most were raised in the preparations for the Seattle Conference in 1999 but not necessarily under the same recognisable headings. Broadly they come under a heading of 'Implementation of the Uruguay Round Agreement' and represent SPS issues that need to be tackled if a successful Doha Round is to be achieved.

Equivalence

The basic premise of this is that countries accept that the object of SPS measures is to ensure that the risk presented by the ultimate product presented for consumption by consumers is at an acceptable level. Coupled with this is the recognition that different measures could be equivalent in providing the same level of health protection against risks of disease or contamination. The SPS Agreement (Art. 4) requires governments, under certain conditions, to recognise other governments' equivalent measures. The problem that faces developing countries (DCs) in particular is how to establish to importing countries' satisfaction that their domestic systems do deliver the same level of safety as the importing countries' own arrangements.

In the WTO, DCs say that developed countries are not doing enough to accept that the actions they are taking on exported goods, in particular in respect of inspection and certification procedures, are equivalent to importing countries' own, as they do in practice provide the same level of health protection.

Much of the problem lies not so much in the reality of whether the health protection levels are the same, but in the inability of DCs to provide sufficient scientific evidence to support the contention and convince the importing countries' authorities. The question of just how much evidence is required and its precise nature and level of sophistication is not specified in the SPS Agreement and forms a formidable barrier to the achievement of equivalence recognition in the area of SPS.

Regionalisation

Article 6 of the SPS Agreement requires governments to recognise regions within other countries as being safe sources of imports for food and animal and plant products, instead of basing their measures entirely on national boundaries. The regions concerned can extend beyond (straddle) a single country's borders as well as be contained within a country.

The adaptation to regional conditions is key relevance to DCs, especially large countries where geographical, environmental and epidemiologic conditions may vary considerably between regions. The cost of eradicating pests and diseases from particular areas and of obtaining acceptable scientific proof of achievement presents a formidable barrier to countries benefiting from Art. 6.

The Committee has so far failed to agree on whether it would be useful to develop guidelines that would define what is required, with the consequence that there is no work programme on implementing 'regionalisation'. Latin American countries broadly favour guidelines. Some others such as the US would prefer to leave the task to the OIE and IPPC, with their technical and scientific expertise. The EU supports the development of guidelines, but is concerned that this might encourage countries to delay implementing regionalised measures until the guidelines are agreed.

Special and differential treatment[1]

Special and differential treatment (SDT) is part of the WTO Doha Development Agenda and, under the 1 August, 2004 General Council decision (sometimes called the 'July 2004 package'), the SPS Committee has to report back to the General Council by July 2005.

The WTO SPS Agreement includes provisions relating to SDT in respect of SPS measures. Art. 10 state that 'where the appropriate level of SPS protection allows for the phased introduction of new

SPS measures, longer time frames for compliance should be accorded on the products of interest to developing country members so as to maintain opportunities for their exports.' It further indicates that, 'with a view to ensuring that developing country members are able to comply with the provisions of this Agreement the Committee is enabled to grant such countries, upon request, specified, time limited exceptions in whole or in part form the obligations under this Agreement, taking into account their financial, trade and development needs.' Art. 9.1 and 9.2 supplement these provisions by providing that members must facilitate the provisions of technical assistance to developing countries and must consider providing technical assistance where this is necessary.

These provisions should in theory ease the problems which DCs face in meeting EU SPS measures. However, there exists generally dissatisfaction relating to the degree to which SPS issuers such as the EU have in practice complied with the spirit as well as the wording of these provisions. The obligation 'must consider providing' has been regarded as being ineffective and a later slightly stronger amendment (at the Doha WTO Ministerial Conference) to 'should provide' is generally regarded as unlikely to change the situation.

The latest decision on special treatment[2] strengthens importing countries' commitments to provide an opportunity for exporting DCs to seek revisions or ask for technical assistance when new or revised measures affecting imports are proposed or introduced. Whatever additional 'special and differential treatment' is then agreed will be publicised as a supplement (or 'addendum') to the document that originally announced the new measure.

The outcome could take a number of forms. The new or proposed measure could be revised for imports from all WTO members. The importing country could provide technical assistance to the exporting DC to help it meet the new requirements. Special treatment could also be given to exports from DCs, such as a longer period to adjust, or the outcome could be a combination of these.

SPS and the Cotonou Agreement

The Cotonou Agreement (Art. 48) reaffirmed the parties' commitment to the SPS Agreement annexed

Box 1. Sources of SPS-related assistance

The International standard setting bodies have substantial programmes related to SPS capacity building. For instance:

- The IPPC have developed a diagnostic tool, the Phytosanitary Capacity Evaluation, to help identify countries' capacity and identify needs for assistance available (see www.ippc.int);
- The OIE provides financial support for the participation of the Chief Veterinary Officer of its member countries in OIE standard setting bodies.

The WTO, FAO, OIE and WHO have also been involved in the establishment of trust funds by Codex, IPPC and OIE to assist in the more effective participation of developing countries in their standard setting activities.

Other organisations such as the World Bank, IICA, UNIDO and UNCTAD also have substantial programmes related to SPS.

The Standards and Trade Development Facility (STDF) was established following the commitment made by the Heads of the WHO, FAO, WTO and OIE and the World Bank at the Doha WTO Ministerial Conference to explore new technical and financial mechanisms to promote the efficient use of resources in SPS related activities. The STDF is administered by the WTO with the stated aim of promoting capacity building projects related to SPS. There is also a database (see http:/stdfdb.wto.org)

The EU has a range of technical assistance programmes targeted at helping ACP countries, notably the Fish Support Programme and the Pesticides Initiative Programme. In addition, EU member states contribute widely to bilateral projects.

See also http://agritrade.cta.int/infosources/sps.htm

to the WTO Agreement, taking account of their respective levels of development. Furthermore, the parties undertook to reinforce coordination, consultation and information as regards notification and application of proposed SPS measures, in accordance with the WTO SPS Agreement, whenever these measures might affect interests of either party.

A very important element of the Cotonou Agreement is that it foresees the replacement of the non-reciprocal trade preferences regime of the Lomé Conventions with a new WTO-compatible trade regime between the EU and ACP countries, the economic partnership agreements (EPAs).

EPAs are free trade agreements (FTAs) that will, among other things, involve the acceptance of the principle of reciprocity of trade between the EU and ACP producers of agricultural produce. The actual level of reciprocity and its timetable for implementation are, however, issues for negotiation – although the remaining time available to reach an agreement (until the end of 2007) raises problems of its own. It is unlikely that any waiver of this date can be obtained. Consequently, what is to be achieved has to be achieved within this relatively narrow window. This indicates a need for an element of prioritisation and targeting of the issues to be discussed.

The issue of SPS is highly relevant to the discussions on reciprocity, as a level playing field will not exist between EU and ACP producers if the latter are either unable to meet the SPS requirements or the cost of so doing renders their production uncompetitive. This has implications not just for exports to the EU, but also for competition and market share in the domestic market, be it national or regional.

A report by PriceWaterhouseCoopers (2004) on the 'Sustainable Impact Assessment of the EPAs' reinforces these concerns, not only for the present situation, but also for the future development of ACP economies into participants in the global trading environment. The report notes that, with regard to the reciprocal obligations of EPAs, 'the ACP countries maintain relatively high tariffs on food products, the removal of which could increase the imports of EU products'. It further points out that 'where these products compete with domestic production, they could further discourage the development of processing and manufacturing capacity in ACP countries in export-oriented and other industries'.

It seems clear that unless local industries and support infrastructure are allowed and/or helped to become SPS compliant, the prospects for countries to benefit from domestically owned secondary processing and diversification of export profile will be small. Whilst it is arguable that EU-based firms may buy up local firms having such potential and therefore expansion/diversification will occur, this will have the effect of simply turning ACP countries into supply bases for the EU consumer.

In this context, it is worth noting the power of the EU supply chains. These not only exert increasing control over suppliers' operations (SPS and others), but they have traditionally relied on EU sources for SPS compliance evidence such as certification, codes of practice, standards, etc. A continuation of this situation will possibly prevent the development of the local market supply potential and customers for such services. In particular, these activities are likely to restrict the development of local codes of practice and standards, which when benchmarked to international counterparts can substantially lower the costs of SPS compliance to local producers.

Many would contend that this runs contrary to the development aspects of the Cotonou Agreement. Liberalisation is of course necessary in today's market and investment is a desirable side effect of such action. However, the liberalisation (reciprocity) of the ACP markets should avoid eliminating the potential for locally owned and governed sectoral development. SPS is a central consideration in this respect because the cost of meeting SPS increases significantly when moving up the value chain. This relates not only to finance and equipment, but also to the SPS-related technical and human resources and supportive infrastructure (such as accredited laboratories) and conducive legislation that are required.

ACP capacity is generally regarded as being inadequate to accommodate the increasing level of EU food safety measures, particularly as regards to local certification, testing, inspection, etc. The Cotonou Agreement recognises that ACP countries may need assistance to overcome their capacity deficiencies.

However, the time that is left before EPAs are to become a reality (1 January, 2008) leaves insufficient time for any significant capacity building to be achieved. The issue of how long a period can be negotiated before it is desirable from the ACP viewpoint for reciprocity to be fully in effect consequently becomes closely attached to the question of how long it will take for individual ACP countries to become as SPS compliant/sufficient as their EU competitors. As the ACP countries are unable to achieve this by themselves, this in turn becomes related to the question of how much assistance the EU is willing to make available and within what timescale.

Relevance of SPS issues to ACP countries

Key issues

Whilst much discussion centres around the impact of individual SPS measures (such as traceability, pesticide maximum residual levels – MRLs, etc.), the core issue relates to the operation of the umbrella under which all SPS measures take place – the WTO SPS Agreement. Considerable concern exists that, in its present form, the SPS Agreement is unclear in certain areas and consequently does not provide a reliable foundation stone on which a successful EPA can be established. Unless the ACP countries can be certain of the SPS objectives they are expected to achieve and be sure that these cannot be arbitrarily moved and/or interpreted by standard setters such as the EU, it becomes difficult for them to agree. There are several interrelated constituents of this ongoing concern, which were highlighted by Grant Isaac (2004).

The first issue relates to the power of the SPS Agreement. A **legitimate** SPS measure confers on a member the unilateral right to ban any type of product from any source, and this right cannot be challenged under international trade law. The second issue is associated with the ambiguity surrounding the wielding of the Agreement's power: essentially, there remains uncertainty as to what constitutes a **legitimate** SPS measure.

The inalienable right of members to protect human, animal or plant safety and health is enshrined in the SPS Agreement and accordingly, if a **legitimate justification** exists, members may restrict or prevent imports through the use of mandatory sanitary and phytosanitary measures. In fact, there are three important provisions of the SPS Agreement – differing from traditional trade principles – that support the unilateral establishment of SPS measures by members.

1. First, members may discriminate against imports because of the presence of risks in the exporting country (Art. 2.3). The SPS Agreement recognises that different regions with different geographical conditions and agronomic practices face different incidences of pests and disease. Hence, members are not required to grant either national treatment or most favoured nation (MFN) status to agricultural exporters whose products may contaminate the domestic food supply.
2. Second, members may also establish domestic SPS measures higher than accepted international standard if there is **legitimate justification** to do so. Generally, international trade agreements commit members to adopt international standards if available; however, the SPS Agreement permits members to establish even higher standards. Consequently, the SPS Agreement creates a regulatory floor but not a regulatory ceiling.
3. Third, members may establish provisional measures based on precaution, in the event that there is insufficient scientific evidence to conduct an appropriate risk assessment. They must also follow this up with efforts to obtain evidence for a more objective assessment of the risk 'within a reasonable time' (Art. 5). This effectively provides the unilateral right under the WTO to impose trade barriers that cannot be challenged by other members.

Issue 1 – Ambiguities within the SPS Agreement

Although at first glance it may appear that the provisions in the SPS Agreement are well specified, leaving little room for controversy; there are several important sources of ambiguity that are at the heart of many problems DCs have relating to SPS and trade with the EU.

Ambiguity 1 While the non-discrimination provisions limit the focus of trade rules to 'like products', it is obvious that some SPS-related risks may, in fact, be associated not with the end-use characteristics of a product, but rather with the processes and production methods (PPMs) employed. Indeed, this is at the heart of the WTO trade disputes over beef hormones and genetically modified crops (Isaac and Kerr, 2003a).

Ambiguity 2 According to the Agreement's Art. 5:7, members may adopt temporary, precautionary bans to prevent the introduction of risks when sufficient scientific evidence is absent. The problem here does not lie with this provision, but rather with how to remove the provision once it is triggered. The SPS Agreement is silent on the steps that need to be taken by a member country that has lost international market access because trading partners have invoked this provision. Greater clarification is required in the SPS Agreement on how long is 'temporary' and on the quantity and type of scientific evidence that is deemed sufficient.

Ambiguity 3 The SPS Agreement sets a regulatory floor but not a ceiling. Members are committed to both the international harmonisation of SPS measures and the mutual recognition of measures employed by other members. With respect to mutual recognition, a member is committed, in principle, to granting equivalence to the SPS measures adopted by an exporting country 'if the exporting Member objectively demonstrates to the importing Member that its measure achieve the importing Member's appropriate level of sanitary or phytosanitary protection' (Article 4.1). The problem is that – provided that the national treatment provision is met – the Agreement is silent on the limits for countries to have their regulations substantially above those of other member countries. Therefore, while there is a minimum level of SPS measures that must be met, is there a maximum defining the point that importing member countries cannot legitimately expect potential exporting members to achieve?

Ambiguity 4 This is associated with the role of socio-economic consideration in risk assessment. The SPS Agreement permits members to establish SPS measures based on scientific risk, as well as on broader assessments of risk such as relevant economic factors, including (Art. 5:3):

- 'the potential damage in terms of loss of production or sales in the event of entry, establishment or spread of the disease or pest;
- the costs of control or eradication in the territory of the importing Member; and
- the relative cost-effectiveness of alternative approaches to limiting risks'.

Trade agreements traditionally avoid such socio-economic assessments because of the subjectivity complications associated with them. However, the SPS Agreement recognises that imported risks to human, animal and plant safety and health are likely to have socio-economic impacts that can be significant. The inclusion of this article raises ambiguity about how socio-economic assessments may be worked into the **legitimate justifications** based on sufficient scientific evidence. None of the international scientific organisations deferred to by the WTO provide much scope for socio-economic assessments, so it is unclear how and when they may be included in a legitimate fashion.

Issue 2 – Inadequate capacity building

A second major issue relates to the capacity building necessary to meet the EU SPS requirements. The increase in the technical level of requirements and the nature of the mechanisms needed to meet them now constitute a significant barrier to exporters. In many instances large importing chains are using their influence to insist on compliance with SPS measures that are strictly only required by EU law within its own geographical boundaries (e.g., traceability). This imposes an additional burden on the small producers who make up a large proportion of ACP suppliers.

Despite the assistance that is available from the EU and other organisations (see Box 1), there remains an inadequate knowledge about how to easily access what is available. Concern also exists that what is available is in itself basically inadequate to the size of the task. This situation exists alongside the limited ability of some countries to actually obtain and absorb the assistance in the time frame that the EPA

negotiators have available. Also in some instances it is not purely SPS-related assistance that is needed, but indirectly related infrastructural upgrading such as transport infrastructure that allows samples to be sent to laboratories for testing within a specific and reliable time frame.

A related problem is that, whilst some project assistance that is available may rectify an institutional deficiency (e.g. a modern laboratory), these sometimes are of limited value as they are not subsequently operated on a revenue-effective basis or the demand at national level is insufficient to sustain the level of technical resources needed over time. A regional approach to some of these areas would be cost productive.

Whilst the EU has said that it will adopt a flexible and understanding attitude to the SDTs required in relation to the capacity-building needs of ACP countries, it nevertheless will only do so where the principle of SPS measures (consumer protection) are not eroded.

The above indicates that the EPA playing field on which negotiations are taking place includes some obstacles whose exact nature and role require clarification. This requires:

(a) Clarification of precisely what the SPS Agreement allows the EU to do and the limitations and obligations that may be cited by ACP countries where specific measures are considered to exceed what is necessary for the adequate protection of health.

(b) Identification and quantification of what ACP countries need at national and regional level, to meet EU SPS requirements and as a result be in a position to participate fully in a reciprocal trade agreement as envisaged under Cotonou.

Impact

The requirement to meet SPS legislation is a horizontal barrier to all exports to the EU and is not subject to negotiation from any category of exporter irrespective of their status (LDCs, etc.). Any negotiation that takes place can relate only to the mechanisms (e.g. timing/phasing, assistance, etc.) of the introduction of the measure, not the principle.

The impact of these requirements necessarily reflects the ability of individual countries to comply and the importance of the agricultural sector exports to the whole economy. In some instances exports might not be large in volume/value terms, but represent an important element of domestic employment – particularly in relation to small producers.

The impact also varies according to the export profile of countries/regions. Some countries' exports are more heavily oriented towards fruit and vegetable exports whilst others have a different dependency on meat and fish exports. For instance, in the first case the current review of acceptable pesticides (MRLs) by the EU and consequent withdrawal of many which are traditionally used by small ACP farmers/producers will impact severely on this sector. In the second case, the animal/meat/fish sectors have been highly regulated for many years and whilst the requirements are undoubtedly being increasingly enforced, the principal problem lies more with the increasing height of the entry barrier for any firm considering selling to the EU for the first time.

The impact of SPS measures generally, however, are a reflection of the extent to which they are enforced in practice. This enforcement has traditionally originated more at the EU end of the supply chain than at the point of origin, although there are notable exceptions among some ACP countries where exporters have taken a lead in compliance measures.

This situation is now changing significantly with the introduction of the Feed and Food control Regulation 882/04. This regulation is not in itself an SPS measure but by its nature requires that all EU SPS legislation be enforced (with respect to feed and food produce exported to the EU) to a particular standard by the national authorities of all exporting countries.

The regulation also effectively forces the private sector exporting plant product into much closer collaboration with the public sector Competent Authority in much the same way that already exists in the animal-related sector. The direct result of this is to raise the profile of the capacity building needs of ACP countries to ensure their exports are SPS compliant. This is because their institutional mechanisms (legislation, laboratories, inspection systems, etc.) to achieve this objective will be subject to examination and approval by the European Com-

mission's executive arm, the Food and Veterinary Office (FVO).

The cost of such capacity building encompasses the entire food control system and will require action at national and regional level, as well as involving greater support for non-state actors. Box 2 illustrates the coverage of what is generally recognised as the elements required of an effective Food Control System.

Possible areas of consensus

At the broad level, all ACP countries already share an interest in obtaining agreement on SDTs as regards the phasing in of SPS measures (where this does not result in a risk to health) and on the necessity to obtain sufficient assistance to enable them to meet the capacity requirements of SPS (e.g. laboratories, modern legislation, certifiers, etc.).

At a more specific level, there is less awareness and discussion than is merited on two important areas where a broad consensus should be possible:

- that the WTO SPS Agreement be reviewed in relation to several areas of ambiguity and clarification included in the terms of any EPA to be signed; and
- the concept of equivalence provides a basis for the achievement of Mutual Recognition Agreements between trading partners. It is therefore in the general interest of the ACP countries to identify specific sectors where recognition of equivalence in relation to Standards, Codes of Practice, etc., are likely to be successful.

Possible areas of divergence

In general, the divergences of opinion within the ACP relate to the overall conduct of EPA negotiations and matters not specific to SPS. Where divergence does occur it is usually between sectoral interest groups and the regional organisation. Sectoral interests often attempt to argue for unachievable positions to be adopted, such as SDT requiring a lower standard for LDCs to meet because they are the most vulnerable in the export chain. Others argue for a moratorium of five years on the EU introducing SPS measures. Both of these demands are non-starters.

Other divergent areas tend to relate to issues such as the type of SPS functions that could be transferred to the regional level and the associated question of perceived reduction in sovereignty.

Summary

- **The wording of the SPS Agreement is ambiguous and needs to be revised.**

Box 2. Requirements to meet Regulation 882/04

1. Modern food law and regulation
2. Co-ordinated food control management
3. Well-trained and effective inspection services
4. Accredited laboratory services
5. Effective information, education and training schemes
6. Institutionalised public and private sector co-operation

Box 3. Principal WTO SPS Trade Concerns 1995–2004

Animal health, particularly mad cow disease (BSE) and foot and mouth diseases, have dominated 10 years of discussions in the SPS Committee. The WTO 2004 Report notes that animal health and zoonoses account for 40% of concerns raised since 1995.

Over the decade, plant health accounted for 29% of all concerns, food safety 27% and other concerns such as transparency 4%.

The WTO Secretariat paper reports that developing countries have been participating actively. Over the period, 101 issues were raised by DCs (sometimes by several countries), compared to 143 raised by developed countries.

- ACP countries need capacity building especially in their Institutional Food Control Systems.
- Specific sectors could form the basis for equivalency agreements

Relevance to the EU and its likely position

Key issues

The EU seems primarily concerned that the issue of the capacity of ACP countries to meet SPS requirements is not allowed to delay the signing of EPAs beyond the timetable agreed to in the Cotonou Agreement.

The EC is also concerned that requests for additional resources to upgrade the capacity to meet SPS requirements generally and the Feed and Food Control Regulation specifically do not result in the allocation of funds that are not already agreed within the framework of Cotonou Agreement under the European Development Fund (EDF).

The EU wishes to avoid the discussion on trade reciprocity under EPA being linked to the provision of the capacity building which is required to ensure ACP exporters are not barred by their inability to meet SPS requirements.

With regard to equivalency agreements, the EU has indicated that it would, for the time being, have difficulties in entering into such agreements with ACP countries. This attitude is based on the EU's assessment that ACP states do not have the capacity to effectively test and certify products and thus do not have systems equivalent to those of the EU. The EU, however, does not exclude the possible conclusion of such agreements in the longer term.

Feed and food regulation

Over recent years, the FVO has developed its working methods and procedures in several important respects. It has moved away from the focus on standards in individual production establishments towards evaluating the performance of the relevant competent authority in the overall operation of national control system, especially its ability to transpose, implement and enforce EU legislative standards effectively.

The Feed and Food Controls Regulation 882/04 is a reflection of this policy and has been introduced to complement the umbrella Regulation 178/2002 which sets out the basic principles of food safety within the EU. Regulation 882/04 establishes how these basic principles will be interpreted, implemented and enforced in a harmonised manner by the EU and its member states' authorities through official controls of both EU-produced and imported feed and foods. Box 4 outlines the Regulation's provision.

Regulation 882/04 is highly relevant to the ACP as those countries' national authorities will be required to provide detailed information to the European Commission about their feed and food control systems and related guarantees that products destined for the EU meet EU safety standards or those considered to be equivalent. In many instances the existing elements of ACP countries institutional control system may not be considered adequate to provide the required level of confidence in their system. Box 2 shows some of the principal areas where countries may require assistance to upgrade the performance of their national control systems.

It will be a key aspect of the application of the new Food and Feed Control Regulation that 'equivalence' does not become interpreted in practice as 'sameness'. The European Commission has stated clearly that 'there is a need to take special account of the needs of developing countries' and, indeed, the Regulation itself provides (Article 47.2) that the information requested by the EC from third countries must be 'proportionate to the nature of the goods and may take account of the specific situation and structure of the third country and the nature of the products exported to the Community'.

Overall, the EC considers that the new system should help third countries to meet EU standards by clarifying the requirements and improving the transparency of the approval system.

However, it is accepted that there are a number of areas where problems for third countries can be envisaged and the Regulation therefore contains framework provisions to enable the EC to provide mechanisms and to fund activities that will assist DCs. These include:

- a possible phased introduction of certain specific requirements;

Box 4. Scope of impact of Feed and Food Control Regulation 882/04

- Regulation 882/04 specifically addresses Official Control systems and their operation by Competent Authorities to ensure that EU standards are met for all foods and feed exported to the EU.
- It applies to all third-country exports of any food or animal feedstuffs, whether derived from animals, fish or plant, to the EU.
- Current controls on the import of products of animal origin remain in place.
- A more harmonised approach to controls on imports of food and feed on **non-animal origin** will be introduced.
- The role of FVO is extended into the non-animal product sector.
- Third countries' authorities will have to provide detailed information about the structure and management of their Official Control systems.
- 'Guarantees' that products meet EU safety standards or those considered 'equivalent' will be required.
- Products of non-animal origin known to pose increased risks will be defined and be subject to increased controls prior to release into the EU market.
- The Regulation does not introduce new technical, safety or quality standards and must be considered in parallel with all existing EU legislation.
- Transitional measures will enable existing approvals to remain in force and for listed countries to retain access to the EU market pending their assessment under the new system.
- TThe Regulation provides a framework to help developing countries meet EU import requirements and enable the European Commission to fund activities that enhance food and feed safety.
- TIt does not directly address business operators; however, changes to Official Control regimes will impact indirectly on private operators, particularly in the non-animal product sectors, in respect of record-keeping and documentation.

- technical assistance projects;
- twinning projects between developing countries and member states;
- assistance in providing the required information (using EC experts) and development of guidelines to assist developing countries in organising official controls on products exported to the EU (those areas seen as priority areas);
- visits by EU experts to assist in the organisation of official controls; and
- participation of DC's control staff in training courses organised in the EU.

The EC has emphasised that transitional measures will enable approvals to remain in force and for listed countries to retain access to the EU market pending their assessment under the new system.

Review of EU Free Trade Agreements[3]

As the definition of norms and standards is predetermined by the superior WTO rules, bilateral arrangements mainly focus on procedural issues. In this respect, a common characteristic of all recent EU free trade agreements (FTAs) is their emphasis on facilitating the application of the WTO SPS provisions through:

- fostering consistent application of WTO SPS measures by pursuing a common understanding of the existing WTO provisions; and
- harmonisation through consistency with WTO and mutual recognition provisions.

The EU FTAs differ in four main respects:

- the extent to which they reaffirm WTO rules;
- the emphasis on co-operation on SPS measures;

- the adoption of a general exception clause similar to GATT Art. XX; and
- the specification of technical assistance in SPS issues.

Only rarely do the agreements contain individual provisions that go beyond WTO commitments. These concern a limited number of product-specific supplements, procedural provisions on fixed item schedules or decision procedures, equivalence provisions and some specific objectives.

The Chile Agreement and SPS

The trade provisions of the Association Agreement with Chile, to date the most recent FTA concluded by the EU in November 2002, stand out as the most advanced in EU bilateral agreements and are potentially the ones from which ACP negotiators can learn most. The Agreement recognises the importance of SPS in trade between the two signatories and contains comprehensive annexes, which specifically cover SPS measures applicable to trade in animals and animal products, plants, plant products and other goods, along with animal welfare. These set out procedures for dealing with problems raised by either party. These procedures, together with definitions of what is required in relation to equivalence and competency with respect to testing/ certification standards, etc., were agreed by the negotiators and enshrined in the annexes.

Consequently a much clearer and formulated understanding of what is required exists and neither party can arbitrarily introduce SPS-related measures which may be regarded as unfair or unsubstantiated by the other. Of particular importance is the inclusion of specific SPS-related technical assistance commitments.

European Commission strategy

Although the European Commission accepts the principle that the required level of food safety can be achieved by regulatory mechanisms that are not the same as exist within the EU, in practice it is likely that what is being sought is the establishment of food control systems that are a reflection of the EU's own arrangements. This has some logic as it is easier for the EU to deal with a number of FTAs that have similar food control systems to its own. This also assists in any further integration that the EU would like to see between regions themselves at some time in the future.

The EC would therefore like to be able to control or at least steer ACP countries in the way that they upgrade their food safety systems. Because of resource constraints, the Commission is limited in its ability to tackle this task at the same time as the EPA negotiations and would prefer to see full discussion take place once the various regions have signed the Agreements. In the meantime, the EC is content to see and encourage some capacity building, but to deter widespread and possibly diverse spending on systems that may not be compatible with its own. Among the tactics to achieve this, are:

- To argue that adequate sources of funds for capacity building already exist and that there is no need to provide any extra at this time.
- To argue that the EDF funds provided under the Cotonou Agreement are at the disposal of the recipients and it is for them to establish their priorities for their use.
- To argue that there is no need to link the capacity building needs to the discussion on the timeframe for reciprocity in trade between the EU and the EPA regions. This can all be sorted out later once the EPAs have been signed.

In relation to the removal of ambiguities with the WTO SPS Agreement, the EC's overall aim is to preserve its right to introduce whatever SPS measures that it deems necessary. It is therefore likely to prevaricate over any suggestions for reviews that might lead to measures that could restrict its current less-restricted remit under the SPS Agreement. Nevertheless, it may be open to clarification of its attitude to some of the ambiguities in the SPS agreement within the context of an EPA, given the precedent of how SPS was tackled in the EU–Chile Agreement.

Summary

- **The Feed and Food Regulation poses formidable capacity building requirements.**

Table 1. SPS provisions in EU free trade agreements

	MED	TDCA	Mexico	Chile
Confirmation of WTO provisions				
Reaffirmation of WTO SPS Agreement	–	√	√	√
Co-operation on SPS measures	√	√	√	√
Harmonisation of standards as an explicit target	√*	√	√	√
Protection of health and life as a general exception similar to GATT ARt. XX	√	√	√	√
Explicit provision of technical assistance on SPS matters	–	–	–	√
Individual supplements beyond WTO provisions				
Product-specific provisions or amendments	√ for Israel (cut flowers)	–	–	–
Procedural specifics**				
Establishment of a joint management committee	–	–	√	√
Detailed process of equivalence determination	–	–	–	√
Guidelines for conducting equivalence determination	–	–	–	√
Time schedules and provisions on internal reporting and consultation	–	–	–	√
Operationalising administrative provisions for imports	–	–	–	√
Requirements for information exchange	–	–	–	√
Provisional approval of certain establishments without prior inspection	–	–	–	√
Specific objectives	–	–	–	√ animal welfare

*Only in the agreements with Israel, Algeria, the Palestinian Authority and Lebanon.
**For the MED agreements and the TDCA, these specifics are either currently being negotiated as part of supplemental technical annexes or such provisions have just been adopted. Nevertheless, they are not an explicit part of the FTA itself. This is true only for Mexico and Chile.
Source: Rudloff and Simons (2004).

- **The EU–Chile FTA has lessons for treatment of SPS in EPAs.**
- **The EC appear unwilling to provide additional finance outside that already committed in the EDF under the Cotonou Agreement.**

Options for the ACP countries

The EU cannot be challenged on its right to protect its citizens from potentially harmful food. This is irrespective of whether countries that supply the food lack the capacity to meet the standard being established.

The primary focus of attention must therefore be on the mechanics of the measure being required rather than on the basic principle. This involves looking at what the EU is doing and identifying whether it is in accordance with the WTO SPS Agreement. The SPS Agreement contains areas of ambiguity that allow the EU to introduce measures that, whilst not at variance with the wording of the Agreement, nevertheless can arguably be viewed as being contrary to the underlying intention, i.e. not to interfere unnecessarily with international trade.

The second focus must be on identifying and costing what the ACP countries need to do to actually comply with the EU SPS legislation. This requires a move away from the broad generalisations that

obscure the real requirements. It is clear that not all countries need the same degree of help, particularly in product areas such as animal exports where considerable compliance has already been achieved. Some element of prioritisation must be introduced to permit the principal blockages in the supply system to be tackled on a timely and cost-effective basis.

The third focus should be on identifying how to ensure that:

- assistance for the selected capacity building is forthcoming;
- the assistance is commensurate with the actual needs; and
- the assistance should not divert resources from the previously allocated priority targets such as poverty relief. In view of the size of the task, it is difficult to imagine how this could not include additional funds beyond those already committed by the EDF.

To achieve the above it may be necessary to establish strong linkages between the actual upgrading of compliance capacity and the timetable for implementation of reciprocity.

Preparatory strategies

Although the option of negotiating a lower level of compliance for ACP countries is not available, some related areas do exist that would contribute to finding solutions to the underlying problems created by SPS measures. These are:

- Identifying what capacity building is needed at the national level and what might be transposed to the regional level (e.g. reference laboratory).
- Preparing a cost breakdown in respect of what is needed and incorporating this into the negotiations.
- Identifying existing SPS-related standards, codes of practice, etc., which could form the basis for the negotiation of Mutual Recognition Agreements with the EU.
- Identifying what time scale is required to meet the requirements of the Feed and Food Regulation 882/04 and negotiating appropriate phasing-in periods. This possibility of phasing in SPS and related requirements is an important element to be actively pursued in negotiations. Provision specifically exists for such phasing in under the Regulation and for account to be taken of the ability of countries to comply.

In addition, it must be recognised that the EU is in a powerful position as a member of the WTO and representing a bloc of 25 countries. It should be strongly encouraged to use its influence to have the ambiguities that exist in the SPS Agreement examined and clarification obtained. Such clarification would help ACP countries in respect of:

- What needs to be done to have a precautionary action lifted and a clear time limit established for such 'temporary' action to last without further and more substantive scientific evidence being provided of the action's validity. The level and content of the additional evidence should also be specified.
- Whether a ceiling can be established which limits the extent to which EU SPS legislation can exceed international norms in any specific area.

However, such clarification will take time and whilst this is being sought in the wider forum of the WTO, it will be beneficial for ACP negotiators to request clarification of the EU interpretation of particular issues which cause problems in the context of the EPAs. Such clarification and any related commitments could be annexed to the EPA as in the precedent of the EU–Chile Agreement.

Given the limited time frame available, however, care should be taken to select issues where agreement might reasonably be expected to be achieved before the entry into force of EPAs on 1 January, 2008. Among candidates for such consideration might be:

- Consultation procedures that include a requirement for the provision of a high level of scientific justification where SPS measures exceed international norms. It should be made clear when the drivers of the measure is genuine risk to health and where it relates to a socio-economic con-

sideration such as the cost of eradication and/or production losses in the importing country.

- The right to suggest alternate approaches to limit risk, particularly where socio-economic reasons are the driver of SPS+ measures rather than any real increase in the level of risk to consumers.
- When precautionary action is taken without adequate scientific evidence, a time limit for the production of such evidence to be established together with stipulations as to the level and nature of such evidence.
- The right to receive technical and/or financial assistance to meet the requirements of specific SPS compliance measures. An action timetable could be agreed that might differ according to a region's needs.

Recommendations for an 'ideal' agreement on SPS in EPAs

The problems to be overcome

The EPA negotiations have a fundamental problem to overcome in relation to SPS: EPAs require reciprocity but this is only achievable in practice if both parties are in a position to trade.

The Cotonou Agreement clearly states that no country should be worse off under its provisions than previously. At present many ACP countries are not in a position to fully meet the SPS requirements of the EU either with regard to the Feed and Food Regulation's institutional needs or to the increasingly stringent and technical nature of control measures such as traceability, HACCP, etc. on the private sector. The root of this problem is considered by the author to lie in two areas:

- The SPS Agreement is flawed in that, among other aspects, it allows individual countries to introduce measures that go beyond what the rest of the world regard as 'safe'. Thus, traders have to contend with constantly moving/diminishing goals. It is perhaps understandable why some ACP observers query whether the policies underlying some of these measures are a type of disguised protectionism – which the SPS Agreement forbids.
- The SPS measures being introduced are based on the ability of developed countries of the EU to meet them. Where a problem exists assistance is made available to enable the new measures to be met. The ability of exporting countries in the developing world to meet these same requirements is seldom taken into account to any significant degree. Whilst some assistance is available to the ACP to help meet SPS measures generally, it is not anywhere near commensurate with what is made available to the ACP's competitors within the EU–25.

Views and recommendations of the author

Given that the ACP countries lack the human, financial and technical resources to equalise this position, then a continuation of the present practice must inevitably lead to a diminution of ACP–EU trade. Alternatively, trade may continue but only under the auspices of EU-based supply chains that have acquired the producers who can no longer afford to remain independent.[4] At best the practices will ensure that export trade for ACP countries is limited to the basic commodity level and raise even higher the existing hurdle to firms developing up the value chain.

The previous sections indicated some of the changes that need to take place to enable the negotiators to achieve a level playing field and where the rules of the game do not provide an opportunity for advantage to the strongest player. Having said that, however, it is necessary to recognise that such changes take time and a strategy must be developed that both recognises and uses this. The example of how the negotiators in the EU–Chile Agreement tackled the problems of SPS through enshrining procedural agreements and definitions together with commitments to specific technical assistance in annexes is considered to be highly relevant.

Within this context the following are some thoughts that are intended to help focus minds on what the author sees as useful core issues.

1. It is necessary for the negotiating parties to recognise that the issue of SPS has the potential to deny them what they each want, i.e. the EU to have EPAs signed on time and the ACP countries

to ensure that sufficient assistance is obtained to enable them to compete on level terms.

2. It must also be recognised that the time scale left for negotiation is now insufficient to allow the necessary level of capacity building to take place even if the funding be made available immediately. Consequently, it must be a fundamental aim of the ACP negotiators to obtain written agreement to very specific capacity building to be provided over a specific time scale that is itself linked to the opening up of particular market segments (reciprocity).

3. These negotiations are the ideal time to press for the inclusion of equivalency arrangements for particular sectors (see the EU–Chile FTA). These sectors should be selected with care and be responsive to any short-term upgrading that might be needed. Such equivalency acceptance would confer considerable competitive advantage *vis-à-vis* non-ACP competitors on the EU market.

4. Within the EPA a mechanism should exist to correct the imbalance of treatment between the poor and struggling exporter and those better off. For example, whilst inspection charges are undoubtedly necessary in the EU, in many instances they impact disproportionately on some exporters – such as small producers – and can make their produce (often multi-element consignments) uncompetitive on the EU market. Such a mechanism could facilitate a refund of such charges and would be in line with the development aims that are also incorporated into the Cotonou Agreement.

5. Each EPA should include a consultation structure that, among other things, enables its members to have an early input into any new SPS measures likely to affect them. This membership must include representatives of the non-state actors likely to be affected and who in the past have not had adequate channels to put forward their views. The terms of reference of such a structure should make it clear that the intention of both parties to the EPA is that SPS measures are to be formulated, introduced, and implemented in ways that are least harmful to developing countries, whilst not detracting from the **proven need for the desired level** of protection of the EU consumer.

6. Where the precautionary principle is invoked by the EU, technical or other assistance must be made available to those countries affected on a scale that is adequate to prove or disprove the perceived risk on a very short time scale. The obligations of the imposing country should also be made clear in respect of time limits for appropriate scientific validation of the action and the scope and nature of such evidence. This would limit the sometimes prolonged disruption of trade that currently follows an exporting country's inability to challenge adequately EU precautionary action.

Finally, it is worth noting that EPAs are intended to be more than just FTAs and to have the capacity to deal with wider trade-related issues. The Lomé Conventions regime was widely seen to have failed to live up to expectation because of the lack of capacity of DCs to take advantage of its provisions. This situation has not changed and failure to adequately address the root problems relating to SPS issues in the context of the run up to EPAs must effectively nullify a major intended advantage of the new Agreement over its predecessor.

Implications for international trade discussions

Given the significant unilateral power it confers and the ambiguity associated with how this unilateral power is appropriately wielded, it is clear that many of the problems in agricultural trade negotiations in future years will increasingly relate in some way to the WTO SPS Agreement. The agricultural trade policy issue arising from this and which needs urgent attention is that the agricultural trade liberalisation efforts – stalled by traditional issues of domestic subsidies, export subsidies and market access disciplines – may be unable to take on the complex challenge of SPS trade disputes unless modifications are made.

Clarifying what constitutes a **legitimate justification** for an SPS-related market entry barrier will also ensure that such barriers are not simply being used as disguised protectionism. Bringing the SPS Agreement fully into the negotiating agenda of the

WTO Committee on Agriculture would begin to deal explicitly with the SPS market entry issues that are so relevant to the ACP countries.

Summary

- **Capacity constraint to tackle SPS issues can prevent EPAs functioning as intended.**
- **Insufficient time exists for sufficient capacity building prior to the EPA timetable for signing.**
- **Watertight conditions need to be written into the EPAs linking the implementation of reciprocity to the provision of appropriate sectoral assistance.**
- **The WTO SPS Agreement will continue to create problems in global agricultural trade and should be referred to the Committee on Agriculture as this sector is of fundamental importance to the ACP.**
- **Clarification of how the EU interprets some of the ambiguous areas of the WTO SPS Agreement should also be sought within the EPA negotiations and this, together with negotiated procedural safeguards, should be enshrined within the EPAs.**

Possible options for negotiators

It is worth emphasising a point that is sometimes overlooked. That is that the EPAs represent an entirely different playing field for ACP countries than has existed in relation to EBA and GSP. EPAs present an opportunity to actually negotiate with the EU rather than purely accept what the EU considers to be appropriate either in respect of tackling trade problems generally or allocations from the EDF in respect of SPS capacity building specifically. Negotiators should make the most of the leverage this provides to ensure that the problems raised for ACP countries by the EU food safety concerns and remedial measures (SPS) are accorded full consideration and are not allowed to be sidelined as peripheral issues to be dealt with at a later date.

The options open to negotiators vary from ignoring SPS issues, leaving them to be discussed outside EPAs, to attempting to obtain firm commitment and clarifications in respect of all SPS problems and having these enshrined in EPAs.

In deciding what would be the most useful stance, it is important to recognise what is achievable within the time that is available. It is unrealistic to believe that agreement can be reached on all the SPS issues referred to in this paper. The reluctance of the EC itself to become formally committed to broad-ranging programmes of assistance within the terms of the EPAs is an important element, but more overriding is the fact that sufficient time does not exist for the luxury of trying for the perfect solution. Focus must therefore be on what is achievable. This must inevitably involve prioritisation and identification of those target issues that may be easier to achieve than others.

To assist this process a few possible options are suggested in Table 2. These outline several possible approaches but basically indicate that it may be preferable to set an objective of having some SPS issues dealt with within an EPA whilst attempting to obtain additional commitment to have the remaining issues (in particular capacity building for particular sectors) dealt with under the Cotonou development pillar. This approach places the focus on deciding what could and should be covered in the EPAs and recognises that some issues will inevitably have to be dealt with elsewhere.

These options are not intended to be definitive nor mutually exclusive, but to present an indicative menu from which different regions may select and/or adapt components that may be appropriate for their particular circumstances. The advantages and disadvantages of different options are similarly only presented as illustrations, as an in-depth examination of each is not practical in the context of the table.

Table 2. Review of options

Option	Advantages	Disadvantages
1. SPS issues are not dealt with under EPAs but under the Development pillar of Cotonou	Removes pressure for agreement within EPA timetable	Removes political influence and leverage available to negotiators and leaves decisions in hands of EU bureaucracy. Possibility of linkage to liberalisation of sectors also diminished
2. SPS issues are referred to in the EPA, enshrining the principle of support for capacity building but without any firm commitment	Relatively easy to negotiate and provides a platform for ongoing discussion	Loses the leverage that exists prior to signature and the absence of commitment renders this of little value in practical terms
3. As for Option 2, but including the establishment of consultation procedures on new measures and clarification of EU attitude to ambiguities in the WTO SPS Agreement	Avoids potentially difficult area of obtaining firm commitment for specific assistance within the time available and tackles important areas in advance of likely prolonged WTO deliberations	Obtaining commitment to specific capacity building may be more difficult outside the EPA and agreement as to what constitutes appropriate consultation procedures may raise difficulties at national and regional level
4. Selected issues are included in EPA with firm support measures detailed plus a commitment to additional assistance to be negotiated under the Development pillar of Cotonou	Allows the most important SPS barriers for individual regions to be tackled in a forum where they have most strength and if selected prudently should not impede the progress to signing	May create problems at national and regional level as to priorities
5. SPS issues are referred to in the EPA enshrining the principle of support for capacity building and making a commitment for assistance to be negotiated elsewhere within a timetable which is linked to the liberalisation of sensitive sectors	Allows ACP regions to prioritise and/ or ringfence particular sectors until assistance has provided an effective SPS compliant environment within which sectors can develop their trade potential	More difficult to achieve as EC will resist such linkage and disagreements may occur within regions as to the appropriate time table
6. As in Option 5, but additionally equivalence agreements included for selected sectors	As in Option 5 and obtains advantage for particular sectors. Time exists for necessary assistance for marginal capacity building	As in Option 5 and the EC will be cautious in their approach to accepting equivalency evidence

Endnotes

1. See WTO document G/SPS/GEN/543, www.wto.org
2. See WTO document G/SPS/33 of 2 November 2004, www.wto.org
3. This section summarises Rudolff and Simons (2004).
4. However, as mentioned earlier, the new EU Food and Feed regulation puts the emphasis on the Competent Authorities and not any more on the individual export companies. This means that even companies that meet the food safety requirements could be in a situation where they would not be able to export, due to the possible inability of the Competent Authority to ensure that EU standards are met.

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CAC – Codex Alimentarius Commission:
www.codexalimentarius.net/standard_list.asp

EU Expanding Exports Helpdesk: advice for developing countries exporting to the EU:
http://export-help.cec.eu.int/

EU food and veterinary inspections reports:
http://europa.eu.int/comm/food/fs/inspections/index_en.html

EU guidelines for importing from third countries:
http://europa.eu.int/comm/food/fs/inspections/special_topics/guide_thirdcountries_en.pdf

FAO http://www.fao.org

FAO International Portal on Food Safety, Animal & Plant Health:
www.ipfsaph.org

IPFSAPH (International Portal on Food Safety, Animal and Plant Health)
http://www.ipfsaph.org

IPPC (International Plant Protection Convention)
http://ippc.int

IPPC – International Plant Protection Convention:
www.ippc.int/IPP/En/default.htm

OIE – World Organisation for Animal Health:
http://www.oie.int/

Standards and Trade Development Facility (Technical Assistance):
www.standardsfacility.org

18

Overview of the EU Policies on Key ACP Commodities

Technical Centre for Agricultural and Rural Cooperation (CTA) – Agritrade[1]

Introduction

Part of the Economic Partnership Agreement (EPA) negotiations between the European Union (EU) and the six African, Caribbean and Pacific (ACP) regions is the liberalisation of trade in agricultural products. Not covered in agreements in the World Trade Organization (WTO) until the Uruguay Round in 1994, trade in agriculture could become a very important aspect of EPAs. Since the EPAs are envisioned to provide for reciprocal free trade between the EU and the ACP regions for 'substantially all trade', arguably the trade regime of the EU with respect to the imports of agricultural products will have to be adjusted.

Currently, the EU has three regimes in place that govern imports from agricultural products from individual ACP countries: (i) the trade provisions of the Cotonou Agreement; (ii) the 'Everything but Arms' (EBA) initiative for LDCs; and the Generalised System of Preferences (GSP) applied to all developing countries. The first two regimes are most significant for ACP countries. Since 1975, special arrangements have been established for ACP exports of agricultural products falling under the EU Common Agricultural Policy (CAP), and agricultural products potentially competitive with products falling under the CAP. These special arrangements are applied at two levels for the ACP as a whole and for specific countries within the ACP and are laid out in annex V and Declaration XXII of the Cotonou Agreement and in a series of commodity-specific protocols: sugar, bananas, beef and veal. This chapter introduces the key features of the respective policy regimes for these three commodities.

Banana sector

The basic EU regime

The EU banana regime covers fresh and dried bananas (excluding plantains), frozen, provisionally preserved and prepared bananas, banana juice, and banana flour, meal and powder.

Within the EU, the banana-producing regions are the Canary Islands, Guadeloupe, Martinique, Madeira, Crete, Algarve (Portugal) and Lakonia (Greece). EU banana producers receive income support, subject to quality requirements, for production of up to 854,000 tonnes. Cyprus was also granted a guaranteed quantity of 13,500 tonnes following accession on 1 May, 2004. The compensation paid to EU banana farmers reflects the difference in price between EU-produced bananas and those that are imported.

In the period 1999–2001 the 15 member states of the EU consumed around 4 million tonnes of bananas per annum. Of these, approximately 0.75 million tonnes were produced within the EU, 0.72 million tonnes were imported from ACP countries, and 2.5 million tonnes supplied by countries in the 'dollar banana zone' (overwhelmingly Latin American countries, the leading suppliers being Ecuador, Costa Rica and Colombia) (see Table 1).

The total figure of close to 4 million tonnes was fairly constant from 1993 to 1999. In 1993, 3,951,000 tonnes of bananas were placed on the EU15 market, of which 644,000 tonnes were produced within the EU, 748,617 tonnes came from ACP countries, and 2,560,00 tonnes were imported from 'dollar producers'. In 1999 total consumption in the EU15 was 3,927,000 tonnes, with 729,000 produced in the EU15, 676,000 in the ACP, and 2,522,000 in 'dollar banana' producer countries.

This chapter combines three *Commodity Executive Briefs* published by Agritrade (http://agritrade.cta.int),. More information on the trade aspects of (other) commodities can be found on that website.

Table 1. Banana supplies to the EU15: 1999–2001 (thousand tonnes)

	1999	2000	2001	2002	2003	2004
EU	729	782	767			
ACP	676	756	729	727	787	770
'Dollar bananas'		2,522	2,543	2,561		
Total	3,927	4,081	4,059			

Sources: Extracted from Table 2.2, Supplies of Bananas to the EU15, 1990–2002, from 'Banana exports from the Caribbean since 1992, Preliminary Report', National Economic Research Associates (NERA), 18 June, 2003. For 2002–04, Europa: Agricultural Trade Statistics, http://europa.eu.int/comm/agriculture/agrista/tradestats/index_trade.htm#parta3

Between 1999 and 2003 EU15 consumption rose by around 5%. On the eve of EU enlargement (2003) the ten new EU member states consumed 564,802 tonnes of banana, of which only 2% came from the ACP, with Caribbean bananas being virtually unknown in new EU member states.

Under the EU banana regime the establishment of producer organisations and associations is encouraged (there are currently 21), and assistance programmes are implemented by member states in collaboration with such organisations and associations within commonly agreed rules.

EU producers are eligible for a compensatory aid scheme currently amounting to €64.03 per 100kg of production, up to a maximum quantity of 867,500 tonnes. This maximum quantity is broken down by producer region as follows:

Canary Islands	420,000 tonnes
Guadeloupe	50,000 tonnes
Martinique	219,000 tonnes
Madeira, Azores and Algarve	50,000 tonnes
Crete and Lakonia	15,000 tonnes
Cyprus	13,500 tonnes

Internal expenditures in the banana sector between 1999 and 2003 averaged €249 million annually. In addition supplementary aid is available to EU banana producers when 'average production income was at least 10% below the average Community income'. In a context of price declines on the EU banana market this provision provides an important safety net to EU producers. Finally EU banana producers are also entitled to structural support in the framework of rural development measures. These programmes should promote any two of the following objectives:

- improvement in the preparation and marketing of products;
- greater competitiveness; and
- environmentally sensitive use of resources.

The stated aim of the EU banana regime is to organise the market in such a way that it will allow the Community market to 'receive satisfactory supplies of quality bananas at fair prices for producers and consumers and ensure a balance between the various sources of supply'.

This commitment to maintaining a balance between the various sources of supply has underpinned EC moves towards the tariff-only regime, which formed part of the final agreement to resolve the long-running banana dispute.

The importance of bananas

While previously there were twelve major ACP banana exporters, there are now some ten ACP countries with a significant stake in the banana trade with the EU. Traditionally the major source of supply was the Caribbean, where in a number of countries the banana sector constituted the heart of the economy and exports to the EU were central. Even with the changes that have occurred in ACP–EU banana relations since 1992 the banana sector remains vital

to the economies of the Windward Islands (except Grenada) and Belize and constitutes a major agricultural sector in Jamaica, Surinam and the Dominican Republic.

While the banana trade with the EU has grown in importance for Cameroon and Côte d'Ivoire, the more diversified nature of their economies means that the banana sector, while an important agricultural sector, is overall less significant than for the Windward Islands (except Grenada), although more important than for Jamaica and the Dominican Republic (see Table 2).

Changing patterns of ACP banana exports

Since 1992 the geographical origin of ACP banana exports to the EU has changed substantially (see Table 3). Three major trends can be identified:

- a decline in the share of traditional Caribbean island suppliers (including Surinam but excluding Belize, a low-cost producer) falling from 52.3% of total ACP banana exports in 1992 to 16.3% in 2004;
- an increase in African banana exports from 37.4% of the ACP total in 1992 to 60.5% of total ACP banana exports in 2004; and
- an increase in exports of bananas from the Dominican Republic and Belize from 9.8% of total ACP banana exports in 1992 to 23.2% in 2004.

The traditional Windward Island producers, Grenada, Dominica, St Vincent and St Lucia, have seen their exports of bananas to the EU decline by 93%, 76%, 66% and 65% respectively. This has been compounded by volatile prices with a strong downward trend in recent years.

In contrast, the rise of African banana exporters has been quite dramatic, with Cameroon's exports increasing by 137% between 1992 and 2004 and those from Côte d'Ivoire increasing by 62%, raising their share of ACP banana exports by 62% (Somalia after an initial spurt of growth fell out of this trade in 1999 as a consequence of civil strife). This has increased the importance of the banana sector in Cameroon from the fifth most important sector, accounting for 6.2% of earnings from exports to the EU in 1992, to the third most important, accounting for 10.5% of such earnings in 2004. The costs of production in Côte d'Ivoire and Cameroon are low and comparable to the 'dollar banana' producers in Latin America.

The growth in African banana exports over this period however is more than matched by the rate of

Table 2. The importance of bananas for ACP economies (1997–2002 US$ thousands)

Country	Average annual total banana exports	Average annual banana exports to EU	Average annual total goods exports	Banana exports as % of total goods exports	Banana exports to EU as % total goods exports
St Lucia	26,196	21,755	62,437	42%	35%
Dominica	13,023	11,542	54,210	24%	21%
St Vincent	17,390	16,529	98,075	18%	17%
Belize	25,494	18,447	259,323	10%	7%
Surinam	21,457	19,243	539,967	4%	4%
Jamaica	29,202	22,894	1,339,323	2%	2%
Dominican Rep.	58,214	36,770	5,086,552	1%	1%
Grenada	133	125	56,158	0.2%	0.2%
Cameroon	45,119	45,119	1,770,163	3%	3%
Côte d'Ivoire	71,168	68,584	4,267,680	2%	2%

Source: Table 3, The importance of Latin American and ACP countries banana exports 1997-2002, in 'Forthcoming changes in the EU banana/sugar markets: a menu of options for an effective EU transitional package', ODI. www.odi.org.uk/iedg/Projects/EU_banana_sugar_markets/SUGARreport.pdf

Table 3. ACP banana exports (tonnes): Selected years

	1992	1993	1994	1995	1996	...	2001	2002	2003	2004
Côte d'Ivoire	144,356	161,261	149,536	160,486	180,827	...	217,886	210,727	205,485	210,866
Cameroon	110,419	146,901	158,230	165,294	166,180	...	215,930	229,722	292,706	262,067
Somalia	181	501	4,634	21,734	25,121	...				
St Lucia	122,066	113,303	91,544	101,494	106,670	...	34,727	49,313	32,520	42,874
St Vincent	71,320	57,608	32,055	47,673	44,176	...	30,829	32,522	20,919	23,969
Dominica	51,606	52,699	43,117	33,437	39,307	...	18,062	17,802	10,823	12,401
Grenada	6,015	6,720	5,325	4,558	2,007	...	591	557	448	406
Jamaica	74,827	77,393	76,418	83,824	89,610	...	42,985	40,600	41,784	28,660
Surinam	29,950	28,001	32,739	28,988	27,160	...	28,731	6,557	...	19,277
Dom. Rep.	38,516	62,104	86,482	75,119	61,371	...	86,064	97,227	109,440	101,355
Belize	28,494	38,516	46,980	42,033	54,109	...	51,609	38,178	73,806	80,292
Total ACP	680,362	748,617	728,701	766,643	801,596	...	727,414	723,235	787,931	782,167

Source: For 1992–1996, 'External Trade of the European Union with the ACP Countries and OCTs 1992–1996'. For 2001–04 see http://europa.eu.int/comm/trade/issues/bilateral/regions/acp/stats.htm

growth in the volume of banana exports from Belize and the Dominican Republic, which increased by 182% and 163% respectively, increasing their share of ACP banana exports by 136%.

The socio-economic impact of change

From an economic and social perspective the most severely affected countries have been the Windward Islands. Their earnings from banana exports peaked in 1992 at US$146.1 million, and have shown a declining yet fluctuating trend since, falling to only US$46.1 million in 2002. (More recently a strengthening of the euro against the dollar will have raised these dollar-denominated earnings.) This has seen the contribution of bananas as a percentage of exports of goods and services fall from 22.1% in 1992 to 5.3% in 2002.

The decline in exports to the EU and associated earnings losses has seen the number of registered banana farmers (nearly all small-scale producers) fall from just over 24,000 in 1993 to just over 5,300 in 2003. Yet in Dominica, St Vincent and St Lucia the banana sector in 2000 still accounted for 68.2%, 45.5% and 23.4% respectively of rural employment and 26.6%, 29.5% and 18.8% respectively of total employment in these countries.

This demonstrates the limited progress made to date in developing alternative employment- and income-earning opportunities in these environmentally vulnerable and geographically remote banana-dependent economies, where 36,000 people continue to depend on the banana sector.

What is more it should be noted that the much smaller numbers now engaged in production, along with lower volumes and higher production costs than elsewhere in the ACP, and high transportation costs, are seriously threatening the future viability of the banana industry in the Windward Islands. Indeed this was the conclusion of a 2002 IMF report which noted that 'increased competition in the world market and uncertainties concerning preferential access to the EU have contributed to weak prices and lower farmers' confidence'. Overall it concluded 'recent developments in the international banana market have brought into question the viability of the industry'.

Similar questions have been raised about Jamaica's continued involvement in the banana-export trade, while Surinam's banana exports hit profound difficulties in 2002 with the bankruptcy of its banana-exporting company and it remains to be seen whether recovery is possible.

The old banana regime

The regime applied to ACP exports of bananas to the EU market since the establishment of the ACP–EU co-operation framework has undergone three significant changes. The first of these was in 1993, with the establishment of a single EU banana regime, in July, to replace the various national regimes which had been applied until then. This was necessitated by the creation of the single internal market in Europe which opened formerly protected national markets to increased competition, initially between ACP suppliers but subsequently from so-called 'dollar bananas'. This regime had a number of significant features:

- a duty-free quota of 857,000 tonnes for traditional ACP suppliers;
- a quota of 2,000,000 tonnes to cover non-traditional ACP countries and third countries (essentially dollar producers), with the former enjoying duty-free access and the latter subject to a duty of ECU100 per tonne;
- a licence system that distinguished between operators marketing EU-produced and ACP-produced bananas (Category 'B' licences), and established operators in the EU marketing non-traditional ACP bananas and dollar bananas (Category 'A' licences), with the former covering 30% of imports and the latter 66.5% of imports and the remainder (so-called category 'C' licences) being allocated to new operators marketing non-traditional ACP and dollar bananas; and
- an out-of-quota tariff on non-traditional ACP bananas of €750 per tonne and €850 per tonne on third-country quantities.

Almost from the outset this regime was subject to challenge by Latin American suppliers and aggrieved US-based banana companies, who felt discriminated against. The issue was first taken up in the GATT and subsequently the WTO, despite EU efforts to modify the system through expanding access for dollar bananas (first to 2.1 million tonnes and subsequently to 2.2 million tonnes) and reducing the duty (to ECU75 per tonne). In September 1997 the WTO dispute settlement board ruled in favour of the complainants, finding the EU in violation of WTO rules on about a dozen counts, particularly with reference to the agreement on import-licensing procedures. The EU was granted 15 months to comply with its WTO obligations. A deadline for amending the regime was set for the end of 1998.

This led to the second modification of the banana import regime in 1998. The principal elements involved:

- a tariff quota of 2.553 million tonnes; this figure included an autonomous quota of 353,000 tonnes given in 1995 to cover increased imports following EU enlargement. The quota specified quantities for Ecuador, Costa Rica, Colombia and Panama;
- the removal of country-specific allocations under the traditional ACP quota; and
- the abolition of the operator categories set out in the original regime.

This latter measure involved the abandonment of the division of operators in the sector by category and function and their replacement by a single division into 'traditional operators' and 'newcomers'. The latter were to be allocated a larger share of the tariff quota (8%, up from 3.5%). Traditional operators were defined based on actual imports. Licences could be used for both dollar and ACP bananas.

However, some parties to the dispute were still dissatisfied. Ecuador asked for the WTO to reconsider the case and the USA threatened the unilateral imposition of trade sanctions. For its part the EU asked the WTO to rule on the new regime. On 6 April, 1999 the WTO delivered its verdict. It found that the new revised regime was still inconsistent with WTO rules. This ruling prompted the subsequent application of sanctions for non-compliance, with the USA introducing sanctions on EU exports totalling US$191.4 million.

The EU decided not to appeal against the ruling, and set about reforming its regime yet again. Discussions were held with the USA among others, and agreement was reached in April 2001. This gave rise to the 2001 reform to the EU banana regime, which involved a two-stage process of reform and the establishment of three tariff quotas:

Bananas and EU enlargement

With dollar bananas dominating the market of new EU member states, transitional arrangements were put in place following the accession of ten new member states on 1 May, 2004 permitting the import of an additional 300,000 tonnes of bananas to 31 December, 2004 at a tariff rate of €75 per tonne. This largely maintained the *status quo* with reference to dollar banana exports to new member states and effectively prevented ACP suppliers from capitalising on the 13% expansion of the EU banana market.

- Quota 'A': 2,200,000 tonnes at the rate of €75 per tonne;
- Quota 'B': 453,000 tonnes at the rate of €75 per tonne; and
- Quota 'C': 750,000 tonnes at the rate of €0 per tonne.

While quota 'C' was reserved for ACP operators, 'A' and 'B' quotas were nominally open to bananas from any origin. Imports outside of these quotas were subject to a customs duty of €680 per tonne, except for the ACP countries, which benefit from a tariff preference of €300 per tonne. Some 83% of 'A' and 'B' quotas were allocated to 'traditional operators' and 17% to 'newcomers'. Under the 'C' quota 89% were allocated to traditional operators and 11% to 'newcomers'.

This quota system was to be transitional, however, with the establishment of a tariff-only system by 1 January, 2006 at the latest. This led to often heated discussions over the level of flat-rate tariff to be applied under a tariff-only system.

The move to the tariff-only regime

On 2 June, 2004 the Commission proposed to the Council that negotiations should be opened with Latin American suppliers and others to establish the new tariff-only regime. In so doing the then Agriculture Commissioner, Franz Fischler, is reported to have said: 'We are now moving to the final phase of our agreement and replacing the complex quota system by a simple tariff system. What will change is the import regime, not the level of protection. If our member states agree, the Commission will negotiate an adequate tariff level. We will have to square the circle and safeguard the sometimes conflicting interests of our consumers, producers and trading partners'.

Informal discussions were held with Ecuador at the beginning of October 2004 and on 23 October Pascal Lamy, the then Trade Commissioner, proposed a tariff of €230 per tonne at the ACP–EU ministerial trade committee meeting in Brussels. This figure, he is reported to have said, was arrived at after 'complex calculations' and represented a tariff 'which is equal and will maintain market access to the EU for banana-producing countries'. He further added: 'I know that some ACP countries will think that this amount is too low, while the Latin American countries will think it too high. I am not surprised by this – this is the way negotiations go. I wanted to announce this figure today given the deadlines that are looming, however this figure was just put on the table as a basis for negotiations and these negotiations will continue'.

The immediate reaction was as predicted. The ACP thought the tariff was too low and would 'seriously affect' many members of the ACP group. They favoured a tariff of €275 per tonne, a level that initial EC assessments had suggested would ensure that overall price formation on the EU market would be similar to the present one and that as a consequence the ACP would maintain their position, while some individual ACP countries would lose out within the group.

Latin American suppliers, in contrast, felt that the tariff was too high and should be no higher than €40 per tonne. Initial EC assessments, however, suggested that with such a tariff level market prices would fall and consumption would increase, while ACP suppliers from the Caribbean would be uncompetitive, although some suppliers from Africa would continue. Latin American suppliers indicated that they would appeal against the EC proposal at the WTO.

On 31 January, 2005 the EC notified the WTO of the level of duty to be applied under its new tariff-

Box 2. Assessments of the impact of different tariffs

EC scenarios[2]

Scenario I (€75 per tonne)
Market prices would fall and consumption would increase. ACP supplies from the Caribbean would be uncompetitive, although some supplies from Africa would continue.

Scenario II (€175 per tonne)
Market prices would fall and consumption would increase, though less than in Scenario I. ACP supplies would still be less competitive and their exports would fall.

Scenario III (€275 per tonne)
Whilst the competitive position of individual ACP suppliers would vary, the overall price formation on the EU market would be similar to the present one.

Scenario IV (€375 per tonne)
Market prices would increase and consumption would fall. All ACP suppliers would be competitive and the Latin American share would fall.

UK DFID tariff-equivalence calculation

This study attempted to calculate a 'tariff equivalent' that would replicate the conditions prevailing under the old regime. It arrived at a figure in the range of €197–259 per tonne (or higher if transportation costs from Caribbean producers were to be included). At this level the Caribbean supply would be maintained but Latin American producers might lose market share to lower cost African ACP producers. Lower tariffs would lead to lower prices and greater competition with severe consequences for Jamaican and Windward Island producers. A tariff of €75 per tonne would almost certainly spell the end of production for export from these countries.

FAO study

An FAO study finds that at a tariff of €75 per tonne EU prices in 2006 would fall by 20% and EU import volumes grow by 13%; at €200 per tonne prices fall by 10% and import volumes grow by 3%; and at €300 per tonne EU banana imports remain unchanged.

only system, with the level being set at €230 per tonne. According to EC statements at the time this should 'preserve the current levels of market access'. Following this formal notification on 30 March, 2005 Latin American suppliers launched a challenge in the WTO to the proposed tariff, requesting arbitration. There was concern that the EC proposals would 'result in a tripling of tariffs on their produce and would undermine their market share in Europe'.

On 1 August, 2005 the WTO arbitration award was announced. It held that the proposed EU tariff level for bananas 'would not result in at least maintaining total market access' for Latin American suppliers; it thereby upheld the appeal of the Latin American banana suppliers. ACP banana-exporting countries immediately expressed 'concern about the marginalisation of vulnerable economies from global trade', as a result of the WTO process. They were highly critical of the limited access they had enjoyed to the arbitration process, and the absence of due consideration for their concerns. The ACP group maintained that the ruling undermined 'the very fabric of the ACP–EU banana trade', and argued that the ruling would completely exclude the ACP producers from their sole export market. The EC for its part committed itself to carefully studying the ruling to examine the available options.

On 12 September, 2005 the EC came up with its response: a proposal for a flat-rate tariff of €187 per tonne. This, the EC felt, 'maintains an equivalent level of preferences for ACP bananas'. Consultations were then launched with Latin American suppliers over this proposal, since they had announced themselves deeply unhappy with it. The ACP for their part expressed concern over this level, which they feared would only exacerbate the decline in the market share of Caribbean banana already underway.

Consultations with Latin American suppliers proved fruitless and on 26 September, 2005 the EC itself took the case back to the WTO for further arbitration. On 28 October, 2005 the WTO arbitrator rejected the EU case and ruled in favour of Latin

American suppliers. This resulted in the EC once more revising the level of the proposed flat-rate tariff designed to 'maintain the same level of protection and preference for African Caribbean and Pacific countries as the existing regime provides', lowering it to €176 per tonne. The flat-rate tariff was eventually introduced from 1 January, 2006.

Background to the tariff-only debate: The evolution of ACP market shares

The concerns expressed about the new flat-rate tariff to be established need to be seen against the background of changing patterns of supply of bananas to the EU market from ACP countries. A 2004 report by National Economic Research Associates on Caribbean banana exports to the EU since 1992 highlighted:

- the large overall fall in the volume of Caribbean banana exports to the EU, which was universal except for one supplier;
- substantial falls in the tonnages of Caribbean exports to the traditional UK market (down from 360,000 in 1993 to 178,000 tonnes in 2002,

Table 4. Evolution of the banana-tariff proposal

Chronology	What was said at the time
June 2004 Opening of negotiations with Latin American suppliers on level of flat tariff to be applied under a tariff-only system. **October 2004** Informal discussions held with Latin Americans. **27 October, 2004** €230 per tonne tariff is announced. **31 January, 2005** €230 per tonne tariff officially notified to the WTO.	The EC's objective is to 'maintain the same level of protection and preference for African Caribbean and Pacific countries as the existing regime provides'. Press release IP/04/707-02/06/2004 According to Commissioner Lamy this tariff 'would keep market shares steady and maintain market access to the EU'. ICTSD (Vol. 8, No. 37, 3 November 2004) 'The EC will maintain a preference for African, Caribbean and Pacific countries in a manner respecting entirely the EU's obligations and commitments towards all interested parties.' Press release IP/05/118-31/01/2006
30 March, 2005 Latin Americans launch an official challenge in the WTO and go to arbitration. **1 August, 2005** WTO arbitration rules in favour of Latin American banana suppliers. **12 September, 2005** New EC proposal for a tariff of €187 per tonne put forward. Consultations with Latin American banana suppliers. **26 September, 2005** EU requests second WTO arbitration.	'The EU banana regime is changing but the level of protection is not increasing ... I believe this figure and methodology has allowed us to square the circle and safeguard the sometimes conflicting interests of our consumers, producers and trading partners.' Mariann Fischer Boel, press release IP/05/377-31/03/2005 'The tariff proposed by the EU was designed to be a neutral and fair conversion that would maintain current market access for all banana suppliers to the EC.' Peter Mandelson, press release IP/05/1030-02/08/2005 'The Commission's new proposal confirms Europe's commitment to ending this longstanding dispute. We have been careful to ensure that preferential access for our ACP partners is maintained.' Peter Mandelson, press release IP/05/1127-12/09/2005
27 October, 2005 WTO arbitrator rejects EU proposal for a tariff of €187/tonne.	'We are surprised and disappointed that the arbitrators did not back our proposal. We believe that the system we proposed would have maintained access to our markets in a fair manner. Mariann Fischer Boel, press release IP05/1359-27/10/2005
December 2005 EC announces a tariff of €176 per tonne. **1 January, 2006** New flat-rate tariff of €176 per tonne enters into force.	'This is a fair and balanced result for everyone, which will fully maintain access for Latin American producers while continuing to take into account EU and ACP producers.' Mariann Fischer Boel, press release IP/05/1493- 29 November, 2005

despite an expansion of total UK imports from 470,000 to 833,000 tonnes);

- falling export values (fob) which indicate major reductions in growers' incomes;
- the complete cessation of exports from Surinam and near cessation from Grenada;
- substantial reductions in the numbers of growers, and acreages under cultivation;
- the strong downward trend in both retail and producer prices, with significant falls over the period in real terms; and
- the persistent nature of these trends.

The report identified three factors contributing to this trend:

- the expansion of quotas for third-country and non-traditional ACP imports;
- the ending of the category 'B' licences for traditional ACP importers; and
- the movement from individual quotas to an overall ACP quota.

The report noted that the movement away from country-specific quotas has led to 'substantial increases in production and exports from some of the lower cost ACP countries'. While Caribbean exports had fallen by 52% (except for Belize and the non-traditional supplier the Dominican Republic) exports from Côte d'Ivoire and Cameroon have risen by 122% and 194% respectively.

Overall the report concluded that 'prima facie, the evidence suggests that the regime has offered progressively less protection to the most vulnerable producers, with the result that they have suffered the consequences of falling prices for their production and loss of market share to lower-cost producers ... for many individual Caribbean countries that have traditionally exported to the UK the extent of the decline, whether measured in terms of the prices available to their growers or in terms of their production, has been severe. For these countries, the regime has clearly not been successful in ensuring the continuing viability of their banana exports'.

It is against this background that the National Economic Research Associates report cited an IMF study on St Vincent which concluded: 'the viability of the industry is now in serious question post 2005'.

This IMF view would appear to be upheld by recent simulations undertaken in the Caribbean. These simulations suggested that at a tariff of €200 per tonne declines in export volumes of 74% for St Vincent, 53% for St Lucia, 50% for Jamaica and 21% for Belize would be likely. From a Caribbean perspective the impact of such declines in banana exports would stretch beyond the realm of foreign-exchange earnings and job losses, to include 'disastrous effects on entire communities'.

It is against this background that ACP concerns over the establishment of the new flat-rate tariff of €176 per tonne need to be seen.

The new banana import regime

The new banana import regime that entered into force on 1 January, 2006 establishes a flat-rate tariff of €176 per tonne for bananas imported from 'most-favoured nation' suppliers and an annual import quota of 775,000 tonnes subject to a zero-duty rate for ACP bananas. The explicit objective of this tariff remained the maintenance of the existing market position of various suppliers. ACP suppliers objected to the tariff as too low, Latin American suppliers remain convinced that it was too high. The EU for its part is set on continuing to apply the tariff and monitoring the market changes, with a view to adjusting the tariff should the objective of maintaining the existing market position not be achieved through the new system. Given trends in market share between ACP banana suppliers, which have seen the share of traditional Caribbean suppliers falling from 384,278 tonnes (56.5%) in 1992 to only 207,879 tonnes (26.6%) in 2004, the question arises: what does the EU policy objective mean in practice? Is the aim to maintain current market shares and thus halt this trend? Or is the aim to allow this trend to continue, with the share of Windward Island banana exporters continuing to fall?

A key issue in determining the outcome of the new flat-rate tariff in terms of intra-ACP market shares will be how the system established for the management of the import licences will operate in practice and the impact this will have on individual

Box 3. Operation of the 'first-come first-served' system

Upon arrival the operator requests treatment under first-come first-served, uses an existing licence, or requests MFN treatment. The request is sent to the EC for processing two working days after receipt. Bananas are discharged upon arrival but the operators will only know the treatment accorded two days later, so a bank guarantee has to be lodged.

If the first-come first-served quota is about to be reached, a pro rata reduction will be applied to all requests from member states' customs authorities. If duty-free treatment cannot be accorded as the bi-monthly first-come first-served quota has been fulfilled, the operator submits a new declaration requesting another customs treatment.

The status of the quota can be followed on the website http://europa.eu.int/comm/taxation_customs/dds/en/qothome.htm.

ACP countries' shares of the EU market. For the period January and February 2006 some 160,000 tonnes of the 775,000-tonne tariff rate quota were to be allocated, 135,000 tonnes for traditional and non-traditional operators and 25,000 tonnes for operators having imported bananas under the old A/B quota or the enlargement quota.

From March to December 2006 the ACP quota will be managed on the basis of an allocation of 40% of licences to traditional operators and the allocation of the remainder on a 'first-come first-served' basis. A further phasing-in of the 'first-come first-served' quota system is envisaged for 2007, based on an analysis of the operation of the system over a few months of its operation. It has been suggested by senior EC trade officials that the 'first-come first-served' system will be further extended in 2007 and will be used exclusively in 2008. However, other DG trade officials have denied this intention.

According to an analysis by FRUITROP, a key factor in the future evolution of market shares will be access to the reefer fleet. Whoever has access to maritime transportation will be able to expand supplies. Recently world reefer capacity has decreased by around 12.5%, despite growing demand. This has pushed up freight charges. Indeed, in 2003 freight prices were the highest in seven years, while spot market prices were 20–25% higher than in 2002. Compounded by high oil prices these trends have continued and will continue. This will put further pressure on traditional Caribbean banana producers, particularly in the Windward Islands, should the new EU system result in further downward pressure on wholesale prices for bananas.

EU assistance for restructuring in the ACP

The EU acknowledged that on completion of the single internal market in Europe some difficulties would be created for traditional banana suppliers, particularly those in the Caribbean. In 1994 therefore, the EU passed a regulation (2686/94) providing for a special system of assistance (SSA) to help ACP banana suppliers to restructure to meet the challenge of improved access for non-ACP suppliers. The assumption underlying the regulation was that all ACP countries producing bananas could become competitive exporters. However the February 2000 report 'Evaluation of EU assistance to ACP banana producers' reached the conclusion that this assumption was never realistic since only Côte d'Ivoire and Cameroon 'among ACP countries have any realistic possibility of competing on costs with Costa Rica or Ecuador'. In all, some €75 million was committed.

Box 4. Impact of a €175 tariff

According to the 2004 NERA/OPM study a tariff-only system with a tariff of €175 per tonne would see a 16.2% decline in the EU banana price, which would result in the termination of banana exports from St Vincent, the probable ending of banana exports from Dominica, a 77.5% decline in banana exports from St Lucia, a 56.5% fall in banana exports from Jamaica, and a 22.1% fall in banana exports from Belize.

In 1999 the SSA was replaced by a 'special framework of assistance' (856/1999) which was to last ten years. This promised greater levels of funding (€45 million per annum) and a wider remit to include the promotion of diversification as well as support for competitiveness. There has been criticism that the 'special framework for assistance' was still tending to support programmes in the banana sector in countries that have only limited potential to be competitive and that insufficient attention was being paid to diversification. As a consequence in 2002 some 64% of funds allocated were directed toward diversification compared to 12% in 1999. This reflected the conclusions of the February 2000 evaluation, which emphasised the need for support for diversification rather than restructuring, given the competitiveness challenges facing traditional Caribbean banana suppliers. However, most of these projects have been small-scale pilot projects which highlight the difficulties faced in promoting diversification in the particularly difficult environmental (periodic hurricanes) and geographical circumstances faced in the Windward Islands.

With EU-financed interventions proving insufficient so far to address the competitiveness gap (Windward Island production costs are three times those of Ecuador, due to higher wages paid to growers and higher transportation costs) the outlook for Windward Islands banana exports under a tariff-only 'first-come, first-served' system looks rather bleak. Since 2004 the level of assistance provided has been reduced by 15% per annum, in line with the initial regulation.

In this context, a number of questions hang over the future of EU assistance to banana-dependent ACP economies. Firstly, how will a scheme for the allocation of funding based on an evolving measurement of the 'competitiveness gap' respond to the new market situation created by the 'first-come first-served' import-management system? In addition, with evaluations of the current scheme focusing on the failures to get to grips with the diversification challenge, how is the EU likely to redesign its aid-deployment system to deal with the challenges thrown up in the banana sector?

Currently it would appear that the EC wishes to place far greater emphasis on budget support to Caribbean banana-dependent economies with this

Table 5. Annual commitments under the special framework for assistance (€ millions)

	1999	2000	2001	2002	2003
Belize	3.10	3.10	3.40	3.50	6.20
Dominica	6.50	6.50	6.70	6.40	5.90
Grenada	1.00	0.50	0.50	0.50	0.50
Jamaica	5.30	5.30	5.00	4.70	4.40
St Lucia	8.50	8.88	9.20	8.80	8.00
St Vincent	6.10	6.45	6.40	6.10	5.60
Suriname	3.10	2.70	2.70	2.50	2.20
Sub-Total	**33.60**	**33.43**	**33.90**	**32.50**	**29.80**
Cameroon	6.2	5.7	5.60	5.1	–
Ivory Coast	4.7	4.35	2.85	2.6	–
Somalia	–	–	0.60	2.8	–
Madagascar	–	–	–	0.5	5.00
Cape Verde	–	0.6	–	0.5	–

Source: Europeaid website: http://europa.eu.int/comm/europeaid/projects/edf_en.htm#this_page and 'Forthcoming changes in the EU banana/sugar markets: a menu of options for an effective EU transitional package', ODI, London, www.odi.org.uk/iedg/Projects/EU_banana_sugar_markets/SUGARreport.pdf

Table 6. Annual commitments under the special framework for assistance (€ millions)

	1999	2000	2001	2002	2003
Belize	3.10	3.10	3.45	3.50	6.20
Dominica	6.50	6.50	6.70	6.40	5.90
Grenada	1.00	0.50	0.50	0.50	0.50
Jamaica	5.30	5.30	5.00	4.70	4.40
St Lucia	8.50	8.88	9.20	8.80	8.00
St Vincent	6.10	6.45	6.40	6.10	5.60
Suriname	3.10	2.70	2.70	2.50	2.20
Sub-Total	**33.60**	**33.43**	**33.85**	**32.50**	**29.80**
Cameroon			5.60	5.1	
Côte d'Ivoire			2.85	2.6	
Somalia			0.60	2.8	
Madagascar				0.5	5.00

Source: Europeaid website: http://europa.eu.int/comm/europeaid/projects/edf_en.htm#this_page
and 'Forthcoming changes in the EU banana/sugar markets: A menu of options for an effective EU transitional package', ODI, www.odi.org.uk/iedg/Projects/EU_banana_sugar_markets/SUGARreport.pdf

being linked to the implementation of public-policy reforms, designed to open up economic activities to the free flow of capital, goods and services. In this context support for banana-related adjustment is likely to be increasingly merged with general EU support to economic adjustments linked to the implementation of liberalisation measures being brought together under the EPA negotiations.

Sugar sector

The revised EU sugar regime

The reform of the EU sugar regime, while initiating major changes in line with the general process of CAP reform, has retained many of the elements of the basic structure of the sugar regime established in 1968:

- Prices are still established administratively rather than by the market, albeit at a level which, within four years, will be 36% lower than the current prevailing price level.
- There are still quotas on production.
- A system of levies remains in place, although this has the changed function of supporting industry restructuring during the transitional period rather than supporting sugar exports.
- Intervention buying will remain in place for four years, after which it will be replaced by a floor price and support for private storage.
- A regulated import regime will remain in place.
- Although an export regime remains, it is being fundamentally restructured to bring it into line with WTO panel rulings on the EU's WTO export obligations.

In addition to these basic elements, which have been retained in modified form, some new elements have been introduced, notably:

- direct aid payments to EU sugarbeet farmers to compensate for the reductions in the sugar price;
- a 'voluntary' restructuring scheme for beet processors wishing to leave the industry; and
- the opening up of the possibility of using non-quota sugar in the chemical and pharmaceutical industries as well as for bio-fuel development.

In November 2005 the following specific measures were introduced:

- A 36% reduction in the guaranteed price for white sugar for four years, beginning in the 2006/07 season.
- The introduction of compensation to sugarbeet farmers 'at an average of 64.2% of the price cut', through a 'decoupled' payment linked to 'cross compliance' which will form part of the 'single-farm payment scheme'.
- The payment of an additional 'coupled payment' equivalent to 30% of the price cut for a transitional period of five years plus the possible payment of 'limited national aid', but only for 'countries which give up more than half of their production quota'.
- The establishment of a 'voluntary restructuring scheme lasting four years for EU sugar factories and isoglucose and insulin producers, consisting of a payment to encourage factory closure and the renunciation of quotas'. The aim of the restructuring fund is to: 'encourage less competitive producers to leave the industry'; finance social and environmental adjustment costs, and provide funds to most affected regions to diversify. Payments will be €730 per tonne in the first two years, falling to €625 in year three and €520 in year four.
- The funding of restructuring measures through a special levy placed on remaining quota holders over three years of the transition.
- The introduction of the scope to use restructuring funds to compensate beet producers affected by factory closures (reportedly up to 10% of the amount).
- The establishment of a 'diversification fund for member states where the quota taken up is reduced by a minimum amount, with diversification funds increasing the more the quota is renounced'.
- The merging of the 'A' and 'B' quotas.
- A provision for the use of non-quota sugar in the 'chemical and pharmaceutical industries and for the production of bio-ethanol'.
- The maintenance of the intervention agency during the four-year transition period followed by 'the introduction of a private storage system as a safety net in case the market price falls below the reference price'.
- The allocation of an additional quota of 1.1 million tonnes to 'C' sugar-producing countries against 'a one-off payment corresponding to the amount of restructuring aid per tonne in the first year'.
- An increase in the isoglucose quota of 300,000 tonnes for existing companies, phased in over three years.
- The possible purchase by Italy (60,000 tonnes), Sweden (35,000 tonnes) and Lithuania (8,000 tonnes) of extra isoglucose quota at the restructuring aid price.

The detailed modalities for the implementation of the reforms have yet to be agreed. It is expected that by the end of February or the beginning of March of 2006 a full legal text of the reform measures will be produced and adopted by the EU Council. Following approval by the European Parliament and the drafting of implementation rules, the new sugar regime will be able to enter into force from 1 July, 2006. The first year of application of the new regime will run for 15 months, after which the sugar-marketing year will run from October to September.

The EU export regime

According to the Agriculture Commissioner, Mariann Fischer Boel, the agreed reform package will 'bolster the competitiveness of the EU sugar industry, improve its market orientation and produce a sustainable market balance in line with the EU's international commitments. ... This agreement will also ensure that we come rapidly into line with the recent WTO panel'.

Following the WTO panel rulings and subsequent appeals decisions the EU will be limited to the WTO ceiling of 1,273,500 tonnes of exports supported by €499.1 million in financial support. The EU will no longer be allowed to export an amount equivalent to 'ACP and Indian imports into the EU under preferential arrangements' and will have to desist from the sale of 'C' sugar onto world markets.

However the reform measures do open up a new outlet for 'C' sugar production through the provision for the use of non-quota sugar in the production of chemical and pharmaceutical products and in bio-fuel development. As the chemical and pharmaceutical component of this market currently takes around 500,000 tonnes of sugar per annum, an expansion of this market and the intensified development of bio-ethanol production based on sugar (with public assistance through tax breaks and other financial incentives), could provide a domestic outlet for future surplus 'C' sugar and accumulated EU sugar stocks, which by the end of 2005 were projected to have reached 1 million tonnes.

This measure could avert a sudden upsurge of EU sugar exports, prior to compliance with the more narrowly interpreted version of the EU's WTO commitments. It will certainly free up elements of the 'non-annex 1' budget currently deployed in support of sugar-containing chemical and pharmaceutical products, for deployment in support of other sugar-containing food-product exports. This is a further vehicle through which EU sugar exports will take place.

With the process of price reduction closing the gap between EU and world market prices, EU financial allocations to export refunds on the raw-material content of value-added products will be able to finance a much larger volume of exports (slightly more than twice the current volume of sugar-containing products) with the same level of export refunds (currently frozen at €415 million per annum under the WTO agreement). If, as seems likely, the elimination of export refunds on the raw-material content of value-added food products is 'back-loaded' in the EU's final offer on export subsidies under the Doha Round, then during the transition period up to 2013 a substantial expansion of EU exports in sugar-containing food products is likely to occur as a result of EU sugar-sector reform.

According to the analysis of the United States Department of Agriculture (USDA) the net result of EU sugar-sector reform by 2011 will be a reduction of sugar production by 'between one-quarter and one-third from roughly 20 million tonnes today to perhaps 13 to 15 million tones', with the EU ceasing to be a major exporter and becoming a net importer.

The EU import regime: Implications of reform

The USDA in its review of EU sugar-sector reform has pointed out that 'starting in July 2006, the new EU sugar regime will still require significant levels of border protection, with no substantial non-preferential imports of sugar into the EU expected in the near future'. This is particularly likely to be the case if the EU secures special treatment for sugar under any WTO agreement on agriculture. This would see the EU retain special safeguard measures.

Table 7. ACP SPS access

	SPS quotas (tonnes W.S.E.)
Barbados	2,841.2
Belize	4,985.2
Congo	2,519.2
Cote d'Ivoire	10,000.0
Fiji	19,181.8
Guyana	19,931.7
Jamaica	15,926.8
Kenya	11,023.4
Madagascar	2,550.0
Malawi	10,000.0
Mauritius	41,980.1
St Kitts & Nevis	1,831.3
Swaziland	30,000.0
Tanzania, United Rep of	2,485.9
Trinidad & Tobago	5,592.2
Zambia	12,731.5
Zimbabwe	25,000.0
Total	**215,580.3**

Formally the EU reform measures do not affect the preferential import arrangements that are in place. India will continue to enjoy its 10,000 tonnes of duty-free access to the EU market. The EU's Balkan neighbours will continue to enjoy duty-free access and existing MFN commitments will continue to be honoured. The ACP, for its part, will continue to enjoy duty-free access for the tonnages agreed under the sugar protocol (1,294,700 tonnes), while LDCs

will continue to enjoy progressively expanded quota-restricted duty-free access until 2009, after which full duty-free access will be granted. The implementation of the EBA initiative will, however, reduce the tonnages which non-LDC ACP countries can export under the Special Preferential Sugar arrangement to a point where by 2009 no such exports take place. This will constitute a serious loss of preferential access for a number of low-cost ACP non-LDC sugar suppliers, most notably Zimbabwe, Swaziland, Guyana and Fiji, where SPS is equivalent to 45%, 20%, 11% and 10% respectively of their total preferential access to the EU market.

As a result of the reforms however, all sugar imports into the EU will be subject to income losses as internal EU prices are reduced in line with the agreed reform schedule. The first ACP countries to experience losses will be the sugar-protocol beneficiaries, since raw sugar prices will be reduced from the 2006/07 season by an amount equivalent to the refining aid paid to EU cane sugar refiners (–5.1%). EBA and SPS suppliers will not be affected by this measure, since the price they receive is not supported by refining to EU cane refiners. EBA and SPS sugar exporters will only be affected by the price reductions introduced in 2008/09 and 2009/10, when prices traditionally received for these sugar exports will fall by 12.6% and 32.6%.

For EBA sugar exporters, however, according to a USDA analysis 'the new sugar reforms introduce a measure to 'review' EBA sugar exports to the EU should they increase by more than 25% year on year. A review would enable the EU to impose restrictions or even withdraw the EBA import concessions for sugar, although the Commission continues to be careful in its language on this issue as there is unlikely to be much political support at the moment for restricting LDC export opportunities to the EU'. Indeed, EC spokespeople have sought to reassure LDC suppliers that such safeguard measures will only be invoked where there is evidence of 'triangular' trading of sugar destined for the EU.

Table 8. Impact of EU sugar-sector reform

Million tonnes	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Production	18.7	15.3	14.7	13.7	12.9	12.9
Carry-over	0.7	0.7	0.7	0.7	0.7	0.7
Quota 15.5	15.1	14.0	13.0	12.2	12.2	
'C' sugar	3.2	0.2	0.7	0.7	0.7	0.7
Imports	1.9	1.9	2.2	2.3	3.1	3.1
Total available	**19.6**	**17.7**	**16.9**	**16.0**	**16.0**	**16.0**
Subsidised exports	2.8	1.3	1.3	0.0	0.0	0.0
Consumption	15.6	15.6	15.6	16.0	16.0	16.0
Balance	4.4	1.0	0.7	0.7	0.7	0.7
Carry-over	0.7	0.7	0.7	0.7	0.7	0.7
'C' exports	3.7	0.3	0	0	0	0
Imports						
ACP protocol	1.3	1.3	1.3	1.3	1.3	1.3
ACP (SPS)	0.1	0.1	0.1	0.1	0.1	0.0
LDC	0.1	0.1	0.4	0.5	1.4	1.5
MFN	0.1	0.1	0.1	0.1	0.1	0.1
Balkans	0.3	0.3	0.3	0.3	0.3	0.3
Total imports	1.9	1.9	2.2	2.3	3.1	3.1

Source: USDA GAIN Report E35225-30/11/2005, www.fas.usda.gov/gainfiles/200512/146131717.pdft

Agriculture Commissioner Mariann Fischer Boel has pointed out that 'developing countries will continue to enjoy preferential access to the EU market at attractive prices'. According to the USDA 'The reforms are expected to leave the EU sugar price at roughly double world market prices compared to currently being over triple world prices'. With current world market prices and exchange rates this would appear to be something of an exaggeration, with EU post-reform sugar prices being only around 40% above the world market price. Nevertheless for low-cost ACP sugar producers the EU market will remain more attractively priced than the world market. However, in a number of ACP regions, sugar prices on neighbouring markets will prove more attractive that EU sugar prices and this will have an impact on the volume of sugar exported from these regions to the EU.

Table 9. An alternative take on future imports: EC projections of sources of imports under sugar-sector reform (million tonnes)

	Base year	2012/13 (Post reform)
ACP/India	1.3	1.3
EBA/SPS	0.2	2.2
MFN	0.1	0.1
Western Balkans	0.3	0.3
Total	1.9[4]	3.9

Source: Extracted from 'Reforming the European Union's Sugar Policy: Update of Impact Assessment (SEC, 2003) 1022', Table 4, Commission Staff Working Paper, Brussels, SEC (2005).

Review of implications of reform for the ACP

The direct impact

For the ACP the most important of the agreed reform measures is the reduction in the EU sugar price. According to the EC press release 'the guaranteed price for white sugar will be cut 36% over four years', beginning in the 2006/07 season. The press release indicates that this will involve a cut of '20% in year one, 25% in year two, 30% in year three and 36% in year four'. However, analysts show that these cuts refer to the net earnings of EU beet farmers and refiners, and are inclusive of the restructuring levy payments that they must make. Thus the reference price follows a slightly different course of price reductions, remaining at €613.9/tonne through the 2007/08 season before falling by 17.1% to €524 in 2008/09 and a total of 36% in 2009/10 to €404.4/tonne. This translates into price cuts for ACP raw sugar as set out in the table below:

Table 10. Changes in prices for ACP raw sugar

Year	Price per tonne	% change (cumulative)
Current regime	€523.7	0
2006/07	€496.8	-5.1%
2007/08	€496.8	- 5.1%
2008/09	€434.1	-17.1%
2009/10	€335.0	-36.0%

In this context, in the first two years of reform the only price cut that ACP suppliers face will be that equivalent to the loss of the refining aid formerly paid from the EU budget to EU cane refiners. In this context the ACP as a whole will face the following income losses on their exports under the sugar protocol (Table 11).

These losses may be broken down by ACP sugar-protocol beneficiaries as in Table 12. This neglects the losses to those ACP countries that have or will abandon sugar production entirely as a result of the price cuts (e.g. St Kitts & Nevis). To these losses from 2008/09 onwards need to be added the losses suffered by SPS sugar suppliers and ACP EBA sugar exporters. Assuming a total supply from both sources of 200,000 tonnes, this would amount to losses of €12.4 million in 2008/09 and €32.4 million from 2009/10 onwards.

In the short term the reform measures as adopted by the EU Council of Ministers do represent a significant 'saving' for ACP countries compared to the losses that would have arisen under the initial EC proposals (minus €430 million compared to minus €661 million). Effectively, when compared to the initial proposals, the final agreed reform programme 'saves' the ACP some €231.2 million (about €57.8 million per annum) over the first four years of the reform period. This represents a reduction in losses

Table 11. Losses on ACP sugar-protocol earnings from final agreed EU sugar reforms

Year	Raw price €/t	Tonnage	Earnings (€)	Losses (€)
2005/06	523.7	1,294,700	678,034,390	0
2006/07	496.8	1,294,700	643,206,960	-34,827,430
2007/08	496.8	1,294,700	643,206,960	-34,827,430
2008/09	434.1	1,294,700	562,029,270	-116,005,120
2009/10	335.0	1,294,700	433,724,500	-244,309,800
Total 2006-10				**-429,969,780**

Table 12. Losses by ACP sugar-protocol beneficiary countries only*

	Sugar-protocol quota (tonnes)	Current earnings (€)	Earnings 2006/08 (€)	Earnings 2008/09 (€)	Earnings 2009/10 and after (€)
Barbados	50,312.4	26,348,603	24,995,200	21,840,612	16,854,654
Belize	40,348.8	21,130,666	20,045,283	17,515,414	13,516,848
Congo	10,186.1	5,334,461	5,060,454	4,421,786	3,412,344
Côte d'Ivoire	10,186.1	5,334,461	5,060,454	4,421,786	3,412,344
Fiji	165,348.3	86,592,904	82,145,035	71,777,610	55,391,680
Guyana	159,410.1	83,483,069	79,194,937	69,199,924	53,402,383
Jamaica	118,696.0	62,161,095	58,968,172	51,525,933	39,763,160
Kenya	0.0	0.0	0.0	0.0	0.0
Madagascar	10,760.0	5,635,012	5,345,568	4,670,916	3,604,600
Malawi	20,824.4	10,905,738	10,345,561	9,039,872	6,976,174
Mauritius	491,030.0	257,152,411	243,943,704	213,156,123	164,495,050
St Kitts & Nevis	15,590.9	8,164,954	7,745,559	6,768,010	5,222,952
Swaziland	117,844.5	61,715,164	58,545,147	51,156,297	39,477,907
Tanzania, United Rep of	10,186.1	5,334,461	5,060,454	4,421,786	3,412,344
Trinidad & Tobago	43,751.0	22,912,398	21,735,496	18,992,309	14,656,599
Zambia	0.0	0.0	0.0	0.0	0.0
Zimbabwe	30,224.8	15,828,727	15,015,680	13,120,585	10,125,308

*Some adjustments to quota allocations have occurred in recent years, with Kenya and Zambia receiving 10,000 tonne allocations, the Barbados quota being reduced, the St Kitts & Nevis quota being discontinued, and Swaziland enjoying 120,000 tonnes of access. In this context Zambia and Kenya will face losses on exports similar to those of Tanzania, while the losses to Barbados will be less than projected since in recent years they have had a lower degree of exposure to sales on the EU market.

in the first four years of 35% compared to the losses arising under the initial EC proposals. This has been achieved by effectively deferring the full rèduction in the raw sugar price paid to ACP suppliers until 2008/09, saving the ACP some €131,929,930 in 2007/08 compared to the impact of the initial proposal. For comparison the losses that would have occurred under the initial EC June 2005 proposals are set out in Table 13.

In the longer term (beyond 2009/10), the 'savings' are marginal, amounting to slightly over €20 million per annum for the ACP as a whole, a mere 7.6% 'saving' on an annual basis compared to the initial proposal. This means that in the longer term ACP

Table 13. Losses to the ACP under the initial June 2005 EC proposals

Year	Raw price €/t	Tonnage	Earnings (€)	Losses (€)
2005/06	523.7	1,294,700	678,034,390	0
2006/07	496.8	1,294,700	643,206,960	-34,827,430
2007/08	394.9	1,294,700	511,277,030	-166,757,360
2008/09	372.9	1,294,700	482,792,630	-195,241,760
2009/10	319.5	1,294,700	413,656,650	-264,377,740
Total 2006/2010				**-661,204,290**

sugar suppliers will still face 92.4% of the income losses they would have faced under the initial proposal.

The indirect impact

With EU sugar prices set to decline by 36% by 2009/10, the raw material costs of the EU sugar-containing food-and-drink industry will fall sharply. As the USDA has pointed out in the case of Poland, 'less expensive sugar will permit Polish food-processing companies to better compete locally and in export markets', since in sectors such as soft drinks and sweets sugar accounts for 30 to 50% of production costs. The impact of EU sugar-sector reforms on the price competitiveness of EU exports of sugar-containing products both directly and via the increased volume of exports that can be financed within WTO financial ceilings (€415 million per annum) will require careful evaluation in low-cost ACP sugar-producing countries, seeking to develop sugar-based value-added processing for national and regional markets. This is particularly the case since the little-noted provisions dealing with the use of non-quota sugar in the chemical and pharmaceutical industries will serve to free up funds within the non-Annex I budget currently deployed in support of chemical and pharmaceutical exports for deployment in support of exports of sugar-containing value-added food products.

A final indirect impact of the agreed EU sugar-sector reforms relates to its impact on the functioning of regional sugar markets in the ACP. With EU sugar prices reduced dramatically, the EU market will be less attractively priced than a number of neighbouring regional markets. The region most likely to be affected in this regard is Southern and Eastern Africa, where seven countries currently export over 832,000 tonnes of sugar to the EU market. The question arises: what will be the knock-on effects, in terms of regional sugar prices, of a dramatic (36%) fall in the EU sugar price?

The most obviously attractive alternative regional markets in this regard are South Africa and Kenya, both of which – at current exchange rates – will offer prices higher than those obtainable on the post-reform EU market. The very real danger exists that sugar which currently goes to the high-priced EU market will be re-directed to regional markets. If this occurs on a large scale this could undermine national sugar prices. The challenge facing the sugar industry in Eastern and Southern Africa is how to raise regional demand for regionally produced sugar and sugar-containing products, while maintaining the value of regional sugar markets, in the face of the changed price conditions for exports to the EU market.

Careful consideration will need to be given to this question in terms of the policies set in place nationally, regionally and inter-regionally to promote growth in demand for regionally produced sugar and sugar-containing products while at the same time maintaining the value of the sugar market.

The EU policy response to ACP sugar-sector adjustment

The overall response

In February 2005 the EC issued a working document on the 'Action plan on accompanying measures for sugar-protocol countries affected by the reform of the EU sugar regime', setting out how it intends to assist ACP countries in adjusting to the new market con-

ditions created by EU sugar-sector reform. In this document the EC 'recognises that the EU sugar reform may lead to significant adjustment needs in ACP-country signatories to the sugar protocol' and committed itself to 'support ACP countries in their path to poverty reduction and sustainable development'. The ACP countries eligible for support are specified as 'Barbados, Belize, Guyana, Jamaica, Trinidad and Tobago, St Kitts & Nevis, Fiji, Republic of Congo, Côte d'Ivoire, Kenya, Madagascar, Malawi, Mauritius, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe'.

The two major components of the EC response strategy set out in the February 2005 working document are to improve the international trading conditions in which ACP sugar-protocol countries find themselves and assist these countries through the provision of development assistance.

The development-assistance dimension

In terms of development assistance the EU wishes to see the comprehensive country-specific response strategies formulated. The EC has identified three axes for EU assistance:

- the enhancement of competitiveness;
- the promotion of diversification; and
- support to broader adjustment processes, including addressing the short- to medium-term social impacts and the establishment of well-targeted safety nets.

Considerable emphasis is placed on correctly assessing the future prospects of each ACP sugar sector in the context of lower EU sugar prices and the cost structure of the industry. This document states clearly that where 'directing assistance towards maintaining the sugar industry would not be sustainable in the long term, and would correspond to an inefficient use of financial resources, the EU favours supporting diversification or broader adjustment measures'.

The February 2005 Commission working document held that 'the specific needs of SMEs, including small farmers, should particularly be accounted for', possibly through using EIB-administered loan instruments under the Cotonou Agreement's investment facility. The working document favoured making 'maximum use of existing instruments, available though EC cooperation ... or through other bilateral donors or international organisations'. Trade Commissioner Mandelson for his part spoke of the importance of the early deployment of restructuring assistance, so that ACP countries can be supported in preparing for changes rather than simply adjusting to the changes that will flow from EU sugar-sector reform. The significance of early aid deployment is given extra weight by the two-year deferment of substantial reductions in the price offered for ACP sugar under the final reform agreement. The breathing space this provides ACP countries to prepare for change is only of value, however, if external assistance is rapidly mobilised and effectively deployed.

On the funding and delivery of assistance to sugar-sector adjustment the Commission working document favours extending assistance to country-specific sugar-adjustment strategies in the form of non-targeted budgetary support or through support to a sector-wide approach. While it does not rule out a project-based approach to restructuring, this is not favoured since it imposes a heavy management burden on the EC services.

While the February 2005 Commission working document made no reference to the level of restructuring support to be made available to ACP sugar exporters, some €40 million has been allocated under the 2006 budget for this purpose, with Trade Commissioner Mandelson indicating at the WTO Ministerial in Hong Kong that €100 million per annum will be made available for sugar-sector restructuring support in ACP countries up to 2013.

The trade dimension

In terms of the trade dimension, the Commission working document emphasised the importance of trade policy as a 'tool to foster economic growth in developing countries' through their integration into the global economy. In this context the working document expressed the view that 'further market opening can be an important contribution to the expansion of trade in agricultural products and to sustained and continued economic growth for all countries'. It emphasised how the July 2004 WTO

framework agreement 'adequately addresses the special needs and concerns of developing countries and is a good basis to continue the negotiations which should ultimately lead to a more level playing field for all, in particular developing countries striving to integrate into the world economy'. It also highlighted the importance of trade facilitation through the WTO.

According to this document the current EPA negotiations provide 'an ideal opportunity to support the adjustment process of the sugar sector'. The working document made explicit reference to the importance of both free trade and 'trade preferences for regional production' in creating 'additional markets for ACP sugar'. The working document argued that the ACP sugar sectors which will benefit most from such regional trade arrangements will be 'those sugar industries with expansion potential, located in deficit regions, as well as the landlocked producers which are disadvantaged by higher transport costs for their overseas exports'. The working document stressed how EPAs will incorporate sugar-protocol access, offer opportunities for other products, and establish programmes to tackle supply-side constraints, in full compatibility with WTO rules. It is held that this will open up new opportunities for sugar-protocol country exporters to balance the decline in EU sugar prices.

In January 2005 Trade Commissioner Mandelson, on a visit to the Caribbean, spoke extensively about improving market access to compensate for price declines, although the subsequent Commission working document made no reference to this. With agreement to the reform package now secured in the EU Council, the EC is becoming more open to public discussion of the use of expanded market access as part of the EU's policy response to supporting competitive low-cost ACP sugar suppliers in adjusting to the consequences of EU sugar-sector reform. Indeed, in the run up to the EU Council meeting, with the UK Presidency looking for a compromise proposal, prime minister Blair assured Caribbean leaders that he would seek not only to lengthen the transitional period and push for an increase in transitional assistance, but also examine the issue of greater market access. As a result of the final Council agreement the transition period has been extended and an increased volume of assistance looks likely to be made available. To date, however, the issue of expanded duty-free access for low-cost ACP sugar suppliers who can profitably supply the EU market at the lower post-reform prices has not yet been addressed. With the first round of price reductions scheduled for July 2006, this is now a matter of some urgency.

Comment

The dispute over the impact and restructuring

While it is widely recognised that reductions in the EU sugar price will result in profound economic shocks for ACP sugar suppliers, there is no consensus on just how each country will be affected. The EC sees the prospects for profitable sugar production being profoundly undermined in many Caribbean sugar-exporting countries and is insistent that in such countries' funds should be devoted to diversification rather than restructuring. However, many of the governments in these countries do not share the EC's assessment and will not contemplate the demise of their sugar sectors. This is leading to a considerable level of often acrimonious disagreement over what constitutes an appropriate use of any restructuring support made available by the EU. This is likely to result in considerable delays in the deployment of EU aid in the countries concerned. However, it is also having an impact on the EU's broader approach in ways which could undermine efforts to provide restructuring support prior to the consequences of EU sugar-sector reform being felt in ACP countries.

The impact of the modification of the initial reform proposals

The 'savings' arising for ACP countries through the modification by the EU Council of Ministers of the initial EC reform proposals could help cushion some of the initial costs of adjustment in certain ACP countries, providing EU restructuring support is now swiftly and effectively deployed. The experience of the banana and rum programmes are not fully encouraging. It needs to be recognised, however, that the modification of the EC's reform proposals have simply 'bought time' for the implementation of effective programmes of support to ACP sugar exporters

to adjust to the new market realities they will face. If this time is not effectively used then the adjustment costs faced in ACP countries will be as profoundly damaging to even low-cost ACP sugar producers as the initial EC reform proposals.

Early aid deployment and restructuring strategies

The EU's desire to see some high-cost ACP sugar producers deploy restructuring assistance in support of broader processes of economic reform rather than in support of sugar-sector 'competitiveness' measures is having a significant impact on how the EC is seeking to deploy restructuring support. It underlies the insistence of the EC on the establishment of integrated and comprehensive country-response strategies that are based on a 'correct' assessment of the future prospects of the sugar sector in question, prior to the deployment of any funds from the dedicated sugar-sector adjustment facility. This insistence, however, is likely to have profound implications for the deployment of such assistance in all ACP countries, and compromise the early operational deployment of such assistance, despite the widespread recognition of the importance of helping ACP countries to prepare for change rather than simply respond to it.

The indications from certain regions – where the restructuring needs are glaringly obvious (given a recent history of declines in export earnings on sales to the EU resulting from currency movements) – is that since comprehensive restructuring strategies need to be in place before any aid is deployed, financing decisions on restructuring support will only be made in October 2006 at the earliest. This would result in the operational deployment of assistance only taking place in the second quarter of 2007 (at the earliest). If this timeframe for the deployment of EU assistance to ACP sugar-sector restructuring is adhered to, the benefits derived from the effective two-year deferment of substantive EU sugar-price reductions will be lost.

There is clearly a need to develop innovative arrangements to ensure the early in-country deployment of restructuring support. While such innovative solutions are being developed based on many of the elements contained in the Commission's February 2005 working document (budgetary support and private-sector initiative), it remains to be seen how quickly these innovative approaches could be operationalised, within a timeframe consistent with the agreed schedule for EU sugar-sector reform. This issue of deploying EU assistance swiftly in support of 'time-sensitive' adjustment processes constitutes one of the unresolved issues following Prime Minister Blair's assurances to Caribbean leaders of November 2005.

The exclusion of non-sugar-protocol LDC ACP sugar suppliers

A significant feature of the EC's proposed response strategy is its exclusion of certain non-protocol least-developed ACP sugar exporters (for example Ethiopia, where sugar has rapidly become the fourth largest export to the EU). The Commission working document largely ignored the losses which LDC sugar exporters will face (assuming perhaps that expanded access after 2009 will compensate for any price reductions). These will amount to €162 per tonne or €32.4 million on a 200,000 tonne quota. However, even with the lifting of quantitative restrictions on LDC sugar exports in 2009, this level of income losses could affect the financial viability of certain recently developed sugar schemes in LDCs, given the way the financing packages of such schemes are structured. This could require targeted forms of assistance to, for example, financial restructuring of loans to smallholder farmers.

The likely reality of the LDC safeguard clause

While the EC is seeking to give assurances that the safeguard provisions will only be invoked in the case of 'triangular' trade arrangements emerging, the very existence of the safeguard provisions may serve to encourage 'voluntary' restraint in the volumes of sugar exported. Whether in fact such safeguard clauses are invoked will depend on overall trends in sugar imports. Current analysis suggests that at the lower post-reform price, LDC sugar exports to the EU could be as low as 300,000 tonnes and that with a number of traditional ACP sugar-protocol suppliers reducing or discontinuing sales, EU cane refiners may struggle to secure the necessary supplies from within the existing preferential trade arrangements.

The need to rethink the terms and conditions of EIB loans.

While the EC has spoken of using EIB funding to address the needs of sugar farmers and sugar-related SMEs, it seems evident that the EIB's current lending policy in certain sugar-exporting ACP countries prevents the effective deployment of such funds in support of the types of low-cost loans that will be required to facilitate sugar-sector-related adjustments. In some countries EIB policies that insist on the deployment of grant-financed loans at local market rates are simply replicating inefficiencies in local financial markets and resulting in interest rates on loans to sugar-related activities even higher than those offered by commercial banks. This is clearly unhelpful in the context of acute sugar-sector adjustment requirements, which are resulting in a drying up of private-sector financing and an escalation of the costs of loan financing deployed in support of sugar-sector-related activities.

The role of expanded access to the EU market

While Prime Minister Blair implicitly committed himself to examining the issue of greater market access as an integral part of restructuring support to low-cost ACP sugar producers, there are four distinct aspects of this issue that will need to be addressed, namely:

- the timing of the granting of expanded duty-free access to the EU market;
- the basis for assessing existing levels of access;
- the scale of the expansion of the duty-free access to be granted to individual low-cost ACP sugar exporters; and
- the framework for the consolidation of this expanded access both in the short term (up to 2008) and the long term (beyond 2008).

Price reductions will be felt by sugar-protocol exporters from the 2006/07 season (–5.1%), although major price reductions will not set in until the 2008/09 season (–17.1%) and the full effect of the reform-induced price reductions will not be felt until the 2009/10 season (-36%). It is being argued that just as direct aid payments to EU farmers are phased-in in parallel with EU price reductions, so expanded duty-free access for low-cost ACP sugar suppliers should be phased in alongside price reductions. For the countries affected (Belize, Fiji, Guyana, Swaziland and Zimbabwe) this would require an expansion of duty-free access to occur from 2006/07 onwards. However this raises the question of from what basis such expanded access should occur. Should it occur on the basis of:

(a) the sugar-protocol quota?

(b) the sugar-protocol quota and the traditional SPS allocation? or

(c) the average level of exports to the EU market in the proceeding specified period?

Extending the principles underpinning EU farmers' rights to compensation would lead one to base any expansion in duty-free market access for low-cost ACP sugar suppliers on the average levels of sugar exported to the EU over a specified historical period.

On the basis that the aim of expanded duty-free access is to compensate for price declines, this suggests that the level of increased duty-free access to be granted should be commensurate with the revenue losses arising for the sugar sector concerned as a consequence of administratively determined reductions in the price offered for ACP raw sugar. In the case of Swaziland, the application of this formula to the 2006/07 season would require the granting of additional duty-free access of 11,977 tonnes.[5]

This poses the question 'How does the EC intend to consolidate such expanded access in the short and medium term?'. In the medium to long term, clearly it is the EC's intention to incorporate duty-free access for ACP sugar exports into EPAs. However this leaves unaddressed the question of how expanded access is to be secured during the transitional seasons 2006/07 and 2007/08. This is an issue that needs to be addressed urgently.

Duty-free access for value-added exports

A final EU market-access issue that will need to be considered will be the early elimination of special sugar duties imposed on sugar-containing products. The elimination of such duties by creating opportunities for increased exports of sugar-containing products (e.g. canned fruit) could serve to both expand domestic demand for sugar and facilitate processes of diversification. The ACP need to look for an 'early harvest' in discussions with the EU in this area.

Nurturing regional sugar markets

As the USDA pointed out in the case of Poland, EU sugar-sector reform will greatly reduce the costs of sugar-containing food products destined for both domestic and export markets. This will be particularly important for value-added products that also have a high dairy content (given the ongoing implementation of EU dairy-sector reform), for example sweet and chocolates. This will greatly enhance the price competitiveness of EU exports of sugar-containing value-added food products.

In this context ACP sugar-producing countries that are seeking to develop sugar-based value-added food-product industries may well need to negotiate special safeguard clauses to protect against import surges that deal not just with the trade in sugar alone but also with high-sugar-content food products. In this context products within the whole sugar chain, will need to be subject to any special safeguard mechanisms established under the WTO agreement or within EPAs.

Furthermore careful attention will need to be paid to the trade treatment accorded high-sugar-content processed products under any reciprocal preferential trade agreements (e.g. EPAs). If sugar markets are protected yet duties are eliminated on high-sugar-content processed products, this will close down the scope for the development of sugar-based value-added processing activities in ACP regions. This is already occurring in South Africa where despite continued protection of the sugar market (105% tariff), tariffs are being progressively eliminated on sugar-containing food products. This is having profound effects on confectionery, the most severely affected sector, where demand for sugar has been shrinking rapidly. If this trend becomes generalised across other sugar-using industrial sectors, then this could lower demand for sugar in what is the major high-priced regional market for sugar in Eastern and Southern Africa.

Consolidating regional sugar markets

While the February 2005 Commission working document on accompanying measures spoke of supporting the development of regional trade in sugar, such support needs to address the very real constraints that are faced in developing and consolidating a regional trade in sugar. The first issue to be addressed is the nature of demand. ACP countries export raw sugar to the EU, yet regional markets demand refined sugar. Thus if a regional trade in sugar is to be developed, investments will need to be made in refining capacity. Yet funds for such investment are drying up or becoming more expensive, given the income losses the sugar sector is set to face as a consequence of EU sugar-sector reform. Clearly there will be a need for instruments to provide low-cost loans to support such investment. Similarly the infrastructure to facilitate regional trade in sugar and sugar products will need to be established and this will similarly require the provision of low-cost loans.

Finally there will need to be close co-operation in the development of regional sugar policies, since with EU sugar-sector reform many regional markets will become more price attractive than the EU market. If this is not to give rise to both increased official and unofficial trade in sugar within regions in ways that undermine regional market prices, then close policy co-ordination will be required within ACP regions to ensure that regional sugar markets are both nurtured and consolidated.

Beef and veal

The basic regime and beyond

The basic regulations establishing the common organisation of the market in beef within the EU date back to 1968. The system consisted of four major elements:

- price support through a system of intervention buying;
- high levels of tariff protection around the EU market for beef;
- export-refund support to promote beef exports; and
- direct payments.

With the implementation of CAP reform in the beef sector, a number of major changes have taken place, consistent with the shift from price support to direct support payments. This has involved a substantial expansion of direct support payments in parallel with

price reductions and the dismantling of intervention buying.

However beyond this shift in instruments there has emerged a shift in focus, away from an emphasis on the quantity of production to an emphasis on the quality of production. In the beef sector in particular, this has involved two distinct elements: food safety, which is foremost the responsibility of government authorities; and food quality, which is essentially an issue for the private sector (although in the case of the EU, substantial levels of public assistance are being extended in support of the development of quality assurance schemes and quality labels).

Food-safety issues and food-quality differentiation of beef products will be critical factors in the coming years in determining the nature of ACP–EU trade in beef products.

A factor also strongly influencing EU beef production is the progress of reform of the EU dairy regime, since two-thirds of EU beef production comes from the dairy herd. The maintenance of milk quotas until 2015, in a context of increasing milk yields, is leading to a decline in EU beef production (with a decline of 11.9% in the total dairy herd translating into a 3.4% decline in total beef production).

The EU's traditional high-price policy, which maintained EU beef prices at levels substantially above the world market price, was at the heart of the attractiveness of the EU market to ACP beef exporters. The process of EU beef-sector reform is transforming the market situation in the EU faced by ACP exporters and is having significant effects on trade relations.

In terms of future developments the stage is being set for the incorporation of the EU beef sector into the single farm-payment scheme. This will occur from December 2006 onwards, after the transitional arrangements (which involve application of product-specific supports) have run their course. While over time, with the application of the concept of 'modulation', limits will be placed on direct aid payments per farmer, the increased efficiency of new EU support systems (which leaves 1 in 2 euros in the hands of farmers, as opposed to 1 in 4 euros under the old regime) will increase the production impact of the support extended to the farming sector as a whole. This being said, the incorporation of the beef regime into the single farm-payment scheme will mean that farmers are free to choose which products to produce from the broad range covered by the scheme. According to reports the EC envisages this leading to a reduction in beef production, as farmers re-align their production patterns to respond to market changes and exploit their comparative cost advantage in producing the various products that fall under the single farm-payment scheme, rather than pursuing subsidy maximisation strategies.

However, given the interconnections between EU beef and dairy markets the overall net effect of beef-sector reform on production in the EU – and hence trade with the EU – will not fully emerge until quota restrictions have been lifted in the dairy sector, after 2015.

The EU import regime

The basic framework

The high EU prices have traditionally required the EU to maintain high levels of import tariffs in the beef sector. However, with the process of price reductions underway and a shift over to direct farm-

Table 14. The EU beef import regime

		Base rate for reductions	1995	2000	Reduction
Live animals	*ad valorem*	16.0%	15.0%	10.2%	36%
	specific €/t	1,454	1,367	931	36%
Beef meat	*ad valorem*	20.0%	18.8%	12.8%	36%
	specific €/t	2,763	2,597	1,768	36%
Preserved meat	*ad valorem*	26.0%	24.4%	16.6%	36%

Source: 'Situation and outlook: beef sector; CAP 2000 working document, DG Agriculture, April 1997, p. 13.

Box 5. The single farm-payment scheme

The single farm-payment scheme will be paid once a year and will replace most existing product-specific direct aid payments. The national allocation to the single farm-payment scheme consists of the aggregation of the maximum each state could spend on direct aid payments during the agreed historic reference period.

Payments will be made to any farmer actively farming at the date each member state introduces the scheme. Farmer entitlements will be defined by the entitlements the farmer enjoyed during the reference period (normally 2000–02, although there are variations). 'Each entitlement is calculated by dividing the reference amount by the number of hectares which gave rise to this amount in the reference years.' Eligible hectares include all types of agricultural land except land used for permanent crops and forestry. 'Farms may produce all crops with the exception of permanent crops, fruit and vegetables and potatoes.'

This payment is linked to cross-compliance with various conditions, linked to land management, good agricultural practices and environmental considerations.

Member states have various options as to how they calculate and make payments. This can be based on individual farmers' receipts during the reference period or averages for the region or the state. During the transitional period coupled payments may under certain conditions be maintained (so called 'partial decoupling'). All payments made are to be reduced by 3% in 2005, 4% in 2006 and 5% in 2007, under the principle of 'modulation', which is designed to free up funding for wider rural-development activities.

According to the EC the single farm-payment scheme 'provides stable support allowing farmers to produce to market demand and to plan for the future'.

support payments, the need for tariff protection is receding. This will in the coming years be reflected in modifications to the EU import regime, either as a result of multilateral trade negotiations or the conclusion of bilateral trade agreements, particularly an EU–Mercosur free-trade-area agreement.

Currently the EU's import regime for beef consists of a combination of an *ad valorem* duty and a specific amount per tonne (see Table 14). As can be seen, the Uruguay Round agreement resulted in a 36% reduction in these duties over six years. By far the most important duty is the specific duty, which for beef now stands at €1.768 per tonne. It is this duty that is likely to (a 9% decl to the most substantial progressive disits were evoarticularly as part of moves towards establishing *ad valorem* equivalent values, prior to tariff reductions.

In addition to these two duties a safeguard clause allows customs duties to be increased in the case of import surges or a drop in the import prices below a certain trigger threshold.

ACP and other trade preferences

Table 15 shows the preferential quotas for chilled and frozen de-boned beef/veal extended to ACP countries under the Cotonou Agreement and the average quota utilisation over the period.

In total the ACP countries have a preferential beef-and-veal quota totalling 52,100 tonnes. These quotas constituted around 14% of total EU imports throughout the 1990s. However, Kenya has only supplied beef in one year, 1992, and Madagascar has not supplied any beef to the EU since 1998. Since 2002, initially as a result of foot-and-mouth disease, Zimbabwe has also not supplied the EU market.

It can be argued that with moves towards trade liberalisation these quantitative restrictions should be lifted. However the reality is that, with rare annual exceptions, ACP beef exporters have rarely filled the quotas allocated to them, on average supplying only 55.6% of the allocated quota (or around 7% of EU imports). This suggests that tariff barriers do not constitute a significant barrier to trade.

Looking beyond the ACP, in order to comply with its market-access commitments the EU also operates a tariff-rate quota as set out below.

Before EU enlargement the EU in addition granted tariff-rate quotas to pre-accession countries,

Table 15. ACP beef exports to the EU 1977–2004

	Quota (tonnes)	Avge. supply (tonnes)	% quota fill (avge.)
Botswana	18,916	11,403	60.3%
Namibia	13,000	9,415	72.4%
Zimbabwe	9,100	6,266	68.9%
Swaziland	3,363	914	27.2%
Madagascar	7,579	954	12.6%
Kenya	142	1	0.7%

Table 16. Market access in the beef-and-veal sector

	Quota (head or tonnes)	In-quota tariff
Current access		
live animals (adults)	10,000	4–6%
live animals (calves)	169,000	16% + €582/tonne
beef meat (tonnes)	144,000	20%
Minimum access:		
beef meat	20,000	20%

amounting in total (live and meat) to around 142,000 tonnes.

The growing importance of food safety

In terms of exporting to the EU, and following directly on from the BSE experience, there has been a growing policy emphasis on food safety and in parallel a growing emphasis on food quality. Food-safety standards have to be met in order for beef products to be allowed entry to the EU market. Food quality is important from a commercial perspective since it allows beef products to attract the premium prices that make it attractive to export to an EU market in a context where prices have generally been falling, and costs of supplying the market have been increasing.

In order to be granted access to the EU market, verification of food-safety compliance needs to be addressed at three levels:

- recognition by the EU of the country as eligible to export;
- the listing by the EU of establishments eligible for export to the EU; and
- the certification by the local competent authority that the consignment meets EU standards.

This last stage of certification by the local competent authority must comply with a range of basic principles. Meeting these standards fully and consistently places a considerable and growing financial burden on ACP national administrations. Yet getting the paperwork right and establishing a credible system of control by the competent authority is now vital to trading meat products into the EU. If any of the paper work is not in order, or the integrity of the competent authority is brought into question, imports of these meat products into the EU will cease. This placing of responsibility for ensuring the integrity of food-safety controls throughout the food chain (from the production of animal feed through the handling and disposal of animal by-products, to the despatch of the beef from the port) in the hands of a local competent authority, places the performance of public bodies in ACP countries at the centre of the beef trade with the EU. Any failure by ACP governments in performing these functions, if the infringements are considered serious enough, will lead to the closure of the EU market, regardless of the quality of operations of the beef producers and processors involved in the trade.

There is also considerable uncertainty on how the

EU wishes to see the various animal-product-related food-safety regulations applied in ACP countries. For example:

- Will respect for the objectives of EU regulations need to be attained in the same way in all countries?
- Will the EU be able to tailor requirements to country circumstances (with countries at high risk of disease facing stricter controls than those with no history of such diseases)?
- Will all provisions of the applicable EU regulations be equally applied to production in third countries or will certain aspects be waived, providing the safety of meat destined for the EU market is not compromised (for example with regard to disposal of animal by-products)?
- Will the exemptions to small-scale trade in animal feed between farmers within the EU be extended to small-scale feed-trading in third countries (on the basis that for feed contamination to be of concern it must effect a minimum level of total feed intake)?

A further area of potential concern in the field of food safety is the EC's efforts to 'internationalise' its own animal-welfare regulations. The EC supported the February 2004 OIE global conference on animal welfare and is pushing for the establishment of international standards. These EC initiatives cannot be divorced from EU member states' concerns over the potential competitive disadvantages to EU producers arising from higher animal-welfare standards. Harmonisation of international standards for animal welfare would remove any competitive disadvantage that EU producers might face. However this would increase the costs of supplying the EU market. These cost burdens would be likely to fall particularly heavily on ACP beef exporters who use extensive-farming systems of cattle production, and this could over time come to constitute an effective trade barrier. ACP beef exporters will need to pay close attention to EU efforts to promote binding international standards for animal welfare, particularly in the area of transportation.

An area to which ACP beef-exporting governments will need to pay increasing attention in the coming months and years is in operationalising the public commitments that EC officials have made on the provision of assistance to ACP counties in meeting EU food-safety standards. This will be essential if ACP countries are to be helped to maximise their trade potential in the area of beef and other agricultural exports.

The EC has committed itself to ensuring that food-safety standards do not become new non-tariff barriers to trade with the developing world. However this ignores one very important dimension, namely the economic cost of compliance. This cost has been recognised inside the EU, and various public-assistance programmes to support food-safety compliance have been set up. These range from a dedicated budget line (€248 million in the 2004 budget) for food-safety measures, to the inclusion of components for food-safety compliance in direct aid payments to farmers and rural development programmes in favour of food processors.

Yet in many ACP beef-exporting countries, even though the high fixed costs of SPS compliance and verification relate to relatively small production runs, it seems that no assistance programmes commensurate with the challenge faced have been set up to date (it should however be noted that the EU has funded two large TA programmes on SPS for the fisheries and the horticultural sector; for further details on those TA programmes, please visit: http://agritrade.cta.int/infosources/sps.htm). This means that the beef industry in ACP countries is itself carrying the costs of compliance with EU food-safety standards. This is becoming an increasing burden as prices received on the EU market decline (see next section).

This inferior access to public support for food-safety compliance and verification places ACP beef suppliers at a competitive disadvantage in supplying the EU market compared to EU producers. This is an issue which will need to be addressed if they are to continue to supply the EU market.

The impact of reform on the EU beef market

From an ACP perspective there are two major effects of reform on exports to the EU market. The first is the impact on prices received for beef sold in the EU because of the shift from price support to direct-aid

payments to farmers. ACP beef producers saw the value of their earnings from exports to the EU decline progressively under the impact of CAP reform in the beef sector, as EU beef prices have been allowed to fall towards more 'normal' levels. The former EU Agriculture Commissioner, Franz Fischler, estimated that two-thirds of the price declines that occurred in the EU beef market between 1999 and 2002 were the result of CAP reform and only one-third were the consequence of the BSE crisis. While EU farmers have been compensated for these reform-induced price declines by increased levels of direct aid payments, ACP suppliers have simply faced the income losses.

In the case of Southern African beef exporters, the sterling value of beef exports declined by between 28% and 30% from 1999 to 2001. In the case of Namibia this resulted in an income loss of €6 million in 2001 compared to the prices received when Namibia first began exporting to the EU. In the case of Swaziland the declining EU beef price led first to a discontinuation of exports of lower quality beef cuts, and subsequently a discontinuation of all exports in the face of lower local currency earnings on the back of a strengthening rand.

Under the impact of the 2000 round of CAP reforms these price declines continued until 2003. For Namibia, earnings for fresh and chilled beef exports fell from €6.143 per kg in 2001 to €5.589 per kg in 2003 (a 9.8% decline), while for Botswana the decline was from €5.572 per kg in 2001 to €5.075 per kg in 2003 (a 9% decline). The price declines for frozen beef cuts were even more pronounced, with prices for frozen Namibian beef cuts falling from €2.876 per kg to €2.069 per kg (a decline of 28.1%) and those from Botswana falling from €2.508 per kg to €2.120 per kg (a decline of 15.5%). There was however some 'bounce back' in prices in 2004

Box 6. The process of EU beef-sector reform

Since the end of 1992 a process of reform has been underway in the EU beef sector, involving a movement away from price support to increased levels of direct aid payments to farmers. This has featured increasing headage premia and progressive reductions in the intervention price for beef.

The 'Agenda 2000' extension of reform in the beef sector involved a 20% reduction in the intervention price for beef in three stages. On 1 January, 2000 the intervention price fell to €3,475 per tonne for the first six months, to €3,242 per tonne for the season from July 2000 to June 2001, and to €3,013 per tonne for the season 2001/02. On 1 July, 2002 the intervention price was replaced by a 'basic price' for storage of €2,224 per tonne. Under this new system if the EU market price falls below 103% of the 'basic price' then the EU will finance private storage of beef in order to support the market.[6] In addition beef producers will also benefit from a 'safety net' intervention system for bulls and steers, involving the organisation of 'buying in tenders' in particular member states, if the market price for bulls and steers in the member state concerned falls below €1,540 per tonne for two consecutive weeks.

To compensate for these reductions in the intervention price, direct aid to EU beef farmers was increased. Initially these payments consisted of different premia paid per head; however as of June 2003 further reform measures were adopted, involving the progressive decoupling of existing farm aid payments from production through the establishment of a single farm-payment scheme, which embraced a range of commodities.

As with other sectors, the single farm-payment will be linked to 'cross compliance' with environmental, food-safety, and animal-welfare standards, as well as the requirement to keep all farmland in good agricultural and environmental condition.

During a transitional period up to December 2006, EU member states will have a degree of discretion over the pace at which they implement the decoupling of farm payments. By 2008 the single decoupled payment scheme will be extended to the dairy sector (although quotas will remain in place until the 2014/15 season). This is important since trends in the dairy sector have a direct bearing on overall EU beef production.

Table 17. Fresh and frozen beef export from Namibia and Botswana to the EU (2001-04)

	Fresh and chilled beef exports (€/kg)		Frozen beef exports (€/kg)	
	Botswana	Namibia	Botswana	Namibia
2004	5.233	5.589	-	2.210
2003	5.075	5.544	2.120/	2.069
2002	5.662	6.135	2.428	2.157
2001	5.572	6.143	2.508	2.876

reflecting the emergence of a deficit in beef supplies to the EU market.

These price trends also reflect a second major impact of EU beef-sector reform, namely the emergence of a far more differentiated beef market, with divergent price trends in different components of the market. This is a reality which ACP beef suppliers will have to adjust to, with exports of clearly labelled and differentiated beef products being targeted at premium-priced markets, where price trends are stronger, and exports can remain profitable despite the escalating costs of food-safety compliance, which have to be carried by private-sector operators in ACP countries.

This may well require the development of carefully designed labelling and marketing strategies, which will require external technical and financial assistance. This is particularly the case since the volume of exports from ACP countries involved is relatively small, when considering the costs of such labelling and marketing initiatives. The value of such initiatives however is reflected in the higher prices that Namibia's beef exports attract (+8.65% on average) as a result of the FAN quality-assurance scheme, compared to beef exports from Botswana.

In the face of the price competitiveness of Latin American supplies, this would appear to be the only basis on which ACP beef suppliers can continue to supply the EU market profitably in the longer term. This is particularly the case since tariffs on imports from Brazil and Argentina are likely to fall in the coming years with the conclusion of a Mercosur–EU free-trade-area agreement and the expansion of tariff-rate quotas for sensitive products as part of the final deal under the Doha Development Round. This would serve to further enhance the price competitiveness of Brazilian and Argentinean beef on the EU market. The question therefore arises: will ACP beef producers, processors and public authorities be up to the challenge of ensuring a consistent supply of clearly labelled and differentiated quality beef products to the EU market? Development assistance could usefully be sought from the EU in addressing this challenge effectively.

The EU export regime

In the 1990s the EU was the world's leading beef exporter, with over 25% of the world beef trade and a peak level of exports of 1.2 million tonnes. This was a classic outcome of the old CAP regime, which through price support encouraged production, required huge levels of export refunds (over 1.2 billion ecus), and generated substantial intervention stocks. In the 1990s export refunds drove this trade, with export-refund payments being equivalent to around 40% of the market price. In ACP countries where lower quality and hence lower priced beef cuts were sold, the importance of export refunds was even greater in fuelling this trade.

Table 18. EU export commitments under the Uruguay Round

	Value (€ million)	Volume ('000 tonnes)
Base	1,959	1,040
1995	1,923	1,137
2000	1,254	822

Source: 'Situation and outlook – beef sector', CAP 2000 working document, DG Agriculture, April 1997, p.15.

The Uruguay Round agreement, however, placed ceilings on the level of subsidised EU beef exports,

and along with the BSE crisis and the implementation of the reform of the beef sector, this saw EU beef exports begin to fall sharply. By 2004 EU beef exports were only around one-third of what they were throughout most of the 1990s, with export-refund allocations now being substantially below the allowed WTO ceiling (just over a quarter) and export volumes well below half the allowed level on which export refunds can be paid.

Table 19. EU beef imports and exports 1997–2004

	Imports (tonnes)	Exports (tonnes)
1997	387,000	971,000
1998	347,000	695,000
1999	385,000	872,000
2000	378,000	577,000
2001	350,000	498,000
2002	424,000	522,000,
2003	440,000	390,000
2004*	509,000*	333,000

*estimate; subsequent USDA figures gave total imports of 580,000 tonnes

Recent trends in EU imports and exports

In the 1990s EU imports of beef remained fairly constant at around 370,000 tonnes per annum. Since 2002, however, EU imports of beef have risen substantially to an average of around 432,0000 tonnes in 2002–03, before rising to a reported 580,000 tonnes in 2004. Some 70% of these imports came from Brazil and 20% from Argentina, with, in both instances, the full duty being paid. This arises from the highly price-competitive nature of Brazilian and Argentinean beef production (not unconnected of course from dramatic currency movements). For example, Brazilian rib-eye cuts (€7 per kilo) are almost half the price of Irish rib-eye cuts (€13 per kilo) and 30% cheaper than Dutch Limousin rib eye (€10 per kilo). Argentina, while more expensive than Brazilian production (at €9 per kilo), is still highly competitively priced for most European markets.

Since 2002 EU imports of beef have exceeded EU beef exports, a consequence of a strong recovery in EU beef consumption after the BSE crisis, and a contraction in EU beef production linked to the decline in the size of the dairy herd.

A growing trend in the EU beef market is towards increased product differentiation, with a clear distinction emerging between high-quality beef and low-quality beef, labelled differentiated beef, and non-labelled generic beef. The EU25 currently has a shortage of high-quality beef and a surplus of low-quality beef. This arises in large part from the disjuncture between patterns of beef production in new member states (low quality) and aspirational consumption patterns (towards high-quality beef). This in part accounts for the larger-than-expected increase in beef imports in 2004. It also explains why, despite a growing deficit between EU production and consumption (which has emerged since 2003), the EU remains a beef exporter.

This has important implications for the trade relationship with ACP beef-producing countries. On the one hand, with a growing gap between EU beef consumption and EU beef production, there exist opportunities for ACP beef producers to supply high-quality beef, at prices which allow them to profitably export to an increasingly fragmented EU beef market. However with a surplus of low-quality beef, even exporting a mere 330,000 tonnes per annum, the danger exists that EU beef exports could easily swamp ACP markets. This danger is exacerbated by the fact that highly price-competitive Latin American suppliers are increasingly pushing EU traders out of their traditional beef markets. In this context, as in other sectors where the EU has faced intensified competition in bulk commodities in higher priced markets, EU traders may find themselves increasingly looking to supply African markets, as markets of last resort.

This is a matter of some concern, because EU beef exports to ACP countries consist almost entirely of low-quality beef destined for the low-priced end of the market. This tends to compete directly with the production of small-scale farmers and emergent commercial farmers (whose commercial position already tends to be weak), further harming the development of this sector of ACP beef production.

Against this background a number of factors can be seen to influence EU beef exports to ACP countries, notably:

- the openness and demand for beef on non-ACP markets;
- the cyclical ups and downs of European beef production, as well as the pace of change in the composition of production (from lower quality to higher quality);
- the development of domestic consumption of beef within the EU (towards higher quality beef);
- the variations in the level of export refunds offered for different types of beef cuts for different destinations;
- the trade arrangements established by ACP countries to regulate beef imports (tariffs and safeguard arrangements); and
- the WTO ceilings on the volume of exports.

Local supply-and-demand considerations on ACP markets are likely to have only a marginal impact on the actual pattern of EU beef exports to ACP countries.

Future trends

The long-term decline in EU cattle numbers will continue, given the quota restrictions in the dairy sector and increasing milk yields. This will impact on EU beef production, as will the introduction of the single farm-payment scheme, which is seen as contributing to a decline in beef production. The July 2005 EC report on 'Prospects for agricultural markets and income 2005–2012' concluded that net EU beef production would fall from 7.98 million tonnes in 2003 to 7.61 million tonnes in 2012, a decline of 4.6%. Beef consumption, after holding fairly constant to 2007 (8.265 million tonnes in 2003 and 8.260 million tonnes in 2007) is expected to fall to 8.134 million tonnes in 2012.

This is in part the result of the ongoing trend in meat consumption away from beef in favour of poultry and pork. There will nevertheless be a growing gap between EU production and EU consumption of beef, reaching a projected 527,000 tonnes in 2012. This is expected to sustain higher prices.

In this context imports are expected to rise to 628,000 tonnes, but despite the growing deficit on the EU market the EU will continue to export beef, although this will be on a much smaller scale (around 10% of the peak levels). Exports will be around 300,000 tonnes per annum up to 2007, before falling to an average of around 124,000 tonnes over the 2010–12 period. The continuation of exports will largely be a consequence of the imbalance between production and demand for low- and high-quality beef cuts.

A key feature of these trends is the growing importance of quality consideration in the prices received for beef exported to the EU market. If quality

Table 20. EU beef-and-veal market projections, 2003–12 (tonnes)

	Net production	Net consumption	Imports	Exports
2003	7,983,000	8,265,000	440,000	390,000
2004	8,035,000	8,244,000	509,000	333,000
2005	7,928,000	8,210,000	549,000	266,000
2006	8,044,000	8,267,000	560,000	337,000
2007	7,992,000	8,260,000	566,000	298,000
2008	7,924,000	8,238,000	577,000	264,000
2009	7,833,000	8,195,000	588,000	226,000
2010	7,734,000	8,165,000	600,000	169,000
2011	7,654,000	8,151,000	614,000	116,000
2012	7,607,000	8,134,000	628,000	101,000

Source: Extracted from table A.9, 'Prospects for agricultural markets and income 2005-2012', EC Directorate-General for Agriculture, July 2005.

standards can be attained and assured and ACP countries make the transition to marketing their beef production more effectively into increasingly differentiated EU beef markets, then growing trading opportunities can be exploited. In this context, quantitative restrictions on ACP beef exports may even need to be removed.

A further noteworthy feature of these trends is the growing volume of low-quality EU beef cuts being exported. While overall levels of EU beef exports will be substantially down (almost 75% lower than 2003 levels), the scale of EU beef exports will still be large relative to the size of ACP markets. With EU beef exporters facing growing competition in traditional markets from highly price competitive Latin American suppliers, this could lead to significant EU beef exports to ACP markets, most notably in west and southern Africa. This is a possibility to which the ACP governments concerned will need to pay close attention

Implications for ACP countries

Removing residual restrictions

The first and most obvious area in which ACP beef exporters require a policy response from the EU is through the removal of residual tariff barriers and quantitative restrictions on exports. Given the underuse of existing ACP quotas, removing residual tariff barriers would appear to be more important in the short term than the elimination of quantitative restrictions. In the longer term, however, should the EU market prove attractive, the current low rates of off-take in ACP beef-protocol countries could be raised, leading to considerable expansions of production. This would require the identification of remunerative markets, the improvement of quality standards, and the modification of some cultural practices linked to cattle ownership.

While ACP beef exports under the beef protocol enjoy full exemption from the *ad valorem* duty applied to beef imports, they still have to pay 8% of the special duty applied to beef imports (that is to say ACP beef exported under the quota enjoys a 92% reduction in the special duty). This duty is equivalent to around £0.15 per kg. For Botswana the removal of this duty on its full quota of exports would generate an extra €2.837 million and some €1.71 million based on average annual exports since 1976. For Namibia the corresponding amounts would be €1.950 million and €1.412 million. On actual exports this would be equivalent to 27% of the income losses Namibia suffered in 2004 as a result of the reduction in EU beef prices induced by beef-sector reform. With frozen beef cuts being much lower priced the impact of the removal of the special duty is proportionately more important, representing approximately a 10% improvement in the price (as opposed to 3.9% for fresh and chilled beef cuts).

The removal of residual tariffs is in fact an area in which the Namibian beef sector is looking for early movement from the EC, so as to facilitate the mobilisation of funds for support to food-safety compliance programmes. The case is being made for the EU to immediately cancel the residual levy still charged on Namibian beef exports to the EU. This would free up nearly €2 million per annum in extra revenues. These extra revenues, it is argued, could be captured by the Namibian beef industry through a special levy, with the funds thus raised being used to finance ongoing food-safety measures.

The removal of the remaining residual tariff barriers need not await the outcome of the EPA negotiations, since under the existing provisions of

Table 21. Financial impact of the removal of residual duties on beef, 2004*

	Tonnage	Current revenues	Extra revenues
Namibia fresh and chilled	6,503	€36,345,267	€1,414,402
Namibia frozen	2,210	€5,387,980	€530,265
Botswana fresh and chilled	5,233	€26,185,932	€1,088,370
Botswana frozen	–	–	–

*based on €1.45 to 1£

Declaration XXVI of the Cotonou Agreement, the joint declaration on beef and veal, the EU undertakes to 'ensure that the ACP states, beneficiaries of the protocol on beef and veal, derive full benefits therefrom'. Clearly since the imposition of the residual duty prevents them from gaining 'full benefits' from the protocol these provisions could be invoked to allow the removal of the existing residual duty.

Addressing the financial burden of food-safety measures

The issue of the financial implications of technical compliance with EU food-safety standards is an issue of critical importance to ACP beef exporters, particularly since with declining EU prices this is creating a 'squeeze' on the profitability of beef exports to the EU. Unless grant financing is made available by the EU through a dedicated funding mechanism to meet EU food-safety standards in the beef sector (similar to the support extended in the fisheries sector) then ACP beef exporters could find themselves excluded from the EU market, either as a result of failure to comply with EU food-safety standards or because the financial costs of compliance has made exports to the EU commercially non-viable.

While the EC has made a range of public statements stressing the importance of helping developing countries to meet EU food-safety standards, to date it seems that no money has been made available through easily accessible instruments to support the types of activities required.

The economic consequences of the termination of beef exports to the EU market would not be restricted to the lost income on sales to the EU market, but would be compounded by price declines on local and regional markets into which this beef would need to be diverted. This is particularly the case for high-quality beef cuts, for which there is actually a surplus in Southern African markets as a result of the structure of beef consumption and production in South Africa, the major beef consumer and producer in the region.

Serving differentiated markets

The issue of the commercial sustainability of EU food-safety controls will be vitally affected by the ability of ACP beef producers and processors to make the shift from 'trading' beef into an undifferentiated market to 'marketing' beef cuts into an increasingly differentiated EU market. Given the human-resource-intensive nature of these types of marketing activity and the human-resource constraints faced in the principal beef-exporting regions of the ACP (linked in large part to the reversals in human development arising from the HIV/AIDS pandemic),

Box 7. What the EC has said on assisting developing countries in meeting EU food-safety standards

Addressing a conference on EU exports and SPS measures in Brussels on 27 May, 2005 Trade Commissioner Mandelson said that SPS measures were 'a crucial dimension of trade policy ... future challenges in trade policy will not be in the field of traditional tariffs, but in the so-called non-tariff barriers to trade, to which the question of standards is crucial'. He continued 'if not managed with care, these measures can be impediments to trade which are difficult to justify. Managed successfully, they can be a stimulus to trade: enhancing the opportunity to exploit comparative advantage to the mutual benefit of all'. Commissioner Mandelson argued 'we should not shy away from taking a fresh look as how we can best work more closely with developing countries to meet their needs. First and foremost how do we enable them, through effective capacity building, to meet our own and international standards'. He went on 'we need to help developing countries to improve their capacity to abide by SPS rules and requirements and help them provide the infrastructure to do so'. Commissioner Mandelson called for 'specific provision for trade-related technical assistance in the field of SPS [to be] included in our aid programmes'.

Source: Speech by Commissioner Mandelson (SPEECH/05/307-27 May 2005)
http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/307&format=HTML&aged=0&language=EN&guiLanguage=en

Table 22. EU meat and edible-meat-offal exports to the ACP and the world 1997–2003 (million euros)

	ACP	World	ACP as % of total EU exports
1997	150	3,644	4.12%
1998	159	3,285	4.84%
1999	145	3,742	3.87%
2000	223	3,943	5.66%
2001	240	3,830	6.27%
2002	255	3,689	6.91%
2003	247	3,156	7.83%

external financial and technical assistance may well be required to help ACP beef suppliers make the transition. With the EU having extensive programmes of assistance to its own farmers in developing marketing strategies, the EC would appear to be an ideal source of support for such financial and technical assistance. Furthermore the provisions of Declaration XXVI commit the EC to assisting ACP beef-and-veal exporters to 'improve their competitiveness'. This would appear to provide ample scope for extending support to such programmes.

Defending national and regional markets

While the scale of EU beef exports is greatly reduced and EU beef intervention stocks are empty, this does not mean that ACP countries face no threats of market disruption. The EU is facing increased competition on its traditional beef-export markets and is increasingly wanting to dispose of lower quality beef cuts, which find no markets in the EU. As in other sectors (e.g. cereal-based value-added food products), the EU could easily fall back on supplying ACP (mainly African) markets.

There is some evidence to suggest that the ACP is already becoming a more important market for EU meat exports generally, with a 65% expansion in the value of EU meat exports to the ACP between 1997 and 2003, despite a 13.4% contraction in the value of overall EU meat exports.

Against this background ACP beef-producing countries need to look at policy options for managing this potential problem.

This suggests a need for:

- the establishment of mechanisms for monitoring both EU beef exports to ACP markets and also those to non-ACP markets of interest to ACP producers;
- the establishment of swift and effective safeguard measures in the beef sector to allow immediate action to prevent market disruptions;
- the establishment of surveillance mechanisms, with the support of the EU, to monitor applications for export refunds on beef destined for markets of importance to ACP beef producers; and
- the establishment of a framework for consultations on beef-sector issues of concern to existing ACP beef suppliers and potential ACP beef exporters under the EBA initiative.

Endnotes

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2. EC communication authorising the Commission to open negotiations on an amendment of the bound customs tariff for bananas, Brussels COM(1999), Annex 1, 'Implications of a tariff-only system'.
3. Actual sugar exports may exceed the nominal share of the SPS quota allocated to each country.
4. The original table had a sum of 2.3 million tonnes, this is assumed to be a mistake and the corrected figure of 1.9 million is included.
5. On the assumption of the full implementation of EU sugar-price reductions as agreed by the EU Council, a world market price of US$250 per tonne and a €/$ exchange rate of 1 to 1.1.
6. This is roughly equivalent to an intervention price of €2,669 per tonne under the old intervention price system.

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Reform of EU Export Subsidies on Sugar: The Legal and Economic Implications for the ACP Countries

Roman Grynberg, Chris Milner, Wyn Morgan and Evious Zgovu

Introduction

ACP countries have preferential terms of access for their sugar exports to the EU. The sugar Protocol of the Lomé Agreement gives (indefinite) duty-free access for agreed quantities of sugar at guaranteed (protected domestic EU) prices to specific ACP Protocol countries.[1] This results in these ACP countries receiving prices for their sugar exports to the EU that are in excess of those on the world market, and a corresponding transfer of income that embodies a significant element of rent or 'aid'.

In September 2002 Australia and Brazil filed complaints and requests for consultations with the EU at the WTO, concerning the nature of the EU's sugar market. The complaint is that the volume of the EU's subsidised exports of sugar exceed the levels the EU had committed itself to under the Uruguay Round Agreements. If this challenge at the WTO leads to reforms of the EU sugar policies, then this may lead to reductions in protected EU import prices and therefore in turn to reductions in the level of income transfer to the ACP protocol exporters. Reduced rents or 'aid' to these relatively sugar-dependent ACP exporters may have serious macroeconomic implications, in terms of incomes, employment, the balance of payments and tax revenue.

The EU sugar regime

The production of beet sugar in the EU is limited under the Common Agricultural Policy (CAP) by the imposition of country-specific quotas that form part of an overall EU quota limit. Quotas apply to the finished refined product (white sugar) but implicitly constrain production of the raw beet. Each member state (MS) is allocated a quota by the Council of Ministers, which it then distributes to processors according to its own national rules.

The quotas themselves are further subdivided into three parts, namely the 'A', 'B', and 'C' quotas. In essence, 'A' and 'B' are the main quotas and differ only in the level of the levy imposed on producers. 'A' attracts a fixed levy of 2% of the intervention price while 'B' producers face a variable levy of up to 37.5% of intervention price, dependent upon the cost of export refunds. A further storage cost levy, used to pay back producers for storage costs, is charged on all sales bar those into intervention. 'C' quota sugar is not eligible for intervention buying and is thus exported without subsidy and sold at the world market price.

The intervention price is set by the Council and this, along with the storage cost levy, creates a floor price for sugar in the EU. Clearly prices do not always equate to this but will move between this minimum level and the threshold price level (the price at which imports enter the EU) and possibly higher. When production is at a level that threatens the floor price, the Commission buys surplus sugar into intervention from 'A' and 'B' quota production. However, given the export arrangements intervention rarely occurs.

Guaranteed prices for refined sugar are set annually and are then translated into minimum beet prices for producers. Refiners therefore must pay beet producers 58% of the intervention price as a minimum, while processors receive 42% of the intervention price.

The sugar regime has specific provisions for both the export and import of sugar. Exports can be of two types of sugar – surplus quota sugar and 'C' sugar. The former is exported onto world markets with the aid of export refunds. Such refunds are necessary to ensure that the sugar refiners can actually export, the refunds making up the difference between the (high) internal EU price and the (lower) world market

price. The value of these subsidies varies each year depending on the relative level of prices in the two markets, while the final level of export refunds will determine the level of the levy imposed on 'B' quota sugar. 'C' sugar is exported without support and as such is sold at the going world market price.

As with all products covered by the CAP, there is a common tariff imposed on all non-EU imports that is set at a level higher than the internal guaranteed price to protect domestic producers.

There is, however, an exception to this arrangement and that is the provision for preferential imports from ACP countries. Under the Lomé (now Cotonou) Convention, the EU agrees to buy a predetermined, but fixed, volume of imports from a range of countries that are exempt from the duties normally applied to imports and that are purchased at a price that is roughly equivalent to the EU's internal intervention price. The vast majority of such 'preferential' sugar flows to the UK for refining.

Table 1. ACP export quotas in tonnes (1998/9)

Barbados	50,312.4
Belize	40,348.8
Congo	10,186.1
Côte d'Ivoire	10,186.1
Fiji	165,348.3
Guyana	159,410.1
Jamaica	118,696.0
Madagascar	10,760.0
Malawi	20,824.4
Mauritius	491,030.5
St Kitts Nevis	15,590.9
Swaziland	117,844.5
Trinidad & Tobago	43,751.0
United Republic of Tanzania	10,186.1
Zambia	0.0
Zimbabwe	30,224.8
Total	1,294,700.0

Source: ACP (www.acpsugar.org/acpstats1.htm)

The Uruguay Round Agreement covered agricultural products for the first time. For the sugar sector, the emphasis was placed on reducing distortions to trade, either via import restrictions or through export subsidies. In the case of the EU, the system of a guaranteed minimum import price based on a variable levy had to be replaced with fixed import tariffs.

The new policy had to be introduced in mid-1995 and the EU was further tasked with reducing the fixed tariff by 20% in relation to the 1986–88 base period, over the six-year period of 1995/6 to 2000/1. In effect this meant that the import tariff on white sugar was introduced at 507 ECU/tonne in 1995/6 and had to be reduced gradually to 419 ECU/tonne by 2000/1. However, there is a 'Special Safeguard Clause' that allows the EU to impose an additional tariff if the import price falls below 90% of a so-called trigger price of 531 ECU/tonne.

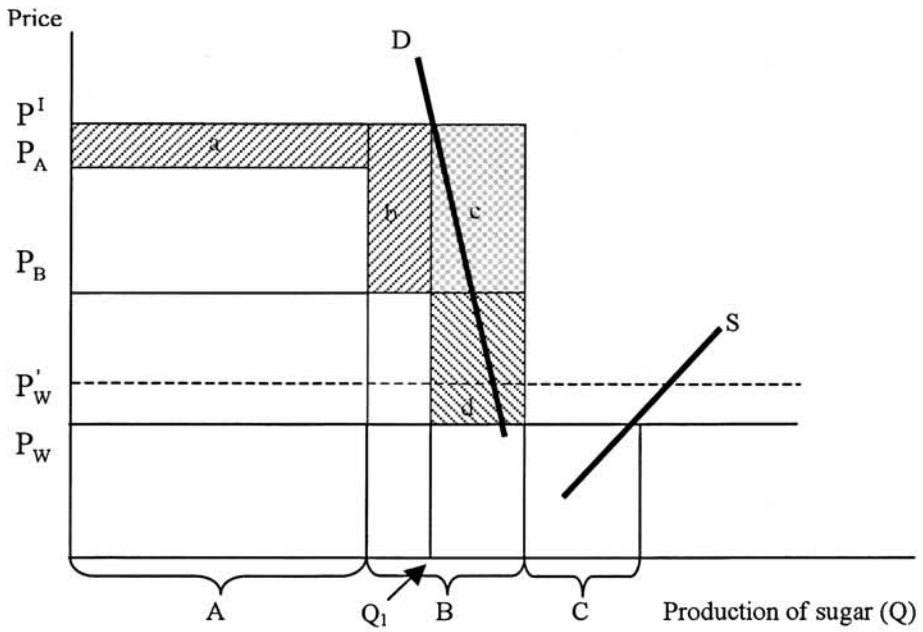
More significantly for the EU, the Uruguay Round Agreement required its policy on export subsidies and volumes to be altered. In 2000/1, the volume of subsidised exports had to be some 21% lower than the base period of 1986/7–1988/9 while the total expenditure on export subsidies had to be 36% lower than the same base period.

Implications of the sugar regime

The principles of the EU sugar market regime are illustrated in Figure 1, with production of sugar divided into *A*- and *B*-quotas and C-production. The production of *A*-sugar is paid the guaranteed price P_A, and the production of *B*-sugar the price P_B, whereas the production of C-sugar is paid the prevailing world market price P_W. The prices of *A*- and B-sugar are linked to the intervention price P^I by charging the production of *A*-sugar a levy of 2% and the production of *B*-sugar a maximum levy of 37.5%.[2] Domestic consumption of sugar in the EU (Q_1) is given by the intersection of the intervention price P^I and the demand curve (D). Excess supplies of *A*- and *B*-sugar ($A + B - Q$) are exported to the world market at the price P_W, the costs of exports (equal to the shaded area $c + d$) being covered by the revenue from levies on *A*- and *B*-production (equal to the shaded area $a + b + c$). The provision of export support through levies on production might be viewed as cross-subsidisation of exports, and incompatible with the regulations of WTO. Certainly the provision for *B*-sugar is subject to reduction commitments according to the WTO agreement.

If the scale of the supported exports in the inter-

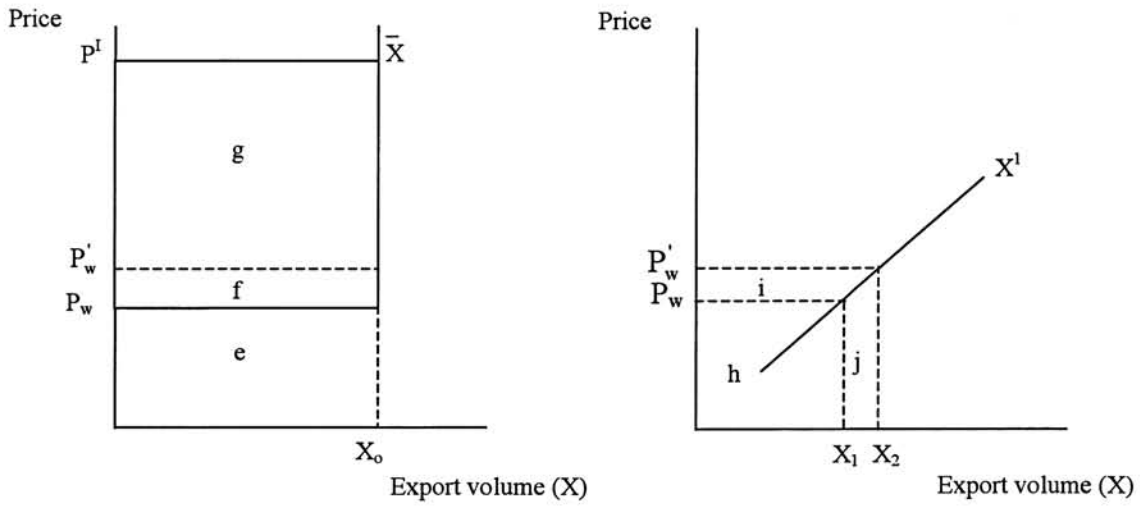
Figure 1. EU sugar scheme



national market is relatively large then one may for some purposes wish to distinguish between the actual world price and a post-reform world price. Reduced exports by the EU, both of those eligible for export port and those not (because of reduced incentives to produce for a protected market), may reduce world supply sufficiently to shift the world price upwards

The implications of the sugar protocol arrange ments for the sugar export earnings of the respectiv ACP countries are illustrated in Figure 2. On th quota set for protocol exports ($P(a)$), the price receive by the ACP exports can be approximated by P^1.

Figure 2. Export revenue and income transfers for sugar protocol countries



The total revenue for an export quota of X_0 is given by the area $(e + f + g)$. When compared with the prevailing world price (P_W), this constitutes an additional income transfer of area $(f + g)$. If the world price is variant with the scale of these EU imports from ACP countries (an equivalent amount of which can be re-exported at world prices by the EU), then this income transfer is a reasonable approximation for valuing the rent accruing to the ACP exporters. In the case of wider reforms of the EU's sugar regime, one might anticipate a rise in the world price of sugar (e.g. to P_W). In which case the total rent transfer associated with the sugar protocol would be better viewed as being equivalent to the area g in Figure 2.

In Part (b) of the figure we recognise that the protocol exporters may generate sugar export earnings from exporting (volume X in Figure 2) beyond their protocol quotas, but at world prices. The export earnings at the prevailing world price are represented by area h. Again, any reforms of the EU regime that raised the world price to would increase export earnings on non-protocol exports to non-EU destinations to $(h + i + j)$. The net effect of EU sugar reforms that reduced the EU import (or intervention) price to P_W would therefore reduce the export earnings of the protocol exporters by $(g - i - j)$.

Impact of current EU sugar regime on sugar protocol countries

The methodology employed is based on Figure 2. We initially base the estimates on the annual average (2001) International Sugar Agreement (ISA) daily price (19.04 US cents/kg) to proxy the world price (P_W) and the average unit value of ACP exports to EU adjusted uniformly for annual (2001) average c.i.f. on London daily price (2.42 US cents/kg) to represent the EU intervention price (P^I).

Table 2. Estimates of current income transfer (2001)

	Value of sugar exports to EU (in US$ million)	Volume of sugar exports to EU (in tonnes)	Total income transfer to ACP exporters[a] (US$ 000, 2001 prices)	Share of total transfer (%)
Barbados	27.2	51,488	16,150.7	3.3
Belize	24.9	47,070	14,798.8	3.0
Congo, Republic of	1.1	2,050	660.1	0.1
Côte d'Ivoire	5.5	10,400	3,268.2	0.7
Fiji	82.1	155,386	48,754.2	9.9
Guyana	102.5	193,945	60,879.4	12.4
Jamaica	78.1	147,720	46,399.3	9.5
Kenya	2	3,789	1,186.9	0.2
Madagascar	8.3	15,731	4,924.1	1.0
Malawi	20.6	39,051	12,219.7	2.5
Mauritius	304.2	575,421	180,714.7	36.9
St Kitts	0	0	0.0	0.0
Suriname	0	0	0.0	0.0
Swaziland	94.9	179,510	56,377.2	11.5
Trinidad & Tobago	24.7	46,699	14,678.4	3.0
Uganda	0	0	0.0	0.0
United Republic of Tanzania	7.5	14,105	4,473.1	0.9
Zambia	8.1	15,395	4,796.2	1.0
Zimbabwe	33.5	63,434	19,887.1	4.1
Total	**825.2**	**1,561,194**	**490,167.8**	**100.0**

[a]Based on unit value of actual imports of ACP exporters to EU, adjusted for c.i.f. Alternative estimates based on the negotiated import price under the sugar protocol were also made.

At this stage (i.e. without reform to the EU regime) it is assumed that the world price of sugar is unaffected by the ACP trade. The results of this decomposition of the value of ACP sugar exports to the EU are reported in Table 2.[3]

The first two columns of Table 2 report on the value and volume of sugar exports to the EU in 2001 of the protocol exporters. Note that we report here on all the quota-owning countries under the Sugar Protocol, some of which (St Kitts, Suriname and Uganda) did not export any sugar to the EU in 2001.

The estimated value of the total income transfer component of the total sugar export earnings (of all the protocol countries in 2001) to the EU is US$490.2 million (2001 prices). This is equivalent to just under 60% of the total value of these countries' sugar exports to the EU.

Mauritius receives the largest share (36.9%), and Mauritius plus Fiji, Guyana, Jamaica and Swaziland receive about 80% of the total transfer. This concentration indicates that any EU sugar reform which lowers the EU import price to the ACP protocol exporters will have very uneven adjustment implications across the countries involved.

The transfer is expressed relative to the current value of total sugar exports and to the EU, and of total exporters in Table 3. Given the uniform treatment of protocol exporters by the EU and that (not surprisingly) all these countries only export to the EU under the protocol provisions, the total transfer constitutes a very uniform share of the value of protocol exporters sugar exports to the EU. For every dollar's worth of sugar exports to the EU, the EU pays about 60 cents over the current world price of raw sugar. Alternatively viewed, each dollar's worth sugar exported to the EU would only generate about 40 cents if sold at the world price. Thus the greater the relative share of sugar exports to the EU in total sugar exports, the more that the ratio in the second column of Table 3 tends towards that in the first column. Thus, Barbados exports sugar only to the EU and the share of the transfer in total sugar exports is the same of it is in sugar exports to the EU (59.4%). Similarly Kenya, Mauritius, Jamaica, Guyana, Tanzania and Trinidad and Tobago export sugar predominantly to the EU only. By contrast, for several of the

Table 3. Current income transfer relative to trade levels

	Transfer as % of the value of:		
	Sugar exports to EU	**Total sugar exports**	**Total exports**
Barbados	59.4	59.4	7.1
Belize	59.4	43.5	8.9
Congo, Rep	60.0	6.7	0.0
Côte d'Ivoire	59.4	24.9	0.1
Fiji	59.4	48.8	8.6
Guyana	59.4	53.6	12.7
Jamaica	59.4	58.1	3.8
Kenya	59.3	59.3	0.1
Madagascar	59.3	51.8	0.5
Malawi	59.3	45.4	3.9
Mauritius	59.4	57.2	11.9
St Kitts	–	–	–
Suriname	–	–	0.0
Swaziland	59.4	35.4	7.0
Trinidad & Tobago	59.4	53.4	0.3
Uganda			0.0
United Republic of Tanzania	59.6	59.6	0.6
Zambia	59.2	15.8	0.6
Zimbabwe	59.4	26.3	1.1
Protocol total	59.4	47.3	2.1

African economies (e.g. Congo, Côte d'Ivoire, Zambia and Zimbabwe), the greater importance of sugar exports to non-EU markets reduces the importance of the transfer relative to total sugar exports.

How important the transfer is in total exports depends upon the size and degree of diversification of a country's exports. For many of the countries the transfer is small relative to total exports. For some, however, it is moderately important (<4% for Jamaica and Malawi), for others rather important (up to nearly 10% for Barbados, Belize, Fiji and Swaziland), and for some it is extremely important (over 10% for Guyana and Mauritius).

In Table 4, we express the total current transfer in per capita terms (total transfer divided by total population) and as a percentage of GDP (total transfer divided by GDP) for each country.

The transfer per capita figures show a very marked variation, depending on the allocation of the transfer across countries and on the size of countries in population terms. For some of the African economies the transfer translates into a negligible per capita transfer. Consider Kenya, Congo (Rep), Côte d'Ivoire, Madagascar, Tanzania and Zambia, for whom the transfer is equivalent to less than a dollar per person. By contrast for some of the small economies the transfer is rather substantial in per capita terms; over fifty dollars per person, for instance, for Swaziland, Fiji, Belize and Guyana. In the case of Mauritius it is equivalent to 150 dollars per Mauritian.

What these absolute amounts of transfer per capita translate into in relative terms depends on average incomes (GDP per head) in each country. We can gauge this from the transfer to GDP values in the second column of Table 4, since this is the same as the transfer per head as a ratio of the GDP per head. Thus, for instance, elimination of the current transfer would be (in accounting terms) lower per capita GDP in Madagascar by 0.1% and in Fiji by 2.9%. In relative terms, therefore, a dollar's worth of transfer implies a larger increase in per capita income the poorer the country. Thus, although the transfer per capita is three times larger in absolute terms for Mauritius than Swaziland. Its elimination would lower GDP per head more in Swaziland (–4.3%) than in Mauritius (–4.0%).

The transfer is most important in relative income terms for Guyana, where the transfer represents 8.7% of GDP. Indeed the particularly sensitive countries might be viewed as all those where the transfer to GDP constitutes more than 1% of GDP; namely Belize, Fiji, Guyana, Mauritius and Swaziland.

Table 4. Current income transfer to relative domestic and per capita income

	Transfer per capita ($)	Transfer as % of GDP
Barbados	60.2	0.6
Belize	59.9	1.9
Congo, Rep	0.2	0.0
Cote d'Ivoire	0.2	0.0
Fiji	59.2	2.9
Guyana	79.4	8.7
Jamaica	17.2	0.6
Kenya	0.0	0.0
Madagascar	0.3	0.1
Malawi	1.2	0.7
Mauritius	150.6	4.0
St Kitts	–	–
Suriname	–	–
Swaziland	51.3	4.3
Trinidad & Tobago	11.3	0.2
United Republic of Tanzania	0.1	0.0
Uganda	–	–
Zambia	0.5	0.1
Zimbabwe	1.6	0.2
Protocol total	3.0	0.6

The impact of EU policy regime on EU and world prices

The impact of an import tariff

Before the Uruguay Round of the GATT was agreed, the EU operated a system of support prices protected by a variable import levy (VIL). The level of the VIL changes with world prices and is simply the difference between the threshold price and the world price. Under this arrangement, the guaranteed internal price in the EU, set by policymakers, is insulated from movements in world prices such that if world prices fall, the VIL will increase and vice versa.

Under the Uruguay Round agreement, the VIL was replaced with a fixed-rate tariff that was to be reduced over a six-year period. By moving to this

system, the EU was no longer able to insulate its domestic price from world price movements and thus it was less able to 'protect' it. Thus, if world prices were to fall, the price at which imports entered the EU would also fall and vice versa. As the tariff is reduced, the relationship between world and EU prices becomes closer until the point where, after complete removal of the tariff, the prices equate. The impact on world markets is to see the level of imports into the EU rise.

The impact of an unit export refund

The use of export subsidies is to provide exporters with a per-unit payment to allow them to sell their exports onto the world market when domestic prices are supported to a level above world prices. If the domestic guaranteed price is fixed then the unit export refund will vary with world prices. As the guaranteed price is reduced then, all other things being equal, the unit export refund is reduced.

By setting a guaranteed price that lies above world price levels, the policymaker will induce greater production of the product. The experience within the EU is that this has moved production of many crops to levels that lie above domestic consumption needs. The excess production then needs to be sold onto the external (world) market, but clearly this can only be done with the use of unit export refunds. There is no impact on the domestic price of this policy, but it does lead to downward pressure on world prices.

Under the Uruguay Round (UR) settlement, the EU has agreed to reduce its volume of subsidised exports as well as its total expenditure on subsidised exports. These goals can be achieved in a number of ways. First, if the guaranteed price is reduced then in effect the incentive to produce is reduced and thus the excess supply is also reduced. In turn this means the volume available for export will decline. The effect on world prices is to see them rise, all other things being equal, as the volume of subsidised supply decreases. In turn, this would imply a reduction in the size of the unit export refund as world prices rise and EU prices fall. In the extreme case of no guaranteed price, the world price and domestic price will equate.

Second, if the export refund is fixed and then reduced, then the volume of exports that can be supported is reduced. Again, this implies that world prices will rise and hence exporters from third countries will benefit.

Evaluation of policy reforms

A number of studies have sought to evaluate the impact of sugar policy reform at a number of levels, varying from single country (or trading bloc) level to global liberalisation of the world market. Clearly, such a task is not simple and the results depend on the assumptions employed, with the result that the impact of similar reforms produce quite different outcomes from a range of models.

Borrell and Pearce (1999) provide a summary of works that examine liberalisation in sugar markets in a number of scenarios. Table 5 replicates some of this information.

Focussing firstly on liberalisation of EU policies alone, there have been several studies which have attempted to measure the impact of reform of both domestic and international aspects of the EU's regime. A report by NEI (2000, p. 37) provides a 'quick and dirty static estimate' of the impact of a 10% reduction in EU production quotas on world prices. Simply by using a correlation between EU stock/consumption ratios and New York spot prices, they suggest a 10% cut in quotas would lead to a 1.5 million tonne reduction in supply (assuming no increase in 'C' sugar). In turn, this supply reduction would lead to an increase in world price of about $15/tonne or 8% of world price.

Frandsen et al. (2001), using a general equilibrium type approach, show how two different scenarios, cutting quotas and cutting intervention prices, can impact on the EU and third countries. The former would lead to a more inefficient distribution of production in the EU and would into impact on production and trade in third countries. If, however, the latter route is chosen and 'B' sugar is eliminated via price reductions, border protection falls by 25% and the EU sees production falling by 19%. The shortfall in supplies is met by exports from third countries, generally non-ACP such as Brazil, and world trade increases by 10% as subsidised EU exports diminish.

The longer term impact of EU policies suggested

Table 5. Summary of the impact of liberalisation on world market prices

Authors	Study base period	Price effect % change	Scenario
Anderson and Tyers (1986)	1987	10%	Liberalisation by East Asia and Western Europe
OECD (1988)	1979–81	1.1%	Reduction in assistance to OECD sugar producers
Webb, Ronigen and Dixit (1987)	1984	53%	Complete trade liberalisation, 12 commodities
Huff and Moreddu (1990)	1982–8	5.25	Multilateral trade liberalisation
Martin et al. (1990)	1980–83	60	Multilateral trade liberalisation
Lord and Barry (1990)	1990	10–30%	Multilateral trade liberalisation
ABARE (1993)	2000 baseline	5.30%	Implementation of UR agreement
USDA (1994)	2000 baseline	2–5%	Implementation of UR agreement
UNCTAD (1995)	2000 baseline	5%	Implementation of UR agreement
Wong, Sturgiss and Borrell (1989)	1985–2004 simulation	8%	OECD price liberalisation
Wong, Sturgiss and Borrell (1989)	1985–2004 simulation	33%	Liberalisation of Japan, EU and US markets

Source: Adapted from Borrell and Pearce (1999), Table 11, p. 18

by Borrell and Duncan (1992) is viewed as reducing world prices by about 17%, which leads to lower annual incomes for Australia and Brazil of $160 million (in 1984 prices).

Borrell and Pearce (1999) use a model of trade behaviour in 24 regions for seven types of sweeteners (the Global Sweetener Model) to compare the outcomes in 2008 of the results of liberalising all markets in 2000 by retaining existing policies. In the case of liberalisation, EU prices fall by 25% while world prices rise by 38%, and EU imports increase by 7 million tonnes.

Borrell and Hubbard (2000) use a simplified version of a G-TAP model to examine the costs of the EU and the impact liberalisation would have, using a simulation-based approach. They suggest that liberalising EU policies completely would lead to an increase in consumption in the EU of 7 million tonnes while exports would be 5 million tonnes lower. In addition, if all OECD countries dismantle their policies, the world price would rise between 30 and 38%, while EU sugar prices would fall by 40%. CEFS (1999) show that a 25% increase in world prices would result from the CAP regime for sugar being removed but that a 50% drop in the EU price would be required to make it equate with the world price.

CIE (2002) extend Borrell and Pearce's (1999) work using the GSM and suggest that doubling import quotas by 2012 will lead to world prices rising by only 3% and EU prices falling by 9.2%. However, export subsidies will need to rise to deal with increased surpluses. Alternatively, halving the intervention price by 2012 will cause EU and world prices to equate, EU prices falling by 49% and world prices rising by 16%. Finally, they examine the effect of halving export subsidies by 2012 and the results show that this would raise world prices by 1% while complete removal raises them by 2%.

Other papers have a more global view of liberalisation. Tyers and Anderson (1986) suggest liberalisation by East Asia and Western Europe would cause world prices to rise by 10% whereas the OECD's evaluation of a 10% reduction in assistance to OECD sugar producers would only lead to a 1% rise in world prices.

Multilateral trade models give different results. Huff and Moreddu (1990) suggest a 25% rise in world prices would result from this form of policy reform, while Martin et al. (1990) suggest a 60% rise. Lord and Barry (1990) are more conservative and suggest multilateral liberalisation would result in a rise of between 10 and 30%.

Simply implementing the Uruguay Round agreements would raise world prices by between 2 and 5% (USDA, 1994), 5% (UNCTAD, 1995) and by 5.3% (ABARE, 1993).

In terms of the ACP countries, the EC (2000) believed that a 25% reduction in the EU sugar price would result in an income loss of 250 million ECU per annum. Borrell and Hubbard (2000) imply such a cut in prices would lead to a loss of 400 million ECU per annum. However, some of this loss would be partly offset by selling more exports on the world market where prices would rise by the aforementioned 30–38%.

Impact of reduction of EU export subsidies on ACP countries

In addition to the possibility of reductions in subsidised exports by the EU resulting from the current case brought at the WTO by Brazil and Australia, there are other potential sources of reform of EU and other OECD countries' sugar policies that may have an impact on world and EU policies. It will be instructive therefore to compare the implications for ACP export earnings of varying intensities of sugar trade policy reforms; marginal reforms that might follow from the current WTO case through to total reforms that fully liberalised OECD (including EU) policies.

Current WTO case

Under the Uruguay Round Agricultural Agreement the EU made commitments relating to sugar on import duties, on the volume of subsidised exports and on the total value of export subsidies. The case brought by Brazil and Australia relates to the volume of subsidised exports. In the year 2000/01 the subsidised quantity had to be 21% lower than in the base period (1986/7–1988/9). These limits do not include either the export of sugar quantities equivalent to the preferential imports from the sugar protocol ACP countries, India, Brazil and Cuba, or sugar exported as food aid. Net of these quantities, the quantity of (directly or explicitly) subsidised exports for the base period (1986/90) was 1,612 ('000 tonnes). As a result, the UR agreement implied a commitment to limit subsidised exports to 1,273.5 ('000 tonnes).

Table 6 shows the three-year average (up to 2000/1) level of exports by the EU; with 2,643 ('000 tonnes) of sugar exported with refund and 3,141 ('000 tonnes) of 'C' sugar exported. If we take 1,700 ('000 tonnes) as being equivalent to the preferential and other exports excluded from the UR commitment and view the UR commitment defining 'subsidised' exports to exclude 'C' sugar, then it is clear that there is no breach of the UR commitment; (2,643–1,700) ('000 tonnes) being less than 1,273.5 UR limit. If, however, we take combined exports of exports with export refunds and 'C' sugar exports as capturing the quantity of subsidised exports, then total 'subsidised' exports net of preferential sugar would be (2,643+3,141–1,700) or 4,084 ('000 tonnes). Reducing this to the UR limit, would require a reduction of 'subsidised' exports of 2810.5 ('000 tonnes) or by 68.8%.

Table 6. Exports to third countries by EU countries (three-year average for 1998/99, 1999/00 and 2000/01) ('000 tonnes)

	Sugar exported with export refund	'C' sugar exports
Denmark	164	126
Germany	332	881
Greece	7	0
Spain	70	139
France	836	1,107
Ireland	8	19
Italy	266	34
Netherlands	51	156
Austria	25	164
Portugal	47	0
Finland	17	3
Sweden	36	50
Belgium	494	135
UK	290	327
EU '15'	2,643	3,141

Source: European Commission

Other wider reforms

The scale of wider reforms is, of necessity, difficult to specify quantitatively, except in the case of full liberalisation. In order to set an approximate limit on the effects of OECD sugar reform we investigate

the impact on ACP export earnings and income transfers of a removal of all import and export distortions by all OECD countries. Our representation (based on an assessment of the evidence reviewed in the previous section) of the price adjustment process imposes a full equalisation of prices ($P^e_w = P^e_{EU}$) at 26.28 (cents/kg). For less extreme reforms we consider two other cases; the possible effects of further multilateral trade negotiations (MTN) and major CAP reform. The nature of the reforms assumed and the associated world and EU price estimates are summarised in Table 7.

These four sets of price (P_w and P_{EU}) combinations are used to re-estimate the change in income transfer to the ACP sugar protocol countries, relative to the present (2001) estimated level identified in Table 2.

Alternative simulated reform effects on sugar protocol exporters

For each policy reform case we derive two sets of estimates, one assuming constant quantities of exports being supplied by each ACP sugar protocol exporter to the EU and non-EU markets and one with quantity adjustments assuming unitary export supply elasticity. The perfectly inelastic values might be thought as representing either shorter term outcomes or ones where there are capacity (e.g. land area) constraints on supply expansion or land or other factor specificities that restrict diversification out of sugar into alternative activities. Certainly in the case of the less ambitious reforms then there may be little incentive to reduce production below protocol quotas, if the return to protocol sugar production remains significantly higher than to non-EU export sugar or to alternative forms of agricultural activity. For these circumstances the perfectly inelastic results may be better focused on. For longer term effects and for large-scale sugar reforms it may be more appropriate to focus on the unitary elastic supply values. A unitary value is chosen for presentational reasons, rather than because there are strong priors or clear indicators from the existing empirical work about the appropriate elasticity to use for each country. Agricultural export supply is often viewed as being relatively inelastic in supply, but it can be expected to more elastic downwards in the long run if production becomes uncompetitive as received prices fall. Note, therefore, for the present exercise that the unit elastic results will understate the fall in income transfer from the EU if export supply is more elastic, while overstating the fall if export supply is less elastic.

The simulations explicitly identifies the change in income transfer to each of the protocol exporters and for these countries as a whole (all in 2001 prices); the fall in the gross income transfer from the EU, and the net effect once allowance is made for the increase in export earnings from any sales to non-EU markets at the raised world price P_w.[4]

Table 7. Summary of sugar trade policy reform simulations

Reform option	Nature of reform simulation represented	Simulated prices (cents/kg)	% change relative to 2001
(A) Current WTO case	Reduction of EU subsidised exports to UR commitment (assuming 'C' sugar is implicitly subsidised)	P_w = 22.28 P_{EU} = 47.12	+17% −7%
(B) (A) + Further MTN reforms	Further reduction of EU export market distortions by 21 percentage points Reduction by EU of import-side distortions by 20 percentage points	P_w = 24.54 P_{EU} = 42.23	−16% +29%
(C) (B) + Major CAP reform	Elimination of EU export subsidies on sugar Further reduction of domestic market distortions by 20 percentage points	P_w = 25.01 P_{EU} = 37.88	+31% −25%
(D) Full OECD liberalisation	Removal of all OECD export subsidies Removal of all OECD protection of domestic production	P_w = 26.28 P_{EU} = 26.28	+38% −52%

The results for simulation A ('Current WTO case') are set out in Table 8. Overall there is a predicted decline in the net income transfer of $16 million if export volumes remain fixed and a decline of $13.4 million if volumes adjust (unit elastic case). This overall net decline is between about 2.7% and 3.3% of the current (2001) transfer. There is, however, marked inter-country variation in the pattern of effects. For all the countries currently receiving an income transfer from the EU there is a decline in the direct or gross transfer, as a result of the imposed fall in the EU import price; this being consistently greater if there is quantity adjustment also (i.e. in the unit elastic case). By contrast there is a rise in income on non-EU sugar exports following the world price rise. Overall, it is not sufficient to offset the direct, gross fall, but for some countries it is. As a result six countries (Congo, Côte d'Ivoire, St Kitts, Swaziland, Zambia and Zimbabwe) are predicted to gain in net income terms (of supplies are fixed), and seven (above, plus Belize) if there are quantity adjustments. By contrast, a few countries more than offset these gains, with Mauritius predicted to experience a net income loss greater than the overall loss (for both elasticity assumptions). Indeed in the unit elastic case the net losses represent about 10% of the current transfer for both Mauritius and Jamaica, about 7.5% and 5% respectively for Guyana and Fiji.

This mixed pattern of country results is driven by two factors. Firstly, any reforms required to satisfy the EU's Uruguay Round Commitments will concentrate relatively narrowly on subsidised exports. It will as a result have greater impact on world than EU import prices. In this simulation of the 'Current WTO case' we assume that the former rises by 17% and the latter only falls by 6%. This is important when we consider the second critical factor, namely the marked inter-country differences in the relative

Table 8. Estimated change in gross and net income transfer to sugar protocol exporters with 'Current WTO case' (US $'000, 2001 prices)

	Change in: (fixed supplies)			Change in: (unitary elastic export supply)		
	Transfer from EU	Non-EU Xs earnings	Net transfer	Transfer from EU	Non-EU Xs earnings	Net transfer
Barbados	-1709	0	-1709	-1822	0	-1822
Belize	-1563	1551	-12	-1666	1815	149
Congo, Rep	-68	1507	1439	-73	1763	1690
Cote d'Ivoire	-345	1296	951	-368	1517	1149
Fiji	-5159	3044	-2114	-5498	3563	-1936
Guyana	-6439	1892	-4547	-6863	2214	-4649
Jamaica	-4904	298	-4606	-5227	349	-4879
Kenya	-126	0	-126	-134	0	-134
Madagascar	-522	203	-320	-557	237	-320
Malawi	-1296	1066	-231	-1382	1247	-135
Mauritius	-19104	1957	-17147	-20361	2290	-18071
St Kitts	0	567	567	0	663	663
Suriname	0	0	0	0	0	0
Swaziland	-5960	10976	5016	-6352	12844	6492
Trinidad & Tobago	-1550	471	-1079	-1652	551	-1101
Uganda	0	0	0	0	0	0
United Republic of Tanzania	-468	0	-468	-499	0	-499
Zambia	-511	3782	3271	-545	4426	3881
Zimbabwe	-2106	7181	5075	-2245	8403	6158
Protocol total	-51832	35790	-16042	-55243	41880	-13363

importance of EU and non-EU sugar trade among the individual ACP protocol exporters. The net gaining countries are those with a relatively high share of non-EU exports; all with over 50% of their total trade with non-EU countries, while the major losers are those with a high share of their sugar trade directed towards the EU.

The qualitative pattern of the results for the first simulation is generally repeated across all the reform cases considered. It is in general the magnitude of the gross and net income transfers that change. Figure 3 summarises the changes in transfers for the 'Current WTO case' and the three wider reforms simulated for the ACP protocol countries combined.[5]

Figure 3 illustrates the progressive increase in the fall in gross and net income transfer through simulation A to D. It also illustrates that the gross loss (or direct loss of income on EU exports) consistently exceeds the net loss (adjusted for increases in non-EU export earnings), and that overall both gross and net income declines are greater where there is allowance for quantity adjustments (with unitary elasticity). Note that the overall, actual (current) income transfer is about $490 million, and therefore for neither assumptions about quantity adjustment is the transfer fully eliminated in net terms.

Given the mixture of net gainers and losers in the simulations, it means that the national shares of the actual current transfer understates how the burden of the losses falls on specific countries. Take the case of Mauritius, with 36.9% of the actual (current) total transfer. It is evident that Mauritius accounts for a larger proportion of the overall net fall (c. 45%). However, the nature of the quantity adjustment assumed makes a significant difference in this case to whether the actual transfer is fully eliminated or not. Mauritius' current transfer is $180.7 million. With fixed supplies it would fall in net terms by $134.6 million and by $199.6 million if export supply is unitary elastic following a total liberalisation of OECD sugar markets.

Alternative perspectives: Effects on non-protocol ACP sugar exporters and importers

Since reforms will affect the world as well as the EU import price of sugar, any reform may affect the imports or exports or both of the non-protocol ACP countries. The clear expectation from the earlier analysis and empirical simulations is that reforms will raise the world price of sugar, and in doing so raise the cost (or opportunity cost) of importing sugar and the earnings from exporting sugar. For illustrative purposes we have taken the current volumes of imports and exports of 39 non-protocol ACP countries, and re-valued this trade at the world prices predicted for the two extreme policy reform cases ('Current WTO case' and 'Full OECD liberalisation'). We are assuming no quantity adjustments, and so may over-state the increase in the import cost and understate the export earnings increase. Subject to this caution, one can take some guidance from Table 9 as to the scale of the effect on non-protocol countries as a whole and to the distribution of the gains and losses across countries. (Section (a) reports the change in export values, Section (b) in import values and Section (c) on the net effect.)

The table shows this group of countries as a whole to be worse off in net terms: –$121 million from full liberalisation and –$54 million from limited liberalisation). Indeed the vast majority of countries would lose in net accounting terms. Although there are several countries whose export earnings will rise, there are only a few that gain in net terms (Dominican Republic, Ethiopia, South Africa and Papua New Guinea). Indeed if export supply is responsive (even if import demand is not very), the number of countries who would be net gainers from liberalisation is likely to increase.

Summary conclusions

Initially we take the world price of sugar as given, and estimate the total income transfer to each sugar protocol exporter arising from the excess in 2001 of the EU import price over the world price. The estimated total value of the income transfer element for all the ACP protocol exporters of the current EU sugar regime is about $490 million in 2001 (at 2001 prices), which is equivalent to nearly 60% of the total value of these countries' sugar exports to the EU.

Mauritius receives the largest share of the transfer (c. 37%), with Mauritius, Fiji, Guyana, Jamaica and Swaziland receiving about 80% of the total transfer.

Figure 3. Summary gross and net income transfer losses for all protocol countries

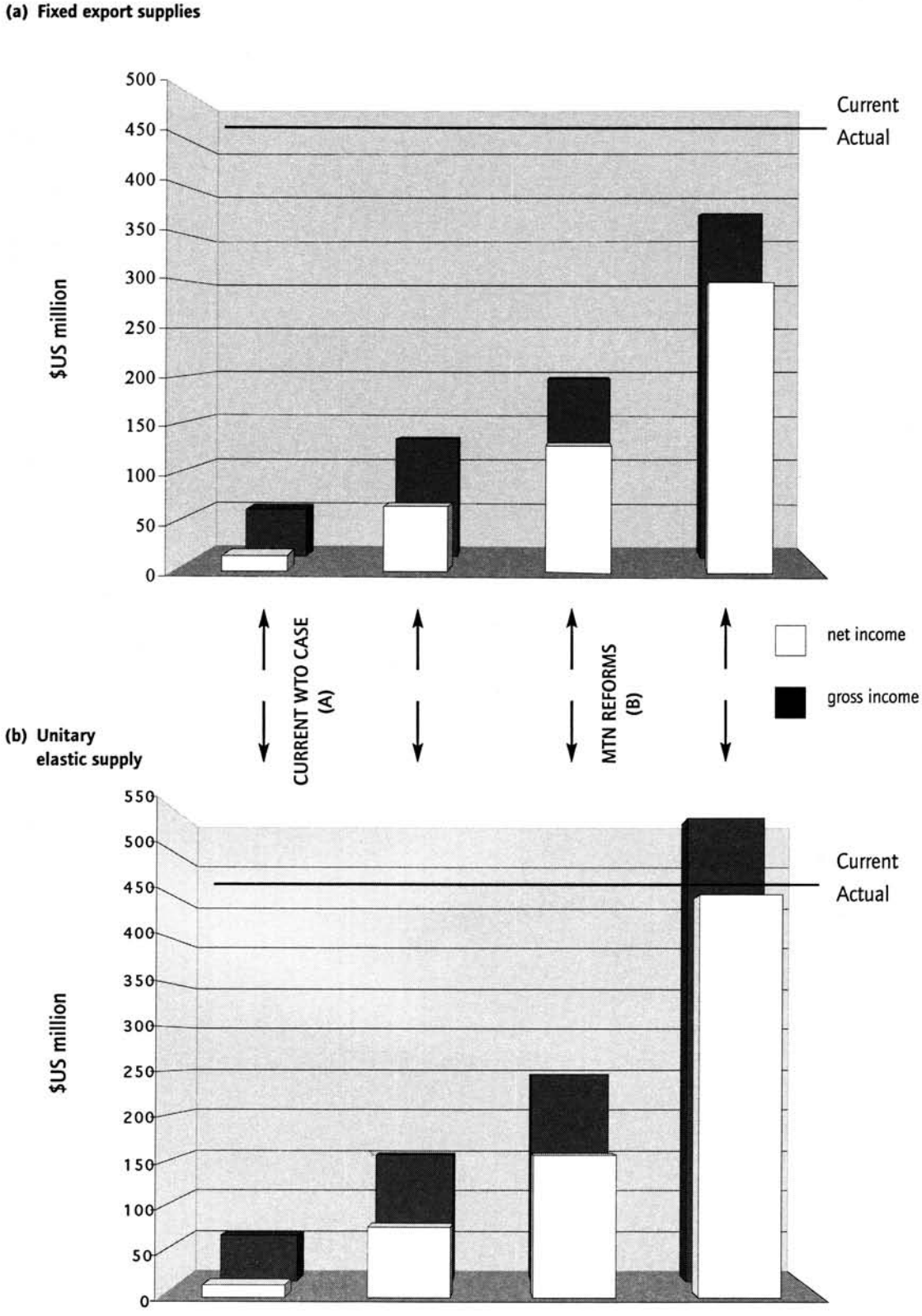


Table 9. Estimated change in value of sugar exports, imports and net trade of non-protocol ACP countries

	(a) Exports		(b) Imports		(c) Net Trade	
	Current WTO case (000 US$)	Full OECD liberalisation (000 US$)	Current WTO case (000 US$)	Full OECD liberalisation (000 US$)	Current WTO case (000 US$)	Full OECD liberalisation (000 US$)
	(assuming fixed quantities)		(assuming fixed quantities)		(assuming fixed quantities)	
Angola	1,134	2,534	5,133	11,470	-3,999	-8,936
Bahamas	0	0	272	609	-272	-609
Dominican Rep.	5,050	11,285	842	1,882	4,208	9,402
Haiti	0	0	5,214	11,652	-5,214	-1,1652
Benin	4	10	632	1,412	-627	-1,402
Botswana	0	0	1,484	3,317	-1,484	-3,317
Burkina Faso	0	0	679	1,516	-678	-1,516
Burundi	0	0	64	143	-64	-143
Cameroon, United Rep.	380	850	1,093	2,443	-713	-1,593
Cape Verde	0	0	1,142	2,552	-1,142	-2,552
Central African Rep	0	0	38	85	-38	-85
Chad	0	0	839	1,875	-839	-1,875
Comoros	0	0	267	597	-267	-597
Djibouti	0	0	414	925	-414	-925
Eritrea	0	0	249	555	-249	-555
Ethiopia	1,620	3,620	1,078	2,410	542	1,210
Gabon	0	0	0	0	0	0
Gambia	2,106	4,706	4,025	8,995	-1,919	-4,289
Ghana	3	7	5,750	12,848	-5,747	-12,841
Guinea	0	0	2,280	5,094	-2,280	-5,094
Guinea Bissau	0	0	99	221	-99	-221
Liberia	0	0	272	608	-272	-608
Mali	1	1	1,517	3,391	-1,517	-3,390
Mauritania	0	0	4,436	9,912	-4,436	-9,912
Mozambique	1,200	2,682	1,752	3,916	-552	-1,233
Namibia	0	0	1,484	3,317	-1,484	-3,317
Niger	0	0	1,369	3,060	-1,369	-3,060
Nigeria	0	0	39,187	87,566	-39,187	-87,566
Rwanda	324	724	648	1,449	-324	-725
Senegal	0	0	2,029	4,534	-2,029	-4,534
Sierra Leone	0	0	434	970	-434	-970
Somalia	2,430	5,430	7,266	16,236	-4,836	-10,806
South Africa	39,399	88,039	5,689	12,713	33,709	75,326
Sudan	1,933	4,319	3,083	6,889	-1,150	-2,570
Togo	0	0	986	2,204	-986	-2,204
Uganda	0	0	1,111	2,482	-1,111	-2,482
Congo, Dem Rep.	0	0	372	830	-372	-830
Papua New Guinea	285	637	26	58	259	580
Western Samoa	0	0	0	0	0	0
Non-protocol total	54,852	122,571	109,169	243,946	-54,317	-121,375

Any reforms of the EU sugar regime that lower the EU import price can be expected therefore to have uneven adjustment implications across the ACP sugar protocol (SP) countries.

Although the current transfer is equivalent to about 60% of the sugar export earnings from EU sales for all the countries, there are marked variations in the importance of the EU sugar market and of sugar trade. As a result the current transfer ranges from being equivalent to about 12% of Mauritius and Guyana's total exports, down to accounting for considerably less than one percent of the value of total exports in several, in particular African, countries.

The current income transfer also makes very different contributions to income and production across the protocol countries. For six countries (Barbados, Belize, Fiji, Guyana, Mauritius and Swaziland) the current transfer is equivalent to over $50 per head of their population. In the case of Mauritius it is equivalent to $150. The significance of these figures in GDP terms depends on the size and average incomes of the economies. It is only for five countries that the total transfer is equivalent to more than 1% of GDP, but for some the percentage is substantial (e.g. Guyana at 8.7% and Mauritius at 4%). It is for these countries that there are corresponding significant production and employment implications arising from the transfer and its removal.

Any reform of the EU sugar regime will tend to lower the EU price and reduce the world price. Taking sensible indicators from the existing literature, we argue that full liberalisation of all OECD sugar markets and trade would raise the world price by 38%. This would in turn imply a 52% reduction in EU import prices, as prices equalised with full liberalisation. We take these values as our basis for representing the effects of alternative degrees of reform on world and EU prices, if reforms we progressively intensified reforms from the current situation. For all of the policy simulations we find that:

- The protocol exporters overall will experience a fall in the net income transfer; the fall increasing as the degree of OECD liberalisation increases (from about $16 million for the partial reform to nearly $300 million for full liberalisation (with fixed quantities or $13 million to c. $450 million (with quantity adjustments)).
- There will be protocol countries that consistently gain and lose in net income transfer terms. The losers (e.g. Barbados, Fiji, Guyana, Jamaica and Mauritius) are those that export sugar only or predominantly to the EU and the gainers (e.g. Congo, Cote d'Ivoire and Zambia) are those with significant exports to non-EU markets. The scale of the individual net losers tends, however, to be considerably larger in absolute terms than the net gainers. For example the largest net gainer from partial reform ('Current WTO case') is Swaziland (+$6.5 million), while the greatest net loss is that experienced by Mauritius (–$18 million).
- The magnitude of both the net gains and net loses from reform tend to increase if allowance is made for the possibility of export-quantity effects.

Besides identifying the importance of the changes in net income transfer relative to the individual countries' trade, income and production levels, this chapter also illustrates that non-protocol ACP countries will be affected by changes in world prices of sugar. The reforms can be expected to raise both the cost of sugar imports and earnings on sugar exports. Again there are also likely to be net gainers and losers from reform in this set of countries.

Reforming the EU sugar regime, whether it is piecemeal change or complete liberalisation, has significant effects on the ACP sugar protocol exporting countries in terms of changes in transfers of income. The extent to which this varies between the countries depends on their reliance on sugar exports for export earnings and also the degree to which they rely on the EU as their main sugar trading partner. Countries relying heavily on sugar exports, and in turn heavily on the EU market, will be highly vulnerable to the negative effects of EU policy reform. These countries will need to diversify their export base away from sugar through policy initiatives of their own and with EU support.

Endnotes

1. In addition to this 'preferential sugar', there are 'special preferential sugar' imports; see above for details.
2. If necessary, a supplementary levy can be applied to cover losses caused by the disposal of Community production in excess in internal consumption.
3. For earlier but comparable estimates of the transfer see MacDonald (1996).
4. It should be noted of course that what is labelled as changes in income transfers might alternatively be interpreted as the changes in sugar export earnings from the EU ('transfer from EU'), in sugar export earnings from non-EU markets ('non-EU Xs earnings'), and in total sugar export earnings ('net transfer').
5. The detailed results for the other cases are available from the authors on request.

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20

EBA-equivalence for non-LDC Sugar Exporters?

Chris Milner

Introduction

The EU's Everything but Arms (EBA) initiative provides preferential access to the EU for least developed countries' (LDCs) agricultural exports. This involves unrestricted duty-free access for most of these products, though in the case of a few sensitive products (including sugar) the liberalisation is to be phased in between 2008 and 2009. EBA offers the agriculture-exporting LDCs the opportunity to increase agricultural production and exports. In the case of those agricultural products, including sugar, that are particularly highly protected, it offers the opportunity to gain a high margin of preference and a large potential income transfer associated with the excess of the EU over the world price (and potentially also in excess of the cost of production in these developing countries). Of course this margin of preference and any associated income transfer will be eroded by the expected reform of the EU's Common Agriculture Policy (CAP) over the coming years, which will reduce EU domestic prices and lower EU tariffs on agricultural products. The recently announced reforms to the EU's sugar regime illustrate this development.

The case of sugar is complicated by the fact that the EU already has a special regime of preferential access for some developing countries (least developed and other) in the ACP (African Caribbean and Pacific) grouping. These Sugar Protocol (SP) countries have both fixed (guaranteed) and additionally negotiated (SPS) quotas for sugar exports to the EU at approximately EU domestic prices. For the LDCs with SP status the EBA clearly offers scope for exporting sugar to the EU beyond their current SP (and additional quotas) on preferential terms similar to their SP sugar exports. But the non-LDC SP countries are currently excluded from this opportunity to increase their sugar exports to the EU beyond their protocol quotas. Of course some may not have the capacity to expand, especially where their protocol quotas are large and account for all or most of their sugar-exporting capacity. But the pattern of protocol quotas has been historically determined and there is not an even distribution across protocol countries, nor is the ratio of the quota to each country's export capacity. In which case some non-LDC protocol countries may have an interest in gaining equivalent treatment for sugar as EBA offers to the LDCs, either to increase their exports to the EU or to offset some of the likely losses from EU sugar reform.

Interest in EBA-equivalent treatment for their sugar exports is not necessarily restricted to the non-LDC membership of the protocol grouping of ACP countries. There are also some non-protocol countries (e.g. Dominican Republic and Papua New Guinea) that have traditionally exported sugar, and there are some that may have the potential to generate an export capacity.

EBA-equivalence may offer these countries scope for expanding sugar exports.

This chapter reports on the findings of a larger study (Milner, 2005) into the nature of EBA-equivalence and its implications for a range of non-LDC sugar exporters.

EBA and Sugar

The full EBA arrangements came into force in March 2001 for an unlimited period, except for three products (bananas, rice and sugar) for which there were phase-in periods to full market access. In the case of the sugar sector full liberalisation of sugar is to be phased in between 2006 and 2009 by gradually reducing the Community Most-Favoured Nation (MFN) tariff to zero; a quota for duty-free access for LDC raw sugar of 74,185 tonnes (white-sugar equivalent) in 2001/2 is to be raised by marketing year 2008/9 to 197,355 tonnes. The provisions of the EU–ACP Sugar Protocol (SP) arrangements are still to remain in place. After the full implementation of the EBA for the sugar sector there will therefore be

two regimes for duty-free access for sugar to the EU: unrestricted access under EBA for all LDCs and quota-constrained access for a mixture of LDCs and non-LDCs under the Sugar Protocol. For non-protocol LDCs therefore there is an unambiguous opportunity to benefit from higher prices and increased export volumes; the extent of the benefits depending on price competitiveness and on the responsiveness of export supply. For protocol LDCs there is also an unambiguous opportunity to gain from EBA. Under SP their duty-free access is quota-constrained, but with EBA they have an opportunity to expand duty-free sugar exports to the EU beyond their SP quotas. (Again the extent of the gains will depend on cost and domestic supply conditions in these countries' sugar sectors.)

For non-LDCs the outcome is more ambiguous. Non-protocol LDCs in general may experience losses to the extent that the sugar trade is diverted away from them towards EBA-receiving LDCs. Such countries clearly have an interest in gaining equivalent treatment to or status as EBA countries (EBA-equivalence). With EBA-equivalence the scope for and extent of gains will depend on the same factors that determine the gains for actual EBA treatment. The non-LDC protocol countries have continued duty-free access, and EBA-equivalence may not offer any additional opportunities if their SP quotas are large and the scope for expanding production and export supply is constrained. Some non-LDC SP countries, whose SP quotas are relatively small and have the capacity to expand their exports to the EU, could however gain from EBA-equivalence.

It is not clear in advance of any negotiations whether specific non-LDCs offered EBA-equivalence for sugar would be included within the global EBA quotas during the transitional period, or whether additional country-specific quotas would apply and for a time period specific to that country. A further complication in the case of non-LDC protocol countries is that any improvement in market access arising out of EBA-equivalence may be offset in part or whole by adjustments to SPS preferential quotas. In assessing market supply needs and SPS quotas the EU is likely to take into account EBA quotas (as well as domestic production and SP and other preferential sugar). SPS quotas may be reduced over the transitional period. This provides non-LDC countries an incentive to seek to offset SPS quota reductions with EBA-equivalent treatment.

Finally, the analysis of the EBA or of EBA-equivalence cannot be separated from the wider EU sugar regime and in turn the impact of the EU regime on world sugar prices. In September 2002 Australia, Brazil and Thailand filed complaints at the WTO concerning the EU's sugar regime. They complained that the volume of the EU's subsidised exports (subsidised explicitly through export refunds or indirectly through the cross-subsidisation provided to intervention sugar) exceeded the levels that the EU had committed itself to under the Uruguay Round Agreement. The WTO subsequently judged the EU sugar policies to be illegal (upholding its judgement in April 2005 following an appeal by the EU). The Appellate Panel of WTO interestingly also viewed the subsidised re-export of an amount equivalent to the imports from the ACP Protocol countries (and from India under a special bilateral agreement) as contributing to the excess of subsidised EU exports. (This ruling of the WTO panel did not, however, affect the right or legality of the EU to import sugar from the ACP and India on preferential terms.)

The need for reform of the EU sugar regime was recognised by the EU prior to the WTO ruling on sugar exports. The rejection of the EU appeal against the WTO ruling has forced the EU to consider deeper reforms. Reforms announced in June 2005 propose a cut in the EU intervention price by 39% over two years starting in 2006, with a reference price of €475 per tonne in marketing year 2007/8 and €385 per tonne for 2008/9. These reforms will clearly lower substantially the benefits of EBA, but will not eliminate them since the EU price will be higher than the world price.

Possible candidates for EBA-equivalence in sugar

Non-protocol candidates for EBA-equivalence

Data on the production of sugar (in raw tonnes), and their gross and net exports in 2001 were reviewed for the ten ACP countries tht are both non-LDCs and non-protocol countries. No data are available for two

of these (Djibouti and Botswana), but neither are expected to have sugar export potential. One country (Ghana) has no recorded production or exports in 2001. Again we can ignore them for the present exercise. Three further countries (Senegal, Nigeria and Gabon) have some sugar production but no exports in 2001. The large negative net exports figures for two of those countries, especially for Nigeria, suggests that export potential looks unlikely. In Gabon's case current production is very small and again the prospect of export potential seems very limited. Finally, in the non-positive net export category is Cameroon. It, however, does have some exports (all incidentally to non-industrial country markets) and a higher level of production than one of the net exporters.

Of the three remaining countries (South Africa, Dominican Republic and Papua New Guinea) South Africa is the dominant existing producer and exporter. We presume however that South Africa's access to the EU market will be governed, in due course, by the EU–South Africa Free Trade Agreement (FTA). That leaves two countries with both positive gross and net exports. In the case of the Dominican Republic all of those exports in 2001 went to USA, while about 80% of Papua New Guinea's exports in 2001 were to the USA. Even if there were preferential terms of access to the USA in both of these cases (as quota suppliers exempt under GSP or the Caribbean Basin Initiative), it does indicate a capacity to export and at terms that may be less favourable than EBA-equivalence.

Protocol candidates for EBA-equivalence

All of the SP countries may be interested in EBA-equivalence in order to offset any loss in SPS quotas. This is particularly so for some of the African SP countries for whom the SPS quota is large relative to the SP quota (e.g. Côte d'Ivoire, Kenya, Malawi, Zambia and Zimbabwe) and for those countries with a sufficiently large absolute SPS quota (e.g. Mauritius, Swaziland). In fact all of these countries may have an interest in EBA equivalence on this criteria, but for some of the countries (e.g. Barbados, St Kitts & Nevis) the SPS is in absolute terms quite small and the scope for offset benefits therefore quite limited in absolute terms.

For the SP non-LDC countries the major source of potential benefit from EBA equivalence lies in the scope to export to the EU beyond their current SP and SPS quotas. Those countries for whom exporting under preferential terms to the EU currently accounts for all or the bulk of their production and export capacity have limited capacity to benefit from EBA equivalence. This group of countries includes Mauritius, Barbados, St Kitts & Nevis, Jamaica and Trinidad.

Of the remaining seven countries, two (Kenya and Cote d'Ivoire) have significant domestic production but no or virtually no non-preferential exporting and they also have net trade deficits on their sugar trade. These are problematic cases. The other five countries (Swaziland, Zimbabwe, Belize, Guyana and Fiji) have from non-negligible to significant shares of non-EU exports in their total exports. These are therefore less problematic cases for viewing as potential beneficiaries from EBA equivalence.

Quantifying the possible implications of EBA equivalence

There are three possible ways in which a candidate country might benefit from EBA equivalence. These are:

(i) the offset or compensation for any loss of exports and income associated with a reduction in SPS quota (the SPS substitution effect);

(ii) the increase in export earnings and income associated with the diverting of current sugar exports from un- or less-preferentially-treated markets to preferential treatment under EBA equivalence (the export diversion effect); and

(iii) any increase in overall exports induced by the availability of preferential treatment under EBA equivalence (the export creation effect).

SPS substitution effect

It is not a requirement of EBA equivalence that existing protocol countries should experience falls in their SPS quotas. It is not unreasonable, however, to expect that with the need to meet WTO obligations with regard to subsidised exports and to fully liberalise exports after 2008 from LDCs under EBA

arrangements that the EU may well be pressured into reducing and feasibly eliminating SPS quotas.

Clearly all of the protocol countries are better off with SPS under current arrangements than with EBA equivalence under proposed or projected EU and world prices. At an EU intervention price of €612 (post-c.i.f. adjustment) then SPS exports are valued at nearly €115 million, generating an excess of export income over and above the world price (or 'income transfer') of €75.6 million overall for the protocol countries. By contrast the EU intervention price indicated for 2008/9 by the EU under recent reform proposals would reduce the total value of SPS exports by about 40% (from €114.9 million to €68.5 million). In turn this reduction in the EU price, combined with the assumed reform-induced rise in world sugar prices, would reduce the total income transfer to protocol countries from €75.6 million to approximately €17.1 million. These reductions vary in absolute terms across the protocol countries as the SPS quota varies (assuming the quota is filled), with Mauritius and Swaziland experiencing particularly large discrepancies in the value of exports and the income transfer under the two regimes. Of course, for some other countries SPS quotas may also be of relative importance. The SPS quota (e.g. Côte d'Ivoire, Kenya, Malawi, Zambia and Zimbabwe) is large for some countries relative to the normal protocol agreed or guaranteed quantities.

The current SPS arrangements may dominate prospective EBA equivalence, but EBA equivalence dominates the complete loss of SPS quotas. Without EBA equivalence and with the loss of SPS quotas there would be a complete loss of the export earnings and income transfer as valued above. Providing that the protocol countries are cost competitive at the reduced EU intervention price (which may not be the case), the protocol countries may offset possible SPS losses (from quota reduction) by negotiating EBA-equivalent access to the EU for sugar. If loss of SPS quota is the appropriate reference point then Table 1 shows in total that up to €17.1 million (about 23%) of the potential income transfer currently earned by SPS exporters can be retained through

Table 1. SPS and EBA-equivalence compared

		Value of exports (in '000 Ecu)		Value of income transfer[3] (in '000 Ecu)	
Country	**SPS quota (tonnes)**	***with SPS* at current EU price[1]**	***with EBA-equivalence* at proposed EU price[2]**	***with SPS* at current EU price**	***with EBA* equivalence at proposed EU price**
Barbados	2841.2	1738.8	1037.0	1145.0	258.5
Belize	4985.2	3050.9	1819.6	2009.0	453.7
Congo	2519.2	1541.8	919.5	1015.2	229.2
Cote d'Ivoire	10000	6120.0	3650.0	4030.0	910.0
Fiji	19181.8	11739.3	7001.4	7730.3	1745.5
Guyana	19931.7	12198.2	7275.1	8032.5	1813.8
Jamaica	15926.8	9747.2	5813.3	6418.5	1449.3
Kenya	11023.4	6746.3	4023.5	4442.4	1003.1
Mauritius	41980.1	25691.8	15322.7	16918.0	3820.2
St Kitts & Nevis	1831.3	1120.8	668.4	738.0	166.6
Swaziland	30000.0	18360.0	10950.0	12090.0	2730.0
Trinidad	2485.9	1521.4	907.4	1001.8	226.2
Zimbabwe	25000.0	15300.0	9125.0	10075.0	2275.0
(Total)	187706.6	114876.4	68512.9	75645.8	17081.3

[1]Current EU intervention price (€632) reduced for cif of €20 per tonne to approximate EU border or tariff-inclusive price
[2]Proposed EU intervention price for 2008/9 (€385) reduced for cif as above
[3]Excess of EU price over world price (current set at €209 and projected at €274) multiplied by the SPS quota

EBA equivalence. (We record a lower limit for the SPS substitution effect as zero for all countries either because SPS quotas may not be reduced or because if quotas are eliminated a country may not be cost competitive at the reduced post-reform EU price.)

Export diversion effect

EBA equivalence may provide an incentive to divert exports from non- or less preferential markets to the preferential EU market, if the EU intervention (or tariff-inclusive) price under EBA terms is greater than the price received in non-EU markets. For those countries we value their current exports of sugar to non-EU markets at the proposed 2008/9 EU import price, where either all of these exports are diverted or where only those exports not to the USA are diverted. We report the corresponding minimum and maximum income transfers associated with these indicators of potential export diversion in Table 2.

In volume terms the large non-EU exporters are Swaziland, Zimbabwe and Dominican Republic, and it is these countries that are potentially large gainers from export diversion. In the case of the Dominican Republic (Cameroon) all non-EU exports are (may be) to the USA, and the scope for gains and incentive for diverting to the EU market may be very limited (with similar preferential terms in both the USA and EU under EBA equivalence). All countries with some exports to other than the EU and USA would have a potential incentive to switch exports towards the EU under EBA equivalence. Even for the lower estimates the income transfer involved is estimated to range from €0.1 million (Papua New Guinea) to €14.5 million (Swaziland), with the protocol countries accounting for the bulk of the total income transfer (€27.6 million).

Table 2. Trade Diversion Potential Effects of EBA-equivalence

	Estimated[1] white sugar equivalent volume of		Value of 'diverted' exports at proposed EU price[2]		Potential value of income transfer[3]	
	Non-EU sugar exports (2001)	Non-EU sugar sugar exports excluding USA (2001)	Non-EU sugar exports (2001)	Non-EU sugar exports excluding USA (2001)	Non-EU sugar exports (2001)	Non-EU sugar exports excluding USA (2001)
	(a)	(b)	(c)	(d)	(e)	(f)
	(in tonnes)		(in '000 €)		(in '000 €)	
(a) Protocol countries						
Belize	46,991	6,579	17151.72	2401.34	4276.18	598.69
Côte d'Ivoire	39,819	(?)	14533.94	(?)	3623.53	(?)
Fiji	34,111	26,531	12450.52	9683.82	3104.10	2414.32
Guyana	54,957	42,467	20059.31	15500.46	5001.09	3864.50
Swaziland	170,149	159,732	62104.39	58302.18	15483.56	14535.61
Zimbabwe	162,146	141,878	59183.29	51785.47	14755.29	12910.9
Total			(185483.1)	(137673.3)	(46243.74)	(34324.02)
(b) Non-protocol countries						
Cameroon	10,329	10,329	3770.09	3770.09	733.4	733.4
Dominican Rep.	137,164	0	50064.86	0	12481.92	0
Papua New Guinea	7,745	1,394	2826.93	508.81	704.80	126.85
Total			(56661.87)	(4278.90)	(14126.66)	(1066.79)

[1]See Appendix 1

[2]Proposed EU intervention price for 2008/9 (€385) reduced by Ecu 20 per tonne to approximate EU border or tariff-inclusive price multiplied by estimated volumes of potential trade diverted by EBA-equivalence.

[3]Excess of EU price over world price (projected at Ecu 274) multiplied by estimated volumes of potential trade diverted by EBA-equivalence

Export creation effect

If EBA equivalence offers higher export prices for marginal production, and in particular in excess of production cost, then countries have an incentive to increase export supply. We investigate the possible effects (again for those countries already exporting to other than the EU, and who may therefore have some existing capacity to export at less preferential terms than EBA equivalence) given positive export supply elasticity. We conduct an analysis using a (relatively low) supply elasticity (0.3), to predict the export volume, value (at the proposed 2008/9 EU price), and income-transfer impacts of the sugar export price being increased from the predicted world price to the proposed EU price (25.1%). We report here on taking total non-EU exports as the base for the calculation. One might view this as providing an upper estimate of the quantity and value of export expansion and of the income transfer associated with EBA equivalence. We therefore also report a lower estimate of zero for all countries, either because there is no current non-preferential exporting currently or because production costs may exceed the proposed EU price.

The cross-country pattern of results in Table 3 is very similar to those for the export diversion effect in the previous section. The large, existing non-EU exporters (Swaziland, Zimbabwe and Dominican Republic) may be able to generate the largest export volume, value, and income transfer effects for a given export supply elasticity. This effect is, however, consistently relatively small compared to the estimated export diversion effect.

Constraints and other issues

The above discussion identifies the incentive that EBA equivalence may offer to increase export supply. But there may be significant constraints to increasing export capacity and supply, in particular at sufficiently competitive prices to take advantage of EBA-type opportunities. Natural conditions (e.g. land availability, climate factors) as well as organisational and infrastructural factors, may not be conducive to the expansion of sugar production and exports, especially in the face of growing domestic incomes and consumption. In this regard, any assessment of an individual country's likelihood of taking advantage of the type of export opportunities suggested by Table 3 needs to be set against an evaluation of cost competitiveness. Higher cost producers are less likely to be able to achieve export-creation effects towards the upper end of the estimation range. Indeed they may not experience any export creation benefits from EBA equivalence.

Overall effect

The range of combined effects is recorded in the final column of Table 4. For only six countries is the lower limit positive (and only marginally so for two of these, namely Papua New Guinea and Belize). Of the remaining four countries, it is Swaziland and Zimbabwe that seem to have the strongest interest in EBA equivalence; with the highest minima and maximum income transfers identified. Guyana and Fiji, however, also have an ambiguous interest in EBA equivalence.

Of course there are a number of countries that may feel there is little to lose by seeking EBA equivalence. There are non-negligible positive potential upper-limit income transfers identified for Belize, Côte d'Ivoire, Mauritius and Dominican Republic. Of course for all the protocol countries an important judgement to make relates to whether opting for EBA equivalence would increase the likelihood that the EU would want to reduce SPS quotas.

Again in judging the likelihood of where countries will fall in the range of possible outcomes one needs to consider whether there are cost competitive or other constraints affecting the scope for export diversion or creation.

The present analysis is not well equipped to capture changes in the fundamentals. The analysis of export diversion and creation focused on those countries that have already some non-EU exports, on the grounds that this suggested the possibility of exporting at less than the full preferential terms. But even countries that are currently viewed as high-cost producers and have limited export experience might in a different environment be able to substantially alter performance. Kenya did not even export in 2001 up to the limit permitted by its SPS quota, and had no non-EU exports. However significant liberalisation of the EU sugar market, and fundamental changes in

Table 3. Estimated effects of potential trade expansion impact of EBA-equivalence

	Non EU exports white sugar equivalent		Predicted increase in export volume in response to EBA*			Predicted increase in export volume in response to EBA (excluding USA exports from the base)		
	Total (in tonnes)	Exc. to USA (in tonnes)	if supply elasticity 0.1	0.2	0.3	if supply elasticity 0.1	0.2	0.3
			(in tonnes of white sugar)			(in tonnes of white sugar)		
a) Protocol countries								
Belize	46991.0	6579	1179.5	2358.9	3538.4	165.1	330.3	495.4
Cote d'Ivoire	39819.0	?	999.5	1998.9	2998.4	?	?	?
Fiji	34111.0	26531	856.2	1712.4	2568.6	665.9	1331.9	1997.8
Guyana	54957.0	42467	1379.4	2758.8	4138.3	1065.9	2131.8	3197.8
Swaziland	170149.0	159732	4270.7	8541.5	12812.2	4009.3	8018.5	12027.8
Zimbabwe	162146.0	141878	4069.9	8139.7	12209.6	3561.1	7122.3	10683.4
b) Non-protocol countries								
Cameroon	10329.0	10329	259.3	518.5	777.8	259.3	518.5	777.8
Dominican Rep.	137164.0	0	3442.8	6885.6	10328.4	0.0	0.0	0.0
Papua New Guinea	7745.0	1394	194.4	388.8	583.2	35.0	70.0	105.0

	if supply elasticity	Value of predicted increase in exports at proposed EU price**			Value of predicted increase in exports (excluding USA exports from the base) at proposed EU price**		
		0.1	0.2	0.3	0.1	0.2	0.3
		(in 000 Ecu)			(in 000 Ecu)		
a) Protocol countries							
Belize	430.5	861.0	1291.5	60.3	120.5	180.8	
Cote d'Ivoire	364.8	729.6	1094.4	?	?	?	
Fiji	312.5	625.0	937.5	243.1	486.1	729.2	
Guyana	503.5	1007.0	1510.5	389.1	778.1	1167.2	
Swaziland	1558.8	3117.6	4676.5	1463.4	2926.8	4390.2	
Zimbababwe	1485.5	2971.0	4456.5	1299.8	2599.6	3899.4	
Total	4655.6	9311.3	13966.9	3455.6	6911.2	10366.8	
b) Non-protocol countries							
Cameroon	94.6	189.3	283.9	94.6	189.3	283.9	
Domincan Rep.	1256.6	2513.3	3769.9	0.0	0.0	0.0	
Papua New Guinea	71.0	141.9	212.9	12.8	25.5	38.3	
Total	1422.2	2844.4	4266.6	107.4	214.8	322.2	

Table 3 (continued)

		Value of income transfer associated with above increase in exports with EBA-equivalence (in 000 Ecu)			Value of income transfer associated with above increase in exports with EBA-equivalence (in 000 Ecu)	
a) Protocol countries						
Belize	107.3	214.7	322.0	15.0	30.1	45.1
Côte d'Ivoire	91.0	181.9	272.9	?	?	?
Fiji	77.9	155.8	233.7	60.6	121.2	181.8
Guyana	125.5	251.1	376.6	97.0	194.0	291.0
Swaziland	388.6	777.3	1165.9	364.8	729.7	1094.5
Zimbabwe	370.4	740.7	1111.1	324.1	648.1	972.2
Total	1160.7	2321.4	3482.2	861.5	1723.1	2584.6
b) Non-protocol countries						
Cameroon	23.6	47.2	70.8	23.6	47.2	70.8
Domincan Rep.	313.3	626.6	939.9	0.0	0.0	0.0
Papua New Guinea	17.7	35.4	53.1	3.2	6.4	9.6
Total	354.6	709.2	1063.7	26.8	53.6	80.3

*proportionate price increase used to estimate the potential supply effect is increase in proposed 2008/9 EU price (adjusted for cif) over above projected world price i.e. (365–274)/274 = 0.251

**Proposed EU intervention price for 2008/9 adjusted for cif

Table 4. Summary of incidence and possible magnitude of EBA-equivalence effects

	SPS Substitution Effect		Export Diversion Effect		Export Creation Effect		Total Effect
	Incidence of Effect[1]	Min→Max Income Transfer[2] (mill €)	Incidence of Effect	Min→Max Income Transfer[1] (mill €)	Incidence of Effect	Min→Max Income Transfer[1] (mill €)	Min→Max Income Transfer[1] (mill €)
a) Protocol countries							
Barbados	✓	0→0.26	×	×	0→0.26		
Belize	✓	0→0.45	✓	0.60→4.28	✓	0→0.32	0.60→5.03
Congo	✓	0→0.23	×		x		0→0.23
Côte d'Ivoire	✓	0→0.91	✓?	0→3.62	✓	0→0.27	0→4.80
Fiji	✓	0→1.74	✓	2.41→3.10	✓	0→0.23	2.41→5.07
Guyana	✓	0→1.81	✓	3.86→5.00	✓	0→0.38	3.86→7.19
Jamaica	✓	0→1.45	×		×		0→1.45
Kenya	✓	0→1.00	×		×		0→1.00
Mauritius	✓	0→3.82	×		×		0→3.82
St Kitts & Nevis	✓	0→0.17	×		×		0→0.17
Swaziland	✓	0→2.73	✓	14.54→15.48	✓	0→1.17	14.54→19.38
Trinidad	✓	0→0.23	×		×		0→0.23
Zimbabwe	✓	0→2.28	✓	12.91→14.76	✓	0→1.11	12.91→18.15
b) Non-protocol countries							
Cameroon	×		✓	0.93	✓	0→0.07	0.93→1.00
Dominican Rep.	×		✓	0→12.48	✓	0→0.94	0→13.42
Papua New Guinea	×		✓	0.12→0.70	✓	0→0.05	0.12→0.75

[1]✓ indicates presence and x absence of effect

[2]Annual amount at projected EU and world prices (expressed at current prices)

economic policy and other conditions within Kenya, may alter patterns of comparative advantage and international specialisation that cannot be captured by the methodology used here.

Conclusions and policy implications

A number of clear conclusions come out of the analytical and empirical analysis, namely that:

1. With the reform of the EU sugar sector and the lowering of the intervention price (and the likely, corresponding rise in world prices) the benefits arising from preferential access to the EU will be eroded. EBA should not impose quantity constraints on access (beyond the transitional period or unless safeguard measures are used), in which case a low-cost producer may see EBA equivalence as offering benefits arising as much from improved access (as from the tariff preference). Some tariff preference would remain from EBA equivalence, however, as long as the EU price is in excess of the world price (i.e. the MFN tariff on sugar is positive).

2. The scope for benefiting from EBA equivalence differs between protocol and non-protocol countries, and between higher and lower cost producers. In the case of the protocol countries there may be an added incentive to acquire EBA equivalent status in order to compensate for the likely reductions (with a reforming EU sugar market) in SPS quotas. The importance of this motive will be affected also by the (historically determined) distribution of SPS and SP quotas across the protocol countries. For those countries with larger SPS quotas the SPS-substitution motive will be a particularly important consideration. Those countries with large SP quotas relative to their capacity have a more limited interest in EBA equivalence since EBA offers no improvement in the margin of preference.

3. Both protocol and non-protocol countries (non-LDCs) may have an incentive to seek EBA-equivalent treatment because it allows them to increase their exports and/or to switch their exports from export markets where their exports are less preferentially treated to the EU. The latter effect is only possible if there is currently exporting to non-EU markets, and on less favourable terms. Although export expansion may be possible for any country whether or not they export currently, it can be more credibly anticipated where there is current exporting at world prices or at prices no higher than is to be expected with EBA equivalence.

4. The countries that appear to be unambiguously the potential large winners from EBA equivalence are Swaziland and Zimbabwe, largely because of the opportunity to divert exports from less preferentially treated markets. Fiji and Guyana have similar incentives for pursuing EBA equivalence, though the scope for export diversion is substantially smaller.

Of the non-protocol candidates, Cameroon, Dominican Republic and Papua New Guinea look unlikely to be substantial gainers for EBA equivalence. They have limited current exporting to non-preferential markets, and the post-reform EU price is unlikely to provide a strong incentive for export growth.

Transitional and other policy issues

The present estimates of the effects of EBA equivalence relate to the proposed EU sugar prices of 2008/9. The price before then will be higher, with correspondingly larger export values and income transfers associated with each of the effects (SPS substitution, export diversion and export creation) than indicated above. In this regard EBA-equivalence might be viewed as offering support for countries' own transitions towards reduced sugar production and export dependence, and of providing some offset (for the protocol countries) for anticipated reduction in SPS quotas. Indeed this offset will be sustained while EBA preference exists. Given EU enlargement and EBA supply, it is reasonable to expect SPS quota reductions to kick in quickly.

Of course the benefit claimed above for SPS substitution may be illusory. Access under EBA equivalence may in fact be constrained by the use of safeguard measures. Indeed negotiating for EBA equivalence by protocol countries may increase the incentive for the EU to reduce SPS quotas (and/or for widening the pool of countries that are offered

SPS quotas to include LDCs with quotas under the transitional arrangements for EBA sugar). In this regard there would need to be considerable care exercised by protocol countries so that EBA equivalence was negotiated to protect SPS quotas and status as much as possible. Similarly LDCs with interest in EBA sugar will be anxious that EBA equivalence does not reduce the quotas available to them in the transitional period. Additional transitional quotas for the EBA-equivalent countries would be attractive, but may be difficult to negotiate in the face of internal resistance to the current EU sugar liberalisation.

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Financing Diversification in ACP Sugar-Exporting Countries

Edwin Laurent

Introduction

The export of cane sugar to the European Union by several ACP countries has been facilitated by special guaranteed arrangements enshrined in the Sugar Protocol. The secure earnings from this trade contribute to the stability of rural incomes, and in several of the countries sugar exports are the foundation for national economic growth and development. However, threats to the regulatory basis on which this trade operates are emerging that could jeopardise the income and employment provided by the industry. In order to safeguard living standards as well as growth and development prospects, in the event of a decline in the industry, economic adjustment entailing the introduction of replacement income and employment-generating activities will be essential.

This chapter examines the likely threats in the EU to the current marketing system for ACP sugar and their impact, and makes recommendations based on the lessons of the recent experience of EU financial assistance to ACP banana exporters, notably the Windward Islands,[1] for providing external support for economic diversification.

The Sugar Protocol

The Sugar Protocol, originally signed on 28 February, 1975, committed the European Community (EC) 'for an indefinite period to purchase and import, at guaranteed prices, specific quantities of cane sugar, raw and white which originate in the ACP States and which these States undertake to deliver to it'.[2] This arrangement has boosted the development of the sugar industry in ACP states and provided the beneficiary countries with guaranteed market access at predictable and stable prices, which for several years have been significantly in excess of world market prices. The latter have, in general, been too low to cover costs of production and offer a remunerative return to ACP producers. Between 1990–2001, average EU prices were 61.14 US cents/kg as opposed to 22.20 US cents/kg on the world market.[3]

The key elements of the Sugar Protocol are the guaranteed purchases of a fixed quantity of sugar (1.3 million tonnes from ACP and India) at the annually 'negotiated' price, whose level is to be *'within the price range obtaining in the community taking into account all relevant economic factors'*. The preferential arrangements for the ACP and India are part of a broader structure, the Common Market Organisation (CMO) for sugar in the EU. This system also encompasses a production quota scheme, guaranteed price and intervention mechanism, export refund programme, and production levies operating within a unified and interlinked structure. If for whatever reason changes in the character or operation of the Sugar Protocol result in significant price declines, exporting countries will be obliged to reduce costs of production, find new sources of replacement income or both.

Threats to the Protocol

Whilst the legal integrity of the Protocol has not been challenged, its ability to continue to provide prices that are sufficiently remunerative is under threat since it is part of the EU's CMO, whose reform is being forced by both internal and external pressures, the latter coming principally from the mandate set out in paragraph 13 of the WTO Doha Ministerial Declaration of 14 November, 2001.

Negotiations had already been launched in the WTO since 2000 under Article 20 of the Agreement on Agriculture,[4] but were given new impetus when, in the following year, ministers launched the Doha Development Agenda with its ambitious plan for agriculture to *'establish a fair and market-orientated trading system through a programme of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct*

and prevent restrictions and distortions in world agricultural markets'. Based on that objective ministers, in their Declaration, committed to *'Comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out all forms of export subsidies; and substantial reductions in trade distorting domestic support'*.[5]

Even as these negotiations were proceeding, Australia and Brazil on 27 September, 2002 filed a complaint in the WTO alleging that export subsidies in excess of the EC's approved ceilings were being granted and that the provision of the guaranteed intervention price, since it is available only to domestic producers, violates the national treatment provisions of GATT Article III. The complaints were followed by fruitless consultations and eventually a Panel, the 'European Communities – Export subsidies on sugar' was established on 29 August, 2003 by the WTO's Dispute Settlement Body and composed on the 23 December of the same year with Thailand joining in as a complainant. The report of the Panel, which ruled in favour of the complainants, was presented to the Parties in the first week of August 2004. The ruling was appealed, but the Appellate Body found that certain EU sugar exports benefited from cross-subsidisation and that the EU had been exceeding its export subsidy commitments. Reform of the CMO for sugar became even more pressing and was being forced on the EC not only by existing WTO liberalisation obligations and envisaged future commitments to emerge from WTO Agriculture negotiations, but more urgently by the necessity to comply with the mandatory Panel ruling.

Reforming the EU Common Market Organisation for Sugar

Anticipating pressures and obligations to 'liberalise', the EU Commission, in July 2004, announced plans for reform of the CMO. In a communication to the European Parliament on the 14th of the same month, the Commission proposed: *'A significant reduction in two steps of the institutional support price for EU sugar with the abolition of intervention and the introduction of a reference price. This reference price will serve in the establishment of the minimum price of sugar beet producers, the trigger level for private storage, the level of border protection and the guaranteed price under the preferential import mechanism'*. It also noted that: *'In addition, the proposal will provide the basis for initiating a structured dialogue with EU partners in the developing world on the sugar sector, in order to consider the manner in which the EU can best contribute to necessary and inevitable adjustment in sugar production in African, Caribbean and Pacific countries (ACP) and India'*.

As the EU Agriculture and Rural Development Commissioner, Mrs Fischer Boel said to the EU Parliament in June of 2005, *'The need for change is born of forces working both at home and abroad'*. That month her Directorate put out a public document summarising the imperative for reform as being driven by:

- the unacceptability of artificially high prices currently three times those on the world market. The reform would promote *'more market orientation'* while restructuring of the sugar sector takes place. Ultimately market prices will revert to their intended role of being the (undistorted) factor in the allocation of resources and investment decisions;
- the ruling of the WTO's Appellate Body against certain of the practices of the EU's sugar regime; and
- the need to replace the existing sugar regime that is set to expire on the 30 June, 2006. Given EBA commitments and the WTO ruling, continuation of the existing system was rejected as an option.

The Plan will start from 2006. As outlined in the European Commission's June 2005 statement, 'The European Sugar sector – Its importance and future', it will *'Substantially cut back sugar exports and export refunds, abolish intervention, reduce EU production and the informal sugar price and grant a de-coupled payment to sugar beet farmers'*. According to the impact projections of the Commission, support prices will drop by 36% over three years.

The negative economic consequences of such a major fall in prices and hence revenue will be considerable. (There will be no increase in overall volume since the country allocations under the Protocol are fixed.) The Commission has confirmed that it will assist the Protocol countries and India to adapt

to the new market conditions with programmes for improving the competitiveness of the sugar sector, where it is economically viable, and provide support for diversification, when improvements in competitiveness in the sugar sector are not sustainable.

Consequences for the ACP Sugar Protocol members

Table 1 summarises the contribution of the sugar industry to foreign earnings and employment, and illustrates its domination of the economies of most of the ACP supplying states.

The beneficiaries of the Sugar Protocol are all small economies and their heavy dependence on the income from their sugar exports to Europe makes them particularly vulnerable since changes to the system that result in income loss or contraction of the industry can have severe consequences for the entire economy. The Technical Centre for Agricultural and Rural Cooperation based in the Netherlands computed the likely impact on national

Table 1. Contribution of sugar to employment and foreign exchange

		Contribution to foreign earnings		Share of employment	
Country	**Year**	**% of agricultural exports**	**% of total exports**	**% of employment in agriculture**	**% of total employment**
Barbados	2001	100.0%	12.5%	52.6%	1.8%
Belize	2001	22.0%	19.6%	51.2%	14.1%
Fiji	2001	67.4%	23%	12.8%	7.3%
Guyana	2000	65.2%	22.6%	32.2%	9.7%
Jamaica	1999	48.7%	8.0%	16.4%	2.9%
Malawi	2001	11.2%	9.0%	5.5%	1.3%
Mauritius	2001	89.6%	19.5%	80.2%	6.4%
St. Kitts & Nevis	1999	92.3%	21.8%	58.27%	8.45%
Swaziland	2001	34.4%	9.4%	80.9%	8.6%
Trinidad & Tobago	2001	18.2%	0.6%	61.7%	4.8%
Zimbabwe	2000	7.6%	3.3%	7.8%	2.1%

Source: Compiled from *Third Party Submission by the ACP Sugar Industries*, to the WTO Panel, 18 March 2004.

Table 2. Projected loss of earnings

Country	Sugar Protocol quota (tonnes)	Current earnings (€) (€523.70/t)	Earnings after Stage 1 reform (€329.0/t)	Income losses from reform (€)
Belize	40,349	21,130,771	13,274,821	-7,855,950
Congo	10,186	5,334,408	3,351,194	-1,983,214
Ivory Coast	10,186	5,334,408	3,351,194	-1,983,214
Fiji	165,348	86,592,747	54,399,492	-32,193,255
Guyana	159,410	83,483,017	52,445,890	-31,037,127
Jamaica	118,696	62,161,095	39,050,984	-23,110,111
Barbados	50,312	26,348,394	16,552,648	-9,795,746
Madagascar	10,760	5,635,012	3,540,040	-2,094,972
Malawi	20,824	10,905,528	6,851,096	-4,054,432
Mauritius	491,031	257,152,935	161,549,199	-95,603,736
St Kitts & Nevis	15,591	8,165,007	5,129,439	-4,313,432
Swaziland	117,845	61,715,426	38,771,005	-22,944,421
Tanzania	10,186	5,334,408	3,351,194	-1,983,214
Trinidad & Tobago	43,751	22,912,398	14,394,079	-8,518,319
Zimbabwe	30,225	15,828,832	9,944,025	-5,884,807

Source: *Agritrade*, a publication of the Technical Centre for Agricultural and Rural Cooperation (CTA)

earnings for ACP states of the reforms currently envisaged by the Commission. Table 2 summarises the projected loss of earnings.

The economic impact of such massive loss of income will be considerable and will force ACP countries to adapt. Already St Kitts-Nevis has found that it is unable to continue in the circumstances and has abandoned the industry altogether.

Experience of the Banana Protocol

Sugar is not the first ACP export commodity to come under threat, placing at risk external income flows and rendering imperative the need to restructure and diversify in order to safeguard earnings and employment. The first such ACP commodity was bananas. Here the creation of the 1993 European Single Market and the subsequent GATT/WTO disputes prompted a still ongoing process of liberalisation of the banana market. The reforms and changes resulted in lower prices for ACP suppliers and, in some cases, exports have consequently fallen sharply or even disappeared.[6] Consequently, with the creation of the Common Organisation of the Market in Bananas (COM), the EU introduced the Special System of Assistance (SSA) in 1994 through Regulation 2686/94 that provided technical and financial assistance measures and income support for banana producers. The measures were aimed at increasing productivity (including through irrigation and drainage and renewal of plantations), product quality, and marketing and at encouraging diversification. The amount provided under the SSA was €78 million during the entire four-year life of the programme. The Special Framework of Assistance (SFA) established by EC Regulation 856/99 replaced this system in 1999. Under the SFA the income-support component was abandoned. Funds averaging in the region of €45 million per annum have been used for a variety of projects covering field productivity improvements, institutional development and reform of the banana sector, diversification projects, and the provision of social safety nets. In addition to the SSA and SFA, the ACP were, in certain circumstances, also eligible for compensation for loss of earnings under the Scheme for the Stabilisation of Export Earnings (STABEX) and more recently through the replacement mechanism for Financing Short-term Fluctuations in Export Earnings (FLEX).

A study by external consultants[7] to evaluate the efficiency, effectiveness, impact and viability of the arrangements concluded that the assistance had covered a broad range of initiatives and that its greatest impact on competitiveness had been where it involved improving productivity in the field. The study recommended that priority in future should, however, be given to diversification. The Commission clearly took steps to implement this recommendation. Whilst diversification projects had accounted for 12% of SFA funds in 1999, by 2002 they were using up to 64% of the total. During the four years 1999 to 2002, out of a total of €176.18 million, the bulk of the funds, €118.33 million, nonetheless went into projects aimed at boosting productivity. Diversification projects were principally in the Windward Islands, with Dominica accounting for €14.84 million, Saint Lucia €24.9 million, and Saint Vincent €6.10 million. Elsewhere, the only other major allocations to diversification projects were in Somalia (€3.4 million) and Jamaica (€3.3 million). Actions to promote diversification were, however, usually confined to the agricultural and rural development sectors.[8]

Was the support effective?

The Windward Islands,[9] which received a substantial portion of the total assistance, are the least-diversified of the ACP suppliers, and despite the assistance provided have not made considerable progress in diversification.[10] In a 2003 Evaluation of the SFA, the UK-based consultancy firm, Landell Mills Ltd, highlighted various shortcomings, including unclear objectives. This permitted considerable influence of individual decision-makers who were sometimes hampered by unrealistic expectations and an ill-defined approach to diversification.

The banana-dependent Windward Islands have several ongoing diversification projects in place supported by external funding since the early 1990s. By the end of the decade there was much greater enthusiasm and commitment but nonetheless the pace of actually getting the projects operational has been slow. This would have been due to a number of factors but it should be appreciated that it is only a few years since the serious acceptance of diversification

as a policy imperative. Given that diversification in single-commodity exporting countries is a long-term process, it is probably too soon to expect dramatic results in the Windward Islands. However there might have been scope for more result-oriented management of the process particularly assisting and encouraging investment in new areas of productive activity and ensuring the transmission of clearer market signals to entrepreneurs.

Applying the lessons

The experience of banana suppliers, particularly in the Windward Islands, in mobilising and applying EU funding for diversification provides a useful foundation, not for replicating but for learning from the experience so as to avoid pitfalls and errors and building on those lessons. Maybe the most important lesson is the need for a genuine commitment in the country to economic diversification. This might seem superfluous but unless such commitment is present there will not be the consistency and adequacy of institutional support and facilitation needed for what will invariably be a particularly challenging enterprise. It must be appreciated that fundamental economic restructuring is required, not simply the selection and introduction of a replacement crop or single productive activity. The search has to be for multiple new areas of productive activity in which the country has or can realistically expect to develop a comparative advantage. Such identification and development of new industries does not readily lend itself to management within an annual project cycle. Rather long-term vision and programming are essential, which must be realised within a consistent policy framework. Indeed the Commission itself recognised this as essential and in its report to the European Parliament on the 23 December, 2002 undertook to explore the possibility of devising multi-year action plans. This is a step in the right direction but the plan period needs to be long enough so as to be consistent with the requirements of the diversification process.

It was only recently that the focus of EU financial support for banana suppliers has been moving towards diversification, and even so this has been principally in the Windward Islands. Elsewhere projects to boost banana production and productivity have dominated. In the case of sugar, diversification needs to be clearly identified from the outset as a priority for funding with the encouragement of private sector investment in new industries in which market signals indicate the existence of long-term international competitive advantage.

The diversification process is an essential component of the economic adjustment that must take place as a result of the envisaged declines in earnings from and employment offered by the sugar industry. To be successful it requires both a conducive institutional and policy framework as well as actual investment in new areas of productive activity.

Impediments

The ACP sugar suppliers are all small developing economies sharing certain economic disadvantages that can have adverse consequences for their ability to rapidly and successfully adapt to market changes. The development of appropriate policies must therefore be informed by familiarity with the economic constraints that these countries face that preclude the successful application of conventional economic remedies.

The impediments that they face include:

- Labour market rigidities. Although there is surplus labour in all of the Protocol states there is inadequate flexibility in the labour force due to a lack of new and appropriate skills.
- Undeveloped capital markets that are not only ineffective in mobilising funds for investment but in general do not make risk capital available for new ventures on reasonable terms, particularly to entrepreneurs who are not yet established.
- Foreign direct investment (FDI) has been a major source of financing investment, particularly in manufacturing and the export service sector of developing countries. However with only two exceptions the ACP sugar exporters have not had notable success in attracting FDI despite a generalised improvement in their investment climate.
- The small size of the domestic market that obliges reliance on exports even in the current context of the decline of trade preferences and the intensification of international competition.

The role of the public sector

The following contributions must be made by the government:

- Provide a predictable, stable and supportive environment for business (both local and foreign).
- Provide institutional support and investment incentives, marketing and support for export, and technology and quality improvement in support of new enterprises.
- Promote the upgrading and adaptation of the labour force and of managers through adequate investment in appropriate technical education and skills training.

At the national level there needs to be clear commitment to diversification and the support of the government for investment in new areas of productive activity to replace or compliment declining income and employment from cane sugar production and exports. A range of programmes will be required which will have to be administered by the public sector, including the training of managers and technicians and the provision of required infrastructure. A key role for governments will be to devise and administer investment incentives and inducements that are coherent with its policy of diversification into new areas in which the countries have already existing or potential advantage. The signals sent to investors in existing and new industries, through incentives, etc., must be rational and clear with no masking of market realities pertaining to international competitiveness. Incentives that promote investment will be essential but where the beneficiaries are in activities with no economic future, they will invariably prove counterproductive. For certain of these activities governments will invariably require donor assistance.

Assisting the investor

The reality in the ACP countries in question is that the private rather than the public sector in general principally undertakes actual investment in new productive activities. Even if the right signals and institutional and other support facilities are available, entrepreneurs, particularly in new or non-traditional activities, often face severe obstacles, the most widespread of which is inadequate access to financing. This manifests itself in three ways:

1. exorbitant cost of capital in terms of interest rates;
2. repayment periods that are too short in relation to the project's income-generation patterns; and
3. excessively stringent collateral requirements.

External grant and concessionary funding can be used in such a manner as to overcome these impediments. The following proposal can provide a means of addressing these difficulties.

A proposal for financing of private sector diversification projects

In view of the following:

- the substantial loss of earnings and employment envisaged due to the changes to the EU's CMO for sugar;
- the high degree of national dependence on the industry in the ACP Protocol Members; and
- the inability of these countries on their own, to generate or mobilise the financing required for the adjustment and diversification process;

substantial external funding will be required to finance the needed investment. The Commission announced that it will provide €40 million to assist ACP Protocol members and has since indicated that there will be a substantial increase to that figure.

In order to ensure that such financial support actually contributes substantially to diversification, the EU and ACP sugar producers should apply the lessons learned from the experience of ACP banana producers in managing SFA and SSA resources. From the outset a strong focus on investment in new productive areas in which market signals indicate an international comparative advantage would be essential. It is proposed that a substantial portion of the financing be made available as risk capital to the private sector for use in new and approved areas of productive activity via a rolling fund to be administered by the banking sector. Investors in new or

expanding manufacturing or agricultural or qualifying service enterprises would be eligible for access to financing.

The following conditions should apply:

- Investment projects and business plans are to undergo and pass rigorous appraisals for viability and sound management according to previously set and approved criteria.
- Reasonable collateral requirements for loans are to be set at a level that provides adequate but fair banking safeguards, but are not so high as to deny suitable investors the opportunity to obtain a loan. The aim here is to ensure that the investor has a genuine stake in the business and is not shielded from risk. In practice, bank personnel are likely to require special training in risk assessment for such 'non-traditional' business enterprises.

In order for actual investment to take place, it will be essential that funds are available to entrepreneurs on reasonable terms that do not preclude access by projects with normal anticipated profitability. Hence:

- the loan repayment periods are to be appropriate for private investment projects, even if this necessitates longer durations than currently available; and
- the rates of interest to apply on qualifying loans should be reasonable and appropriate for such projects even if this could necessitate their being substantially lower than those otherwise prevailing.

It will be necessary for the donors and the governmental authorities to ensure that this facility actually generates the required new investments. They should also ensure that the share (interest and charges) retained by the banking sector is limited to actual costs plus a reasonable margin and that the facility is operated in keeping with applicable WTO rules.

On first sight the provision of access to credit and risk capital on more favourable terms than currently available might conceivably be criticised as interfering with the working of the financial market. However, it should be recalled that a major impediment faced by current and potential investors in productive enterprises in the Windward Islands is that risk capital and credit are in general not available on suitable terms. If, as this paper assumes, the banking policies, terms and conditions in the ACP sugar-exporting states are not substantially more favourable than those in the Windward Islands, then on their own the banking sectors in those countries will not provide the required and adequate financing on acceptable terms for investments in new areas. Therefore, despite institutional and other support, adequate private sector investment in new productive enterprises essential for diversification will not take place. The proposed facility corrects rather than creates distortions in the domestic capital market.

The existence of dual interest rates and lending policies is justifiable since the funds would be provided to the local banks at lower rates and on more favourable terms than those they themselves would otherwise raise commercially. The on-lending at the often excessively high domestically prevailing rates of donor funds, provided on a concessionary basis, would constitute a perverse subsidisation of the financial intermediaries rather than the actual provision of support to investors.

The use of loans rather than grants is recommended since the latter, by shielding entrepreneurs from risk, would weaken the pressures for sound and responsible investment and managerial decisions as well as blurring market signals. These pressures on the investor and clarity of market signals are essential if choices as to areas for investment are in fact to be limited to those in which there is genuine anticipation of comparative advantage.

In the context of the severe economic impediments faced by the small economies dependent on sugar, the achievement of concrete results in diversification requires a pragmatic rather than an ideological approach.

Conclusion

The ACP sugar exporters will need considerable and multi-faceted external financial and other support for the adjustment of their economies as income and employment in the sugar industry declines. An essential component of the adjustment process will be diversification of their economies, but a most serious obstacle is the inadequacy of access to risk capital on affordable terms for entrepreneurs in productive

enterprises. Unless this impediment is overcome, diversification programmes will either fail or make unacceptably slow progress. In addition to the range of public sector and institutional support, priority attention needs to be paid to tackling this deficiency. The proposed risk capital facility is intended to do this. Once it is properly devised and efficiently managed it can address in a practical way one of the principal obstacles to investment in new productive enterprises, the inadequate access to credit and risk capital on affordable terms. With the above-mentioned criteria satisfied, this facility can be self-sustaining with minimal subsequent bureaucratic involvement.

Whilst various donor agencies should be approached for support in the adjustment process, the offer made by the Commission to initiate dialogue with the ACP sugar suppliers and to draw up tailor-made programmes needs to be seized upon so as to ensure that the programmes are consistent with national economic policies and that the scope and terms of support are adequate. Also it is for them to ensure that the funding and support programmes are devised and administered in such a manner that they can have real impact as intended. There is already experience with external support for adaptation and diversification of the banana sector. It would be in the interests of ACP sugar suppliers to learn from that record.

Endnotes

1. Commonwealth of Dominica, Grenada, Saint Lucia and St Vincent & the Grenadines.
2. Protocol 3 of the ACP–EU Partnership Agreement, Cotonou, Benin, 2000
3. C.R. Milner and L.W. Morgan 'The impact of the ACP of the reduction by the EU of import export subsidies on Sugar'.
4. *'Continuation of the Reform Process'* Article 20; WTO Agreement on Agriculture; Marrakesh, 15 April, 1994.
5. Doha Ministerial Declaration, 2001.
6. Major losers have included Cape Verde and Madagascar, which no longer export, and the Windward Islands, Surinam and Jamaica, whose exports declined tremendously.
7. M. Hubbard, A. Herbert and Roumain de la Touche, 'Evaluation of EU assistance to ACP banana producers'.
8. Communication of the Commission and the European Parliament (2002) 763.
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22

Small States in the Banana Dispute and the Lessons to be Learnt from their Experience

Edwin Laurent

Introduction

The high-profile and long-running transatlantic dispute over the European Union's (EU) banana import regime was widely perceived as a straightforward fracas between the EU on the one hand and the US and Latin American exporters on the other. In reality, however, it involved a diverse mix of participants, including some of the world's smallest states, which had a decisive bearing on the evolution of the regime. Among the most determined and active were Caribbean exporters, led by the tiny Windward Islands.[1] This study examines their performance, the implications for them of the outcome of the dispute and the lessons to be learnt – amongst the most intriguing of which is that their size did not automatically preclude small states from actually being more than passive onlookers in the processes of international decision-making that determine their future.

What was the dispute?

The trigger that precipitated the 'banana war' was the approach to the unification of the European Communities' markets from 1 January, 1993. Prior to this, the various member states had operated their own import arrangements for bananas, in some cases applying a variety of tariff and quota restrictions. At one extreme was Germany with no import restrictions and at the other Spain, which effectively reserved its entire domestic market for bananas from the Canary Islands. Between these extremes were the range of import systems operated by the individual member states. France maintained import duty and a virtual ban on bananas from Latin America though it provided import quotas for the bananas from francophone exporters in Africa. The UK permitted virtually unrestricted access for bananas from the African, Caribbean and Pacific group (ACP) with a quota for Latin American bananas. The table below shows the import patterns prior to and since the Single Market.

Table 1. Supplies of bananas to the EU-15, 1990–2002 ('000 tonnes)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
EU DOM	737	699	706	644	585	658	685	811	786	729	782	767	–
ACP	622	596	680	748	727	764	800	693	655	676	756	730	726
of which:													
Carib. ACP*	384	342	384	374	328	340	362	295.4	273	278	288	207	185
Ivory Coast	95	116	144	161	149	160	181	166	158	193	200	218	211
Cameroon	78	115	110	147	158	165	167	157	155	161	205	216	230
Dominican Rep.	4	10	39	62	86	75	61	49	56	42	60	86	97
Dollar	2,363	2,641	2,731	2,560	2,450	2,405	2,470	2,462	2426	2,522	2,543	2,561	2,611
of which													
Colombia	421	518	533	452	511	557	653	569	541	552	617	644	665
Costa Rica	643	608	520	565	727	564	604	603	640	663	656	634	686
Ecuador	381	646	745	651	612	632	686	738	569	697	691	702	829
Panama	649	591	601	569	427	416	311	358	417	422	389	347	307
Total	3,722	3,936	4,117	3,951	3,762	3,827	3,955	3,966	3,867	3,927	4,081	4,059	

Source: European Commission, DG Agriculture. * Traditional suppliers

With consumption growing and already close to 4 million tonnes and average prices well in excess of those on the world market, the EU market was a particularly attractive prize both for exporting nations and marketing companies. The members of both groups therefore were evidently anxious to increase the volume of their banana sales to Europe. But the very cause of the attractive prices, the widespread import regulation, also limited import volumes and the scope for exporters and banana companies to win increased sales. All the major companies and exporting states lobbied in European capitals for whichever post-single-market regulatory arrangement they envisaged would, according to their circumstances, safeguard their existing volumes, prices and profit margins and/or permit their expanded exports.

In the years before the single market, suppliers could roughly be categorised into two interest groups: one that sought to prevent any change to the rules that would reduce their volumes and returns and another that wanted some considerable progress in liberalisation, which would permit the expansion of their sales.

Why was there a problem?

An underlying complication in the EU banana market was the substantial differential in the production and shipping costs of its various suppliers. The large and highly capitalised plantations of Central and South America benefit from favourable climatic and other conditions such as vast expanses of suitable flat land with deep fertile soils and most especially economies of scale in production and shipping. These plantations, which in general enjoy low unit labour and related costs, are able get their bananas to Europe at substantially lower cost than those produced by the ACP or the overseas European producers like the Canary Islands, Martinique and Guadeloupe.

By contrast, production costs in the Windward Islands are high due to a variety of factors including their hilly and difficult terrain, the small size of the severely under-capitalised, family-owned and operated farms (averaging less than 5 acres), unfavourable rainfall patterns and limited availability of arable land, all of which combine to preclude their ability to benefit from economies of scale. This competitive disadvantage is compounded by susceptibility to storms and hurricanes and a wage and social cost structure that are significantly more burdensome than the average for the Latin American plantations.

Table 2 shows the differential costs in 1999 among a sample of producers.

Table 2. Average 1999 fob prices of a sample of suppliers (US$ per tonne)

Ecuador	235
Belize	419
Jamaica	558
Surinam	636
Dominica	547
St. Vincent	500
St. Lucia	498

Sources: *FAO Year Book* and Windwards Islands Banana Development Company (WIBDECO)

It is evident that, being so much cheaper, 'dollar' bananas (as the Latin American bananas are popularly known) would, unless impeded by regulation, quickly be able to supplant European and most ACP bananas on the EU market. To prevent this happening and to permit European bananas and those from the ACP (linked from 1975 by the Lomé Convention to the EC) to be sold, various national tariff and non-tariff barriers were introduced. In order to prevent circumvention of the restrictions through the re-export of 'dollar' bananas from those EC members with liberal import regimes to the more restrictive, derogations from the rules requiring free circulation of goods were invoked for bananas by the UK, France, Spain, Portugal, Italy and Greece. The protective arrangements were enshrined in the Lomé Conventions in which the EC undertook to ensure that none of the 12 traditional ACP suppliers[2] would be placed in a disadvantaged position.

Prelude to battle

The approach of the 1993 Single Market was seen as a threat by the ACP banana suppliers. The derogations permitting their key importers, the UK, France and Italy to block 'dollar' bananas being re-exported from another member state would come to an end and the national regimes were all set to be dismantled and replaced by a unified import regime.

Their fear was that a liberal regime would so dilute their effective preference that they would not be able to compete with bananas from Latin America. On the other hand, producers in these countries and the companies that marketed their fruit, principally Chiquita, Dole, Del Monté and Noboa, were keen for a more liberal regime permitting greater access for 'dollar' bananas.

The first of the battles of the 'banana war' was therefore over the nature of the unified regime. The EC had a bound import duty rate in the GATT of 20%, but given the price differentials it was clear that such a tariff on its own would be insufficient to permit continued access for the ACP. Some European producer interests initially favoured a reference price mechanism[3] or simply a commitment to provide a subsidy that would compensate the producers for any declines in price. The Windward Islands with their overwhelming dependence on banana exports were particularly determined to ensure that any new system would permit the continued marketing of their bananas on a viable basis. They were wary of an arrangement that would rely exclusively on a direct subsidy since, among other things, they were unsure of the required long-term commitment in Europe for such considerable financial support to the ACP. The alluring option of campaigning for the retention of the distinct national regimes was dismissed as impractical in the single market context.

The Caribbean exporters committed themselves quite early to becoming actively involved in the search for a new banana regime. Their aim was to ensure that even with the disappearance of the national regimes, the 1993 European Single Market and its Common Organisation of the Market (COM) would deliver the equivalent security of access and remunerative prices upon which they had hitherto relied.

In the first phase of the banana dispute, the run-up to the Single Market, the main protagonists were Latin American exporters and some of the international companies, particularly Chiquita, that campaigned for a liberalised market in which there would be an end to quantitative import restrictions even if a flat tariff was retained. Such was the confidence in this camp that some gambled heavily on the expectation of being able to export more bananas to Europe. Chiquita bought six custom-built refrigerated banana ships to add to its existing fleet and increased its investment in Latin American plantations. So widespread was the expectation among banana companies that Geest, which had been marketing only Windward Island bananas, bought a plantation in Costa Rica.

Nonetheless, even in the face of such confident and powerful opposition, the Caribbean traditional suppliers were quite determined and insisted to European member states and the Commission that it would not be acceptable to abandon their treaty commitments under the Lomé convention, which had assured them that their exports would not be placed in a worse position than they were currently or had been in the past.[4] Using the indices of economic dependence, they stressed the calamitous economic, social and political consequences of the loss of their banana industry for which there were no short-term alternatives. Their message was clearly and consistently articulated by diplomatic representatives of the Windward Islands but significantly also by senior political figures including their prime ministers who were quite visible and vocal campaigners in Brussels and other European capitals.

The 1st phase of the banana wars

From the outset, the three small islands of Dominica, Saint Lucia and St. Vincent and the Grenadines were at the centre of the coalition that was seeking to ensure that the COM would effectively limit imports of 'dollar bananas' so as to ensure a tight market and high enough prices. The coalition included Caribbean and other ACP suppliers, the Caribbean Banana Exporters Association (CBEA), Geest Plc, Fyffes Plc and eventually the French marketing companies and producer interests in the overseas departments. The coalition's wide-ranging campaign recognised that securing a favourable position in the Council of Ministers would require convincing public opinion and enlisting the support of various groups including the Commission, the EU Parliament, national governments and parliaments, NGOs, church groups and journalists among others. Recognising that EU banana trade policy would not be made in isolation, the 'coalition' targeted important third parties that were exerting pressure on

Europe for liberal reform. Hence, there was a very active campaign in Washington focusing principally on the Congress. As well, direct though limited contact was maintained with Latin American supplying states and the multinational companies themselves in the hope of at least tempering their opposition to a restrictive regime. It was the threat and danger posed to the Windward Islands that provided the moral legitimacy and rationale for the campaign. Its most public aim was to ensure that the EU would honour its obligations to these islands, who given the nature of their production on small family-run farms and their lack of alternatives, would suffer disastrous economic and social consequences should they lose bananas. In addition, they were also to a large extent the 'face' of the campaign. The safeguarding of the banana industry became their top foreign policy objective hence their representatives sought out or even created opportunities to promote and advance their case. Despite the fact that by 1992 the Windward Islands accounted for only 7.6% of the EU banana imports, in the perception of the public (particularly in the UK), a key policy question to be addressed was how the trade in their bananas would be safeguarded.

In the end the COM, enshrined in EC Regulation 404 of 1993, was an attempt to translate the existing national regimes into a unified system. It awarded quotas for Latin American bananas totalling 2.2 million tonnes and each ACP traditional exporter was assigned a maximum tonnage within an autonomous quota for the ACP. There was no price support for the ACP though the European suppliers were subsidised up to pre-determined maximum volumes per region. In an attempt to further unify the market and provide an inducement for traders to handle the more costly ACP and European bananas, a system popularly referred to as the 'B' license system gave them a share of the import licenses for 'dollar' bananas according to the volume of ACP or European bananas that they marketed.

The early challenges

This system was challenged from the outset; five Latin American countries (Colombia, Costa Rica, Guatemala, Nicaragua and Venezuela) initiated a Panel complaint against the quota system in 1993. Following negotiations with the Commission all except Guatemala withdrew their complaint and, the following year, signed the Banana Framework Agreement (BFA) that gave them fixed country quotas and the consequent potentially lucrative power to control their exports to Europe.

The 1994 BFA itself did not end the dispute since it excluded one of the WTO complainants, Guatemala, who could still pursue the dispute. Instead it introduced a new issue of contention, the BFA itself. Then Ecuador, Honduras and Panama – who had previously rejected the quotas offered to them under the BFA – acceded to the GATT and promptly joined Guatemala in their complaint. Protesting their opposition to the BFA's restrictions and ceilings on their exports, they claimed privately that the Commission had not treated them fairly in the allocations. Quite ominously, the international companies saw the BFA as a threat to their operations in Latin America. The awarding of quotas to the exporting countries handed their governments considerable potential power. They could have a real say in the export to Europe since operators wanting bananas could now be subjected to conditions and the prior approval of these countries' authorities. Some of the BFA countries, in particular Colombia, used the arrangement to promote local marketing companies and along with Costa Rica sought to impose export levies.

The ACP was becoming more active in the dispute with a prominent role for the Caribbean as the ambassador of the three Windward Islands began to preside over the ACP Working Group on bananas. ACP participation in the dispute process was organised, a legal consortium was engaged, and a legal defence of the contested provisions prepared. The processes were managed by the ACP Banana Working Group Chairman in full collaboration with national representatives. For the Panel Hearing two of the ACP legal advisers were included on the delegation of Saint Lucia, but they were expelled by the Panel on the grounds that they were not full-time employees of the government. This prompted the leader of the delegation to walk out in protest at what he asserted was an inequitable ruling essentially disempowering small states that cannot afford to retain the required specialists on a permanent basis

and must rely on outside expertise to assist in the presentation of their case before the Panel. Denying them that ability would entrench their disadvantage in disputes as they present and advance their case.

This ruling by the Panel would have been appealed by Saint Lucia and the Caribbean but as Third Parties they could not introduce independent grounds of appeal. Even if the Appellate Body did not explicitly overturn the contentious ruling, by reaffirming the sovereign right of countries to determine the composition of delegations to its meeting, it in effect implied its dissent with the Panel's ruling. As a result, subsequent WTO practice has been that Parties to disputes have been able to engage outside experts. This facility has since been used in many instances by members. Indeed, the WTO Advisory Law Centre was subsequently created in recognition of that capacity gap in developing countries that was so dramatically demonstrated by this incident in 1997.

Resolution of the dispute and subsequent reforms

Following the successful challenge in the WTO to the regime, in an attempt to conform to the rules, the EU introduced a new system on 1 January, 1999[5] that abandoned the 'B' licenses and country-specific quotas for the non-substantial suppliers that were BFA signatories, Nicaragua and Venezuela, and the individual ACP traditional suppliers. From 1999 the latter were assigned a quota of 857,000 tonnes for the group as a whole. The MFN quota remained at 2,553 million tonnes but with shares to the four 'substantial' suppliers, Colombia, Costa Rica, Ecuador and Panama according to their 1994–96 exports and the remaining 9.43% (240,748 tonnes) of the quota reserved for the 'others' category of suppliers. The in-quota tariff rate for MFN suppliers was €75 and a prohibitive €737 for out-of-quota imports. No duty was levied on ACP imports within the group's quota, nor on any that were imported within the 240,748-tonne 'others' category. Additional imports would attract a prohibitive duty of €537 per tonne. The Caribbean and the ACP were not able to overcome the high out-of-quota tariff nor compete within the MFN quota despite getting in duty free, and as a result their exports were virtually limited to the ACP quota. The inability of the ACP to compete even on the basis of duty-free entry demonstrates that effective access is secured not simply by exemption from import duty but rather the adequacy of the preferential margin and the possible existence of other protective mechanisms or structures.

The new system was again challenged, this time by Ecuador, which claimed that the EC had still not complied with the Panel's decisions.

The earlier defeat in the WTO was compounded by the US imposition of US$191 million worth of trade sanctions against the EU, which more than anything else completely changed the attitude of member states. With the dispute costing their exporters, they were determined to end it and directed the Commission accordingly. The latter intensified its negotiations with the United States Trade Representative (USTR) and some headway was made, reaching agreement that the quota system would be retained with licences issued on a historical basis. Very soon however, talks floundered with the main sticking point over the share of licences for newcomers, the EU and Ecuador wanted 20% and the US 3.5%.

To get around the impasse, the Commission begun work on a potentially chaotic 'first come, first served' (FCFS), system for the award of import permits, which would have been disastrous for the Caribbean. But even more damaging to them would have been the alternative single tariff. The US, though, would not accept FCFS, insisting on a historical-based system for the determination of licence eligibility.

The breakthrough

Secret negotiations between the two sides had nonetheless been proceeding simultaneously and in a surprise announcement on 11 April, 2001 the Commission and the US Trade Representative jointly confirmed that an agreement had been reached to end the dispute. Ecuador, the winner of the last Panel, was incensed that a deal was struck without its involvement and threatened to initiate new proceedings in the WTO. To avert this, a new set of discussions with Ecuador were quickly initiated and were formally concluded on Monday 30 April, 2001 with an agreement that left intact most of the US/EU deal but made some minor changes to the proposed implementation.

The agreement

The agreements with the US and Ecuador were reflected in a new set of import rules enshrined in a Commission Regulation adopted on 2 May, 2001 to operate in two phases. The first lasted from 1 July, 2001 to 31 December, 2001, in which the quantitative limitations and tariffs were unchanged. The licensing system was adjusted. The significant feature of the system is that only 'operators' i.e. persons or registered companies or agents who had, during a specified reference period, imported bananas into the EU, are eligible for import licences and hence they determine the source from which bananas are imported.

The US ended its sanctions and along with Ecuador agreed to support the application in the WTO for a waiver for the Cotonou Partnership Agreement. Once 100,000 tonnes were transferred from the ACP quota to the MFN quota and a GATT Article XIII waiver was obtained for the ACP quota (done at Doha 14.11.01) Phase II could begin on 1 January, 2002.

Impact of the changes

The regulatory changes since the early 1990s have had a fundamental impact on shaping the character of the EU banana market, through determining the origins and levels of supply and hence prices. In addition, the requirement that, to be saleable, banana imports must be covered by scarce licences, has generated valuable 'quota rent' that is earned by the licence holder. The extent to which this is shared with other participants along the production/supply chain varies according to the differing circumstances including their relative bargaining strengths.

The changes in regulation, by permitting larger volumes of cheaper 'dollar' banana imports into the UK, caused a decline in prices. Selling prices for Windward bananas fell by 10% from their level at the start of the Single Market whilst 'dollar' banana prices were more or less unchanged. The Windward Island farmers are not only affected by the price drop but even more by the loss of the *de facto* subsidy that they had enjoyed under the 'B' licensing system that ended in 2000.

Simultaneously, with the price decreases, the import patterns were changing not only between the ACP and 'dollar' suppliers but also among ACP suppliers. As shown in the charts below, the traditional Caribbean suppliers were losing out to West Africa and the Dominican Republic whilst Ecuador was expanding as Panama and Honduras went into decline. The subsidised EU producers have been able to maintain their supply levels.

Table 3. Nominal and real retail prices of bananas in the UK 1990–2003

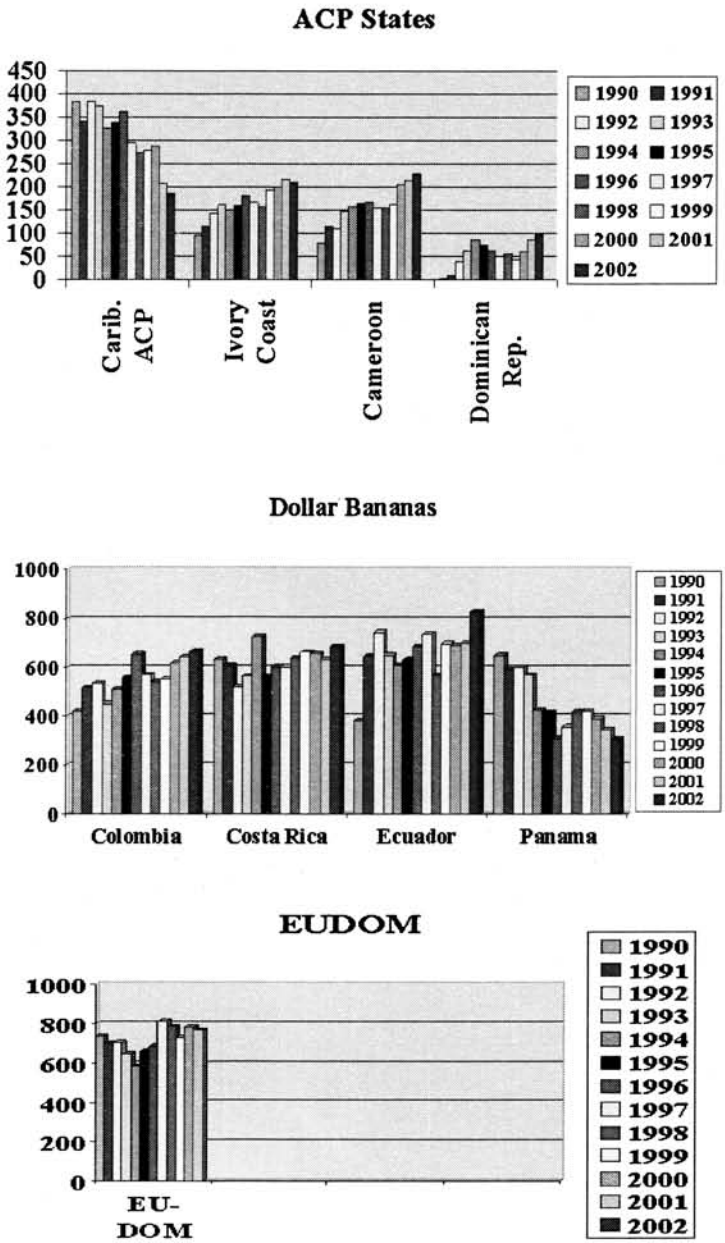
	Retail prices of bananas £/kg	Real prices (1990 = 100)
1990	1.14	100
1991	1.19	98.4
1992	1.06	84.7
1993	0.96	75.4
1994	0.94	72.2
1995	0.80	59.4
1996	0.89	64.5
1997	1.00	70.2
1998	1.04	70.6
1999	1.02	68.2
2000	0.99	64.2
2001	1.08	68.9
2002	1.02	64.1
Jan.–March 2002	1.09	
Jan.–March 2003	0.90	

Source: Fyffes 1992–2003, ONS 1990–91; real prices calculated by NERA[6]

Although the Windward Islands, through their marketing company WIBDECO, controlled sufficient import licences to be able to handle their exports, production was declining sharply. The cause was principally the reduction in the number of farmers and the abandonment of farms. Figure 2 shows the declining number of growers in the Windward Islands, from 24,100 in 1993 to 7,300 in 2001.

The consequences of such a decline on rural employment and income were massive, since there was no sufficient productive activity to fully replace bananas. In his 2002 study of agricultural performance in the Eastern Caribbean, Gary Melville found great official enthusiasm for diversification but overall the production and export performance of non-traditional agriculture was erratic. This he attributed in part to unfavourable climatic conditions including natural disasters, a variety of production problems, and difficulties in meeting the phytosanitary requirements in export markets.[7]

Figure 1. Supplies of bananas to the EU-15, 1990–2002 ('000 tonnes)



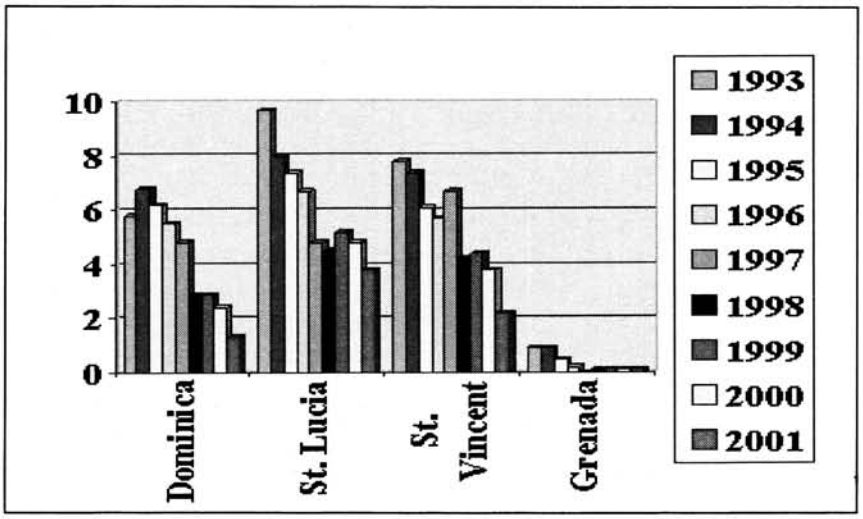
Source: DG Agriculture.

Note: Ivory Coast, Cameroon, and the Caribbean ACP supplier Belize exported above their traditional quotas between 1994–98.

It was not only the loss of direct and indirect employment (at the ports, in transportation, production of packaging materials, etc.) that resulted from the decline in banana production, but also the loss of national income due to declining export earnings from banana exports. Table 4 shows what has been happening in US dollar terms. Given that no account has been taken of inflation, the full impact of the decreases on those countries, which are heavily reliant on banana exports, would be even greater than initially suggested by the figures.

The economic consequences of such a massive loss of earnings by a sector whose income rapidly circulated within the rural and national economies was

Figure 2. Number of active growers in the Windward Islands, 1993–2001 ('000)



Source: WIBDECO

quite catastrophic. In May, the ACP ministerial spokesman Julian Hunte, addressing the 28 ACP–EU Council of Ministers 2003 stated, *'Dominica, one of the most vulnerable suppliers, has been so damaged by the falling prices and resultant export volumes, that its economy is literally on the verge of collapse. It had to have recourse to the IMF but a turnabout would only be possible if the country can again begin to earn sufficient foreign exchange'.*

2004 – Enlargement

In May 2004, 10 new members will accede to the Union and in keeping with its WTO commitments to MFN suppliers and the new member states themselves, the EU increased the 'dollar' quota. This, it was generally agreed, should be related to historical import levels. Writing in *Eurofruit Magazine* of May 2003, Jessica Greniez indicated however that it is not simple to arrive at actual levels of imports and alludes

Table 4. Export values (fob) (US$ million)

Year	Windward Islands					Jamaica	Belize	Surinam
	Dominica	St. Lucia	St. Vincent	Grenada	Total			
1991	32	60	34	4	130	49	7	10
1992	32	72	40	3	147	40	10	10
1993	26	55	25	2	107	36	12	11
1994	24	49	17		92	46	15	11
1995	18	52	25	2	97	46	22	8
1996	18	52	22	1	93	45	29	9
1997	18	37	16	–	71	45	26	24
1998	15	37	22	–	74	36	25	15
1999	15	34	20	–	69	29	27	21
2000	12	28	19	–	59	23	–	–
2001	8	16	13	–	36	–	–	–
2002	–	–	–	–	45	–	–	–

Source: WIBDECO (Windward Islands 1992–2002), *FAO Yearbooks* Vols 47, 50, and 53. Values for Jamaica, Belize and Surinam for 1999 and 2000 are from NERA.

to the *'incoherence of certain customs data supplied by the candidate countries'*. One cause of difficulty was that a sizeable portion of these countries' banana imports had actually been re-exported from the EU, hence the danger of double counting. Over-estimation could have destabilised the market because if the quota was set too high, too many licences would be awarded, resulting in excessive imports that would have driven down prices even further. In addition, there could have been the possibility that effective demand for bananas in the 10 new member states would decline once the latter joined the EU, since their banana imports would face an import tariff that would make them more expensive.

How is the Caribbean adapting?

The changes that have been taking place result in lower prices to farmers who face greater competition and uncertainty. The islands are therefore forced by circumstances to adapt. At the domestic level serious efforts are being made to secure the structural adjustment of the industry. Attempts to increase productivity rely on investment in irrigation, feeder roads and improved farming practices and standards. In the Windward Islands, the management of the industry has been privatized and opened up to competition. Previously, national growers' associations controlled the bulk purchase and distribution to farmers of certain inputs and managed banana collection and export. The aim of all of these measures has been to promote efficiency and to lower costs.

In a situation of declining real prices, it is perceived as essential that farmer's share of the final price is not further reduced. The Windward Islands and Jamaica had been involved in the actual import and marketing of their bananas in Europe. Their marketing companies, though, are under pressure to continue to cut costs and to maximise returns. The Windward Islands have been introducing specific measures to safeguard their position in a weakening market. Firstly, they have been developing contractual arrangements with supermarkets that permit their bananas to be sent from the ripening rooms straight to the supermarkets, in some cases the bananas are actually pre-packed on the farms in the islands for the supermarkets. The Windward Islands have also begun producing organic bananas (still at minimal levels) and ensured that more of their banana production qualifies for 'fair trade' certification and bears that label when marketed. The retail prices of organic and 'fair trade' bananas are higher than for the conventional bananas, hence these niche markets offer a more favourable return to the farmers.

Particularly in these islands with their production on small independent family-owned and operated farms, conducive environmental factors and considerations and marketing being in the hands of various farmers' associations, there is considerable potential for further expansion of the use of the 'fair trade' label. Despite the much higher cost and labour required for the production of organic bananas, there seems to be considerable long-term benefit to be gained by the small Caribbean suppliers from committing more resources to expanding their share of this small but growing and lucrative niche market.

Subsequent challenges

There can be little doubt that small developing economies cannot indefinitely defy the logic of the marketplace, since their ability to export is dependant on the policies of other players in the global trading system. In this case the EU and indeed other prospective importers have their own range of commitments for tariff reduction and broader trade liberalisation goals. Therefore the Windward Islands can only continue trade in the long-term if they manage to produce and supply competitively, whether it is bananas or any other products. These islands, with growing populations and facing irreversible declines in employment and income from bananas, must find new sources of productive activity in which they can be internationally competitive. Ultimately this would be the only prospect for these countries in a liberalised environment in which effective preferences have disappeared. But they require time for orderly transition if they are to be able to make the necessary adjustments.

2006 – Abolition of the quota system

The next challenge for Caribbean bananas will come with the proposed dismantling of the tariff rate quota system and its replacement by a flat tariff scheduled for 1 January, 2006.

Given the differences between costs of production in the Windward Islands and the most competitive 'dollar' suppliers, unless the tariff is sufficiently high, the former will not be able to find buyers for their bananas. As has already been shown in Table 2, there is a massive gap among the various suppliers, with Ecuador for instance able to export at less than half the prices of most Caribbean fruit. Their cost disadvantage is compounded by their substantially higher unit freight charges due to their small volumes. There is no doubt that the large low-cost producers benefit from liberalisation. However unless some means to trade are provided for the small vulnerable suppliers, who have no immediate alternative, then contrary to the very principles of the WTO, only some countries, the already more competitive, will benefit from liberalisation. Adequate (possibly preferential) support arrangements are required by the small suppliers if they are to export successfully rather than being further marginalised in the global trading system.

In order then for the tariff alone to provide the possibility of the Caribbean banana being marketable, the rates have to be at a level that might well be considered too high by some MFN suppliers.

According to the agreement reached at Doha, the EC would, upon request, enter into consultations over the tariff level with any interested member. The talks between the Commission and the nine Latin American suppliers began in late 2004.[8] The Latin American suppliers have the right to take the issue to arbitration if they are not satisfied with the proposed level. If ultimately no agreement is arrived at, the WTO waiver for Cotonou will cease to apply to bananas from 1 January, 2006. It is ironic that it is the ACP that will be at risk if the EU and the Latins cannot reach agreement!

Whilst the Caribbean needs a high tariff under the 2006 flat tariff regime in order that its bananas, which should enter duty free, will be competitive, the Latin American producers resist that. Those that are relatively higher cost are concerned that they could be displaced by the more competitive ACP suppliers (West African and Dominican Republic), who will enjoy a price advantage over them. The lowest cost Latin Americans, such as Ecuador, fear that a high tariff will increase prices and dampen demand, hence their exports would decrease. Also the margins of their trading companies, such as Noboa, would be eroded. Ideas have been circulated that a solution would be to place a ceiling on the volume of ACP bananas which will be eligible for duty-free entry. This could partially appease the Latin Americans but will cause problems of its own for the ACP. Essentially if this duty-free quota is available to all the ACP there will be intense competition among the suppliers, since the more competitive who have the capacity to expand production would invariably do so up to the point where the quota will be oversubscribed by further imports. Off course disruption can be avoided by retaining the licensing system.

2008 – End of the Cotonou Trade Preferences

By 2008, the current Cotonou trade preferences are to expire. Whatever replaces them will be determined by the current negotiations between the ACP and the EU for new Economic Partnership Agreement (EPAs). However, the effectiveness of access will depend not only on the nature of the preferences secured but also the import system in place at the time, which will impact on market prices and security.

Lessons to be learned

Implications of the banana challenge for other commodity protocols and preferences

With the largely successful challenge in the WTO to the Banana Protocol, concerns have been expressed within the ACP regarding possible consequent vulnerability of the other commodity protocols. Is it that politically and legally they are no longer inviolable, or are their provisions for quantitative allocations fundamentally flawed? The methods of allocation of volumes to the ACP vary among the protocols. In the case of bananas, it was initially the guaranteed share of the tariff rate quotas to the individual traditional suppliers, then later to the ACP as a group. (This violated the provisions of GATT Article 13.) In the case of sugar, however, the EC purchased set quantities at negotiated prices. With respect to beef and veal, it has fixed upper limits on the volumes of ACP imports that will enter at reduced duty.

What the protocols ultimately provide for the ACP is the prospect of marketing specified volumes of the covered products on a remunerative basis. However, the instruments and their legal and regulatory arrangements are all fundamentally different. Consequently, the fact that some of the provisions of the Banana Protocol fell foul of WTO rules does not signify that because the other protocols, which share the same objectives but are based on differing trading and regulatory arrangements, would be in similar legal jeopardy in the WTO. Though the successful challenge in the WTO to the Banana Protocol does not directly imply legal vulnerability of the other protocols, their ACP beneficiaries nonetheless need to be concerned. The WTO Panel did not question the underlying aims of the Banana Protocol but by rejecting the quota arrangements and the licensing system used by the EC to give effect to its objectives, it clearly established that the instruments used by members to implement their bilateral treaty obligations must conform to WTO rules.[9] The EU had a definite and unambiguous obligation to the 12 ACP traditional suppliers to ensure that they would not be 'worse off than in the past or at present'. The Panel rejected the arrangements for giving effect to that commitment but did not indicate any acceptable alternative and feasible means of achieving the same objective. Indeed none has so far been found.

The other Commodity Protocols can therefore be challenged, not necessarily directly but through the instruments used to give them effect. Already, Australia, Brazil and Thailand formally challenged certain aspects of the Sugar regime that are essential for the trade in ACP sugar on a remunerative basis. The complainants formulated their case on their perceptions of the precise vulnerabilities and violations of the specific protocol or its beneficiary mechanism rather than those aspects challenged in the banana case, but which might not have been relevant.

Linked to the potential legal vulnerability of the protocols exposed by the banana challenge, is the perception that they have ceased to be sacrosanct. It is no longer 'politically incorrect' to challenge provisions of the ACP–EC Agreement. Although the Commission conducted a spirited defence before the Panel, the EU clearly lost the will to continue to defend the contentious provisions of Protocol V. When the first opportunity arose to dispense with its obligations, the EC sought in the negotiations for 2000 Partnership Agreement with the ACP (Cotonou), to exclude all market access commitments from the Banana Protocol. The ACP was, though, able to finally secure a commitment from the EC, albeit one that was weaker and less clear than its predecessor.[10] The history of the banana dispute suggests that the commitment of the EC to the Commodity Protocols, should they encounter serious difficulties in the WTO, cannot be taken for granted.

Strategy and tactics

It is in the areas of campaign planning and management methodology that the most important lessons for the defence of the other commodity protocols can be learnt from the banana 'wars'. These lessons include:

- **Having an inclusive, coherent and well-co-ordinated coalition.** ACP–EU banana exporters (states and producers associations), their marketing companies, and other allies such as NGOs co-operated and pooled resources to take on the massive task of influencing opinion in the EU as a whole.
- **The need for clearly articulated and simply expressed goals.** In order to get the range of politicians, NGOs, journalists and other non-technical supporters to advance the 'case' for the Caribbean and ACP banana and to sway public opinion, the argument was kept simple, even if the underlying issues were highly complex and technical.
- **Public relations are vital.** Being at a major disadvantage to the 'opposition' in terms of conventional negotiating and commercial power, it was essential to win over public opinion through a massive and effective campaign. Whilst there is natural public sympathy for the underdog, retaining support requires having a competently articulated, sound and morally justifiable case.
- **There must be a redefinition of the parameters of the debate.** If the public is to become engaged, it is necessary to move beyond the technical questions and consideration of the case for the partic-

ular Commodity Protocol simply in terms of conformity of the Protocol's provision and instruments with WTO rules. Rather the debate needs to be expanded to include more fundamental issues including development considerations, equity, and the desirability and right of all countries to participate on a sustainable basis in the global trading system. It must of course be emphasised that the technical legal debate over compatibility needs, in any event, to be simultaneously competently and vigorously pursued. The defence requires high visibility and sophistication in the negotiations.

- **It is necessary to canvass all key targets.** Just as the 'banana coalition' targeted very broadly its lobbying, negotiations and canvassing way beyond immediately responsible Commission officials, the defence of the other protocols will have to do likewise. The banana targets included the Commission at all levels, all EU member states, the US Government and Congress, the Latin American banana exporters, the international community, NGOs, journalists and others.
- **Defence is costly.** A tremendous amount of financial, political and intellectual resources have to be committed.

Other systemic lessons

There are a number of broad systemic lessons to be learnt from the banana dispute that transcend its product and geographic context and are applicable to international trade negotiations by small states.

The first is that small size and consequent lack of commercial and political power do not, on their own, preclude countries from exercising influence over international decision-making and events that impact on their vital national interests. However, they need to understand their real national interests and then define them in the form of clear, readily articulated and comprehensible objectives to which combined national effort can be devoted in a coherent and consistent manner. For small developing countries lacking political and commercial power as well as visibility and influence on the international stage, the share of total resources that they need to invest to win international support would be considerable. Therefore if they are to have real influence, small states are obliged to concentrate their efforts on achieving their priority goals. The conventional approach of giving more or less equal attention to the international advancement of the full range of perceived national goals and interests is beyond the capacity of small states whose efforts would be dissipated in the pursuit of a broad agenda. It might seem counter-intuitive, but small states can actually achieve greater concrete results with ruthless prioritisation of their goals and concentrating their forces on the most important concerns, even if this precludes the direct pursuit of less vital aims. This insistence on the need to focus on priority concerns must not be confused with a simplistic concentration on a single goal or a narrow policy agenda. Rather small states have to be active participants in the multilateral system with an interest in and voice on more than the issues of immediate concern to them if they are to have the ability to exert real influence on any issues including those which are of vital concern. The 'secret' is that they themselves must neither lose sight of the key issues in their fight to advance their national interests, nor so deflect resources to peripheral pursuits as to prejudice the attainment of their priority goals.

It is a truism that the stronger the international opposition to the particular goals the greater the commitment of resources and effort that will be needed. Changing the positions of governments and of major institutions generally requires more than the formulation and presentation of valid arguments. The frequently encountered unwillingness of negotiators to concede, even when faced with irrefutable arguments, could be for a number of reasons, including a resistance to changing already endorsed decisions or positions (sometimes bureaucratic inertia). Also, it is generally the case that the interlocutors are not the real decision-makers but are instructed or influenced by superiors and other entities such as national parliaments, public opinion or even third countries, international institutions or the business community. When presented with conflicting but convincing arguments, the technical or ministerial representatives who engage in international negotiations would of course be expected to seek adjustment to their brief or national position. However,

when they face representatives of weak and relatively un-influential states, they might not feel the necessity to undertake the required negotiations with and/or persuasion of their superiors, parliaments, business and other interests groups required in order to be able to accept the position which the weak states have successfully championed in their negotiations but which conflict with their original national or institutional mandates or interests.

Small states, seeking through lobbying and negotiation to change the position of more powerful countries, need to convince not only their interlocutors at the negotiating table, but having determined all the actual locations of decision-making authority and sources of influence, to seek to win these over as well. The targets then are not just the interlocutors but others within the hierarchy that could even include subordinates who have delegated authority, which the latter might, for whatever reason, be unwilling to override. To be successful the small states will have to engage all required targets within the vertical and horizontal planes of authority.

Whilst such a broad strategy will invariably be demanding, unless all those with influence are either won over or neutralised, any which are not can subsequently seek to block or undo the outcome being sought by the small states.

The historical association of many small states with major powers can sometimes result in an over-reliance on and trust in international goodwill and the expectation that friendly developed countries will secure their interests. Whilst there is considerable evidence in the banana dispute of such principled commitment, it would be uncertain in the long-term or when the small states' aims conflict with the national interests or priorities of their 'benefactors'. Hence, small states must appreciate their ultimate responsibility for achieving through their own domestic and international action, the outcomes that they desire, whether or not that entails mobilising support and working with allies.

Securing international change can be very demanding and likely to be proportionately difficult for small developing countries. Hence, in order to be able to commit the required resources they need to effectively mobilise and engage all their national capacity. Their political, diplomatic, business, NGO, academic and other emissaries who will articulate and advance the identified goals must be very well briefed and present persuasive, consistent and coherent arguments. Senior ministers and even heads of government can be enlisted to use their influence and the opportunities that arise or are deliberately created for interaction with and persuading of decision-makers in target countries and institutions. During the 1990s, given the overwhelming importance of the issue to their economies, advancing their interests in the banana dispute was the overriding foreign policy objective of the Windward Islands. That objective to a large extent defined their policy stance towards the various members of the EU, to Latin America, the US and also in multilateral spheres such as the Organisation of American States and the UN.

In their pursuit of favourable decision-making at an international level, small states will be able to obtain leverage through working with allies and benefiting from the support of friendly countries and institutions. However, actually securing the desired objectives will require effective preparation of positions and arguments and skilful negotiation by the countries' representatives. Hence it is essential that small countries field skilled and dedicated tacticians and negotiators who can actually win debates and change the views of even the experienced and trained negotiators and representatives of the developed countries and the multilateral institutions. The methods to ensure that capacity will be long term and entail a combination of training, careful recruitment, development and retention.

Conclusion

The aim of the small Caribbean traditional banana suppliers at the start of the last decade was simply to secure continued access to the EU banana market on a viable basis. They wanted the changes to the regulatory system to be sufficiently benign to ensure adequate preferential margins and high enough market prices. The islands also understood that they would need to drastically restructure their banana industries to substantially reduce costs of production and to make the industry more competitive. Simultaneously the agricultural sector and wider economy

would need to be restructured to create new sources of income and employment.

Despite their small size and lack of power in the traditional commercial and political sense, these islands through commitment and perseverance were able, along with their allies and supporters, to ensure that the banana import regime retained its preferential character and that the market continued to be regulated so that prices remained substantially above world market levels. The problem however is that despite advances in efficiency reflected in reduced costs and improved quality, the differential between the competitive Latin American producers and the Caribbean producers remains wide. Whilst these islands have achieved a considerable measure of success in the battle over the regulation of the system, they have been losing market share, with their exports falling drastically. In the Windward Islands, for instance, the drop was from 274,000 tonnes in 1992 to 99,000 tonnes by 2002.[11] This loss of banana production has not been significantly replaced by other productive activity. The result has been an increase in unemployment and sharp declines in foreign earnings.

For their long-term economic stability and growth, it will be essential that continued attention be paid to minimising costs of production at all levels in order to reduce as much as possible the cost handicap that they face. Most importantly, renewed commitment and effort will need to be put into diversification, possibly to include organic and 'fair trade' bananas as well as new lines of agricultural and non-agricultural production and services. To be successful, diversification will require that the introduction of viable new crops is initially alongside bananas. An attempt to immediately and simply displace bananas with another crop is unlikely to have any chance of success, though the process of identifying, testing and introducing new lines must be completed in the time remaining when some measure of rural income and employment stability is still provided by the banana industry.

Endnotes

1. The Windward Islands grouping consists of the Commonwealth of Dominica, Grenada, Saint Lucia and St. Vincent and the Grenadines.
2. The traditional suppliers as listed in the ACP–EU Convention of Lomé were Belize, Cameroon, Cape Verde, Commonwealth of Dominica, Grenada, Ivory Coast, Jamaica, Madagascar, Saint Lucia, St. Vincent and the Grenadines, Somalia and Surinam.
3. A minimum selling price for bananas would be set which would be sufficiently high to permit the higher cost European and ACP bananas to be marketed profitably, however, this would not have assured them of being able to market their bananas since marketing companies would have preferred to handle the lower cost bananas on which they would now make greatly increased profit. This alternative was dismissed in the early stages.
4. Protocol V of the Fourth ACP–EC Convention of Lomé stipulated that 'In respect of its banana exports to the Community markets, no ACP state shall be placed, as regards access to its traditional markets, in a less favourable position than in the past or at present'.
5. The EC implementation measures are contained in the following regulations: (i) EC Regulation No. 163/1998 amending the contested parent EC Regulation No. 404/1993 which established the Common Organisation of the Market in bananas (ii) EC Regulation No. 2362 of 1998 which laid down the detailed rules for operationalising Regulation 404 of 1993. Both of the EC 1998 Regulations 1637 and 2362 were applied from 1 January, 1999.
6. 'Banana exports from the Caribbean since 1992', Report by National Economic Research Associates (NERA), June 2003, London
7. 'Situational Analysis of the Agriculture Sector of the OECS member countries', Gary Melville, FAO Capacity Building Project, December 2002.
8. Annex to WTO decision on the waiver for the EC–ACP Partnership Agreement – 14 November, 2001 Doha.
9. The final remarks 8.3 of the Report of the Panel – EC Regime for the importation, Sale and Distribution of Bananas, 22 May, 1997, read, *'From a substantive perspective, the fundamental principles of the WTO and WTO rules are designed to foster the development of countries, not impede it. Having heard the arguments of a large number of Members interested in this case and having worked through a complex set of claims under several WTO agreements, we conclude that the system is flexible enough to allow, through WTO-consistent trade and non-trade measures, appropriate policy responses in the wide variety of circumstances across countries, including countries that are currently heavily dependent on the production and commercialization of bananas'.*
10. *'The Community agrees to examine and where necessary take measures aimed at ensuring the continued viability of their banana export industries and the continuing outlet for their bananas on the Community Market'.* Protocol V Article I ACP-EU Partnership Agreement Cotonou 23.05.2000.
11. Source: Windwards Islands Banana Development Company (WIBDECO)

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Navigating New Waters

A Reader on ACP–EU Trade Relations – Volume 2

Edited by Sanoussi Bilal and Roman Grynberg



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VOLUME 2

Edited by

Sanoussi Bilal

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Global fisheries issues

In the FAO's *State of World Fisheries and Aquaculture 2004*,[1] issues of key importance in world fisheries include:

- **Depletion of fish resources** In early 2000, about 25% of the world's fish stocks were overexploited and depleted, and another 50% considered fully exploited.

  To face the challenge of the sustainable exploitation of fish resources, it is to be noted that many Regional Fisheries Management Organisations (RFMOs) are taking innovative and co-operative action to implement international fisheries instruments, in an effort to rebuild depleted stocks and prevent further decline and to combat illegal, unreported and unregulated (IUU) fishing.

- **Contribution of fisheries to food security** Global production from capture fisheries and aquaculture supplied about 101 million tonnes of food fish in 2002. Overall, fish provided more than 2.6 billion people with at least 20% of their average per capita animal protein intake. Given the highly perishable nature of fish, the contribution of fisheries to food security in developing countries is constrained by the lack of infrastructure, particularly for meeting conservation and trade requirements.

- **Growing international fish trade** Globally fishery products are amongst the most highly traded food commodities, with some 38% of the fish catch traded internationally. Total world trade of fish and fishery products increased to US$58.2 billion in 2002, showing a 45% increase since 1992.

- **Fisheries as a source of employment** In 2002, about 38 million people were earning an income from employment in fisheries and aquaculture. Of particular note for developing countries is the important number of women working in the fisheries sector, mainly in processing and trade.

Fisheries in the context of international trade

Fish and fisheries products have become the most important foreign exchange earner among all agriculture products traded by developing countries. Net foreign exchange receipts[2] in developing countries for fishery products increased from $3.7 billion in 1980 to $18 billion in 2000 – a 2.5-fold increase in real terms.

Developed countries account for more than 80% of the value of the total fishery product imports. The main international markets for fishery products are the European Union, where about 76% of the import value is concentrated, the USA and Japan. In 2003 the EU, the world's main market for fishery products, imported more than €12 billion worth of fish and fishery products.

But whilst the developed countries markets may offer the best prices, fish exporters in developing countries face an increasing number of trade barriers (both tariff and non-tariff) to enter those markets.

Tariff barriers tend to be higher for processed products than for unprocessed fish. Developed countries tend to encourage trade in raw material rather than in processed products, although the greatest economic returns for developing countries are achievable through value-added processing. Non-tariff barriers are those relating to hygiene and food safety, in particular sanitary, traceability and quality control aspects.

This chapter was first published as *ACP–EU Economic Partnership Agreements: Fisheries*, ECDPM Discussion Paper 69 with CTA by CFFA. ECDPM, Maastricht, 2005. www.ecdpm.org/dp69

Fisheries and international agreements

The United Nations[3] and the World Trade Organization (WTO) are responsible for the international legal and policy frameworks that define how fisheries may be exploited and fishery products may be traded. While the WTO provides the institutional structure and legal basis for international trade liberalisation, the United Nations provides the legal basis for the sustainable development and management of fisheries resources, and for responsible fisheries production.

This potentially brings the conservation instruments of the United Nations and the trade liberalisation processes of the WTO into conflict.[4] Further trade liberalisation as promoted by the WTO (the reduction and elimination of tariffs and non-tariff barriers, particularly on products of interest to developing countries) has implications for the sustainability of fish stocks.

Fisheries current status in the WTO and the Doha Round

During the Uruguay Round of negotiations of the General Agreement on Tariffs and Trade (GATT), fisheries and fish products were left out of the Agreement on Agriculture. They are treated as an industrial sector and industrial products respectively by the WTO.

Fisheries are currently dealt with by the WTO at four different levels:

- market access for non-agricultural products (reduction and elimination of tariffs and non-tariff barriers, particularly on products of interest to developing countries);
- agreement on subsidies and countervailing measures. The Doha Round called for negotiations to clarify and improve WTO disciplines on fisheries subsidies, taking into account the importance of this sector to developing countries;
- trade and the environment, particularly as regards multilateral environmental agreements; and
- dispute settlement procedures.

The Doha Agenda includes a number of issues of particular importance to international trade in fish and fishery products, including improved market access, fisheries subsidies, environmental labelling, the relationship between WTO trade rules and environmental agreements, as well as technical assistance and capacity building.

Provisions on fisheries in the Cotonou Agreement

The Cotonou Agreement deals with fisheries under the trade provisions of the Cotonou Agreement and under the provisions dealing with fisheries agreements.

The trade provisions of the Cotonou Agreement

The terms and conditions for the export of ACP fish and fishery products to EU markets are determined in the main by the provisions of the Cotonou Agreement, assuming that the rules of origin can be met. The market-access provisions of the Cotonou Agreement are based on the non-reciprocal trade preferences extended to ACP countries under the earlier Lomé Convention. These allow ACP coun-

Box 1. Multilateral agreements on trade relevant to fisheries

The multilateral agreements on trade relevant to fisheries are:

- Marrakech Protocol to the General Agreement on Tariffs and Trade (1994)
- Agreements on Non-Tariff Barriers
- Agreement on Sanitary and Phyto-sanitary Measures
- Agreement on Technical Barriers to Trade
- Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade (1994) – Anti-dumping
- Agreement on Import Licensing Procedures
- Agreement on Subsidies and Countervailing Measures
- Agreement on Safeguards

tries to export their fish products to the EU without having to pay the import taxes applied to fisheries exports from other countries. The margins of preference enjoyed by ACP exporters under Cotonou depend on the trade regime applied to fishery products from competing countries.[5]

These ACP tariff preferences will continue until the end of 2007. The EU is seeking to replace the current non-reciprocal preferences with WTO-compatible Economic Partnership Agreements (EPAs) that would begin in January 2008.

Cotonou and provisions dealing with fisheries agreements

Fisheries agreements are dealt with in Part 3 of the Cotonou Convention, under Title II: Economic and Trade Co-operation, Chapter 6: Co-operation in other areas. Article 53 on Fishery Agreements stipulates that:

- *'The Parties declare their willingness to negotiate fishery agreements aimed at guaranteeing sustainable and mutually satisfactory conditions for fishing activities in ACP States.*
- *In the conclusion or implementation of such agreements, the ACP States shall not discriminate against the Community or among the Member States, without prejudice to special arrangements between developing States within the same geographical area, including reciprocal fishing arrangements, nor shall the Community discriminate against ACP States.'*

ACP–EU Fisheries (Partnership) Agreements and their influence on ACP–EU fish trade

ACP states have netted considerable financial benefits from EU compensation payments made through bilateral fisheries access agreements. This is far in excess of the financial value of aid disbursements to the fishing sector made through development cooperation programmes. Fisheries agreement negotiations therefore dominate in EU–ACP fisheries relations.

However, questions have been raised about the sustainability of such agreements signed with countries where resources are already fully or over-exploited and where there is therefore no surplus of resources to be offered. In such cases, the signing of access agreements has tended to exacerbate problems of over-exploitation and has generated competition with the national fisheries sector of the ACP country concerned. In certain cases, it has also generated competition for markets.

To address these issues, in June 2004, the EU Council adopted conclusions on an Integrated Framework for Fisheries Partnership Agreements (FPAs) with Third Countries. Through FPAs, the EU is proposing to change the approach it adopts in its bilateral fisheries access agreements, particularly those signed with ACP countries, in order to contribute to responsible fishing in the mutual interest of the parties concerned. FPAs aim both to ensure that the interests of the EU distant-water fleet are protected and to strengthen conditions necessary to achieve sustainable fisheries in the waters of the partner country concerned.

Box 2. What are ACP–EU fisheries access agreements?

In the mid-1970s an increasing number of coastal states established exclusive economic zones[6] (EEZ) by extending their jurisdiction out to sea from 3–12 to 200 nautical miles. This brought almost 90% of the world's exploitable fish resources under the control of coastal states. The fleets of the EU member states, which had traditionally fished in the waters of other countries, suddenly found themselves barred. To ensure continuity of access for their fleets, fisheries agreements were concluded between the EU and the third countries concerned.

Currently, the EU has 18 fisheries access agreements with ACP countries. In exchange for financial compensation provided by the EU, ACP states allow EU fleets access to their surplus resources (in theory those that are not exploited by the coastal state). Since 1994,[7] and as part of the compensation payments, provisions were included in the fisheries access agreements to address such development issues as fishery management and regulation, support to the small-scale fisheries sector, local landings, etc.

Box 3. Sources of information on ACP–EU fisheries agreements

Websites

- Europa – Fisheries and Maritime Affairs – Bilateral agreements http://europa.eu.int/comm/fisheries/doc_et_publ/factsheets/facts/en/pcp4_2.htm
- Agritrade web portal: ACP–EU fisheries relations
- http://agritrade.cta.int/fisheries/agreements/index.htm
- Coalition for Fair Fisheries Arrangements http://www.cape-cffa.org/

Studies, reports

- Evaluation of the fisheries agreements concluded by the European Community', Ifremer, 1999
- http://europa.eu.int/comm/fisheries/doc_et_publ/liste_publi/studies/rsen.pdf
- 'Adoption of Council conclusions on an integrated framework for fisheries partnership agreements with third countries'
- http://register.consilium.eu.int/pdf/en/04/st11/st11485-re01.en04.pdf
- 'ACP–EU Fisheries relations: Towards greater sustainability, summary report', CTA, 2003 http://www.cta.int/events2003/fisheries/General%20report-EN.pdf

However, as exemplified by the latest EU–Morocco fisheries partnership agreement, signed in July 2005, EU compensation will also help create a favourable environment (resources management, research, control, etc.) for the EU fishing fleet's activities, which may increasingly take place under joint ventures with local partners.

Relevance of fisheries to the ACP countries

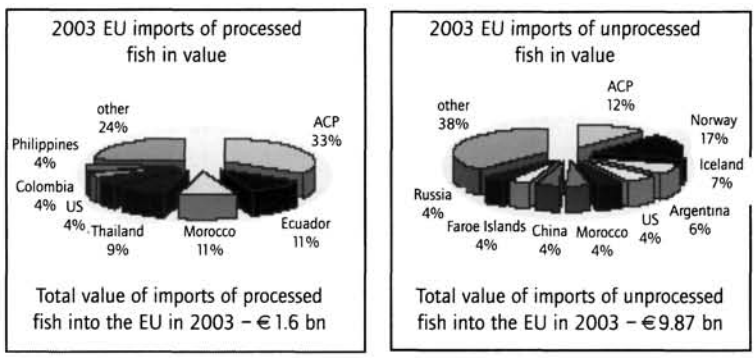
The EU provides ACP states with their most lucrative markets for fish, accounting for around 75% of ACP fishery exports by value.

Fisheries products are one of the few areas where ACP countries have seen their participation in world trade increase. In 2003, the value of ACP fish exports to the EU exceeded €1.74 billion, with some €1.21 billion worth of unprocessed fish and €0.53 billion worth of processed fish.

The main ACP fish exports are:

- Fresh, chilled and frozen fishery products – these account for about 60% by volume and about 50% by value of ACP fish exports.

Figure 1. EU imports of processed and unprocessed fish in value (2003)



Source: 'Overview of Economic Partnership Agreements (EPAs) and related fisheries issues', Lisa Mackie, DG Trade, presented at the expert meeting 'ACP EU Fisheries relations – Maximising socio-economic benefits for the ACP fisheries communities' organised by ACP sec/COMSEC/CTA December 2004

- Canned fish, which accounts for about 20% by volume and 18% by value of ACP fish exports.
- Canned or frozen shellfish (crustaceans and molluscs), which account for about 11% by volume and 30% by value of ACP fish exports.
- Dried, salted or smoked fish, which accounts for some 4% by volume and 3% by value of ACP fish exports.

Key fisheries issues for ACP countries

At ACP level, there is considerable scope for improving the contribution of fisheries to poverty reduction strategies. An important aspect to be noted is the central role that the ACP's artisanal fisheries sector's activities play in food security, job creation and, increasingly, foreign exchange earnings.

ACP countries are therefore faced with a double challenge: the sustainable management of their fisheries resources and increasing and redistributing the benefits derived from these resources.

Sustainable management of fisheries resources

The key issue in fisheries for ACP countries today is declining fish catches due to over-fishing by both national and foreign fleets.

Over-fishing has various causes: the non-existence of ACP national policies and the lack of clearly defined resource access rights; the increasing use of unselective and destructive fishing methods (such as trawling and dynamite fishing); and general over-capacity of the fishing fleets, both in the industrial (national and foreign) and artisanal sectors. It must be noted that over-capacity in the fishing fleets of the (foreign) developed countries' fleets that fish within ACP EEZs, as in the case of the EU, has been fuelled by massive subsidies.

Many ACP countries also suffer from 'IUU' (illegal, unregulated and unreported) fishing activities. IUU fishing has important ecological as well as socio-economic impacts. A recent report,[8] based on case studies from 10 ACP coastal countries, estimates that the average value of IUU catches in these countries is 23% of the value of declared catches.

Creation and redistribution of benefits from fisheries resources

To be able to draw benefits from fish resources, provided they are managed in a sustainable way, ACP countries are also faced with issues concerning value adding and market access.

Value adding: In the case of ACP small-scale processing activities, adding value operations also serve to increase the shelf life of the fish products, making it more transportable and therefore more accessible to, for example, inland populations.

In most ACP countries there is a need for investment in infrastructure – basic infrastructure (water, electricity) as well as fish processing infrastructure – in order to increase the value derived from fishery resources. Improving the returns from value-adding fish processing demands an understanding of the markets and their dynamics at both regional and international levels, as well as the facilitation of regional integration in ACP states.

Market access: Market-access issues arise for ACP countries both at regional and international level, notably with regard to EU market access.

- ***Issues for regional market access***

The potential of regional fish trade in ACP countries is yet to be fully realised. It should be encouraged with a gradual dismantling of existing barriers to trade. These include the lack of transport infrastructure, import tariffs and burdensome bureaucratic measures.

- ***Issues for EU market access***

Tariffs elimination – Erosion of ACP margins of preference

Although no consensus has been reached, it is likely that under WTO rules, import duties on fish and fishery products will be further reduced. As a consequence, ACP countries margins of preference will be eroded.

In the case of the EU, the main ACP trading partner for fisheries products, trade negotiations may provide longer implementation times for the liberalisation of fish trade or mechanisms for compensation. Reducing tariff escalation between raw fish and processed fish products is also needed. This is particularly important when ACP fish products

can't meet the rules of origin requirements, and must pay high tariffs.

Technical barriers – Sanitary and phytosanitary issues
Non-tariff barriers, particularly sanitary and phytosanitary standards, increasingly present obstacles to ACP exports. Such non-tariff barriers are frequently linked to technical standards or procedures.

Two WTO agreements are of particular relevance: one on 'Technical Barriers to Trade' and another on 'Sanitary and Phytosanitary issues'.

Rules of origin (ROO) requirements
Duty-free access for fishery products is qualified by the rules of origin applied to fishery products under the Cotonou Agreement (Protocol I, Annex V). To obtain duty-free access, ACP fishery products must be 'wholly obtained' in the ACP state concerned, as defined by Article 3. The main criteria for defining 'originating products' are registration and flag, ownership and crewing arrangements on the fishing vessels and factory ships, which basically must be either European or ACP, therefore discriminating against third countries.

The restrictions imposed by the rules of origin have for long been a source of contention in EU–ACP fisheries relations, in particular with respect to the valuable tuna fishery. The way 'originating fish' is defined effectively forces ACP processors to purchase from EU high-priced suppliers (as they do not have their own tuna fleets and fish from third country vessels is not 'originating'), in order to produce originating tuna products.

This limits the expansion of ACP processing activities by restricting their possible source markets for raw products and creates an incentive for ACP states to grant EU vessels preferential access to their EEZs so as to ensure that their tuna canneries are supplied with 'originating tuna'. The preferential margin offered to the ACP states for originating canned tuna (and the relatively high price they pay for the raw material) could therefore be considered as a form of upstream subsidies to EU vessels via fishery access agreements rather than a trade concession to ACP states. The ACP countries have demanded that all catches done in their waters (i.e. within their national jurisdiction) should enjoy originating status regardless of ownership of the vessel. To date, however, the EU has failed to respond to these ACP requests.

Impact/relevance for specific ACP sub-groups

In order to define pertinent ACP sub-groups, it is useful to consider various issues:

Nature and extent of fisheries resources This will often vary according to the geographical area. The main ACP commercial fisheries resources include demersal[9] species – in particular shrimp and cephalo-

Box 4. Sources of information

On Sustainable Management of Fisheries resources

FAO Code of Conduct for Responsible Fisheries
www.fao.org/fi/agreem/codecond/codecon.asp

FAO database on capture fisheries, aquaculture and trade
www.fao.org/fi/statist/FISOFT/FISHPLUS.asp

Fishbase
www.fishbase.org/home.htm

UNEP – Impacts of Trade-Related Policies on Fisheries and Measures Required for their Sustainable Management
www.unep.ch/etu/etp/events/upcming/15March_fisheries.htm

On Trade aspects, value adding, etc.

Agritrade portal – fisheries (CTA)

Market Access section:
http://agritrade.cta.int/fisheries/market_access/

WTO section:
http://agritrade.cta.int/fisheries/wto/index.htm

FAO/NORAD *Fish Trade for the People*
www.tradefoodfish.org

GLOBEFISH
www.globefish.org/entry_infopeche.htm

pods (octopus and squid); and pelagic[10] species, in particular tuna, sardines, sardinellas, etc.

Rich fishing grounds attract the interest of distant-water fishing fleets, like the European, that will try and get access to them through, for example, the signing of fisheries agreements.

ACP countries with rich fishing grounds are also, in most cases, important partners for fish trade with the EU, as reflected in the shares of EU import from the various EPA regions.

Profile of the national fisheries sector The importance of small-scale and/or large-scale fishing and/or processing sectors varies for different ACP states. On one hand, these ACP fishing/processing sectors will be interested in being able to export to the EU, Asian and other markets. On the other, there may be some conflicts of interest concerning access to fish resources between national fleets and the EU and other foreign distant-water fleets.

Taking note of the above issues, it is possible to categorise ACP states according to the issues they share in their fisheries relations with the EU.[11]

Countries with an ACP–EU fisheries agreement

Depending on the type of fish resources, two kinds of fisheries access agreements have been signed by the EU with ACP countries: tuna agreements and mixed[12] agreements.

Issues arising for countries having signed a Tuna Agreement with the EU The tuna species of greatest commercial importance are highly migratory, and move between waters under the national jurisdiction of some coastal ACP states and international waters. This migratory habit provides considerable challenges for ACP states, particularly for small islands with large EEZs, particularly as concerns monitoring and controlling the activities of EU (and other foreign) vessels, and verifying whether the catches of tuna are being made within or outside their respective EEZs. As the compensation payments made through the ACP–EU tuna fisheries agreements are set, *pro rata*, according to the level of catches made, this may create an incentive for vessel operators to under-report their catches.

In this regard, the recent introduction of vessel monitoring, surveillance and control systems (MCS) that use satellite-based positioning systems, is an important development. However, the surveillance information is only of value if it is provided on a continuous and real-time basis. Its effectiveness is also highly dependent on the capacity of the coastal state to back up such systems with patrol vessels and the ability to monitor catches directly. The latter is more readily achieved if there are enforceable compulsory local landing provisions integral to the fisheries agreement.

Generally, the EU tuna fleet operating under ACP–EU tuna fisheries agreements does not compete with local ACP fishing fleets, either on markets or fishing zones. However, some technical developments in the artisanal fishing sector (in Senegal, in the Pacific) allowing small-scale rafts to fish up to the high seas, may increase such competition in the

Table 1. EPA regions and percentage of total EU fish imports (in value, 2003)

EPA regions	% of total EU fish imports (in value, 2003)
ECOWAS + Mauritania	38%
ESA	32%
SADC	25%
Caribbean	3%
Pacific	1%
CEMAC	1%

Source: 'Overview of Economic Partnership Agreements (EPAs) and related fisheries issues', Lisa Mackie, DG Trade, presented at the expert meeting 'ACP EU Fisheries relations – Maximising socio-economic benefits for the ACP fisheries communities' organised by ACP sec/COMSEC/CTA December 2004
www.cta.int/events2004/fish/docs/DG%20Trade-en.pdf

future. In some cases, the sustainability of tuna fishing operations has been questioned, particularly in the case of tuna fishing operations using purse seines[13] and fish aggregating devices,[14] as these operations tend to take significant levels of by-catch and juvenile tuna.

ACP countries having signed a tuna fisheries agreement with the EU are mainly from two regions:

Indian Ocean

ACP countries in the Indian Ocean like Comoros, Madagascar, Mozambique, and the Seychelles have important (seasonal) tuna resources. The fisheries relations with the EU are based on tuna agreements. In the case of the Comoros and Seychelles, in 2004 each signed an FPA with the EU.

The distance and extent of the Indian Ocean fishing grounds necessitate the use of local ports by the EU fleets for refuelling and other requirements (transhipping, provisioning, maintenance, etc). These agreements are also important for the local export processing sector (tuna canning) that is highly dependent on the supply from EU vessels for exporting to EU market.

Pacific Ocean

There are three tuna fisheries agreements with ACP countries in the Pacific Ocean (Kiribati, the Solomon Islands and the Federated States of Micronesia (FSM)[15]). For the countries concerned, the financial compensation provided makes a significant contribution to overall government revenue. It's interesting to note that, unlike other fisheries-rich ACP regions, the Pacific only accounts for 1% of fish imports onto the EU market. This can be partially explained by the fact that EU fleets have only recently started fishing in Pacific waters, and that, with notable exceptions, the Pacific Island States generally lack their own tuna fleets and tuna processing sectors. Other fleets – notably the US and Japan, are active there, supplying their own markets.

Issues arising for ACP countries having signed a mixed agreement with the EU The main ACP region where mixed agreements have been signed is West Africa, including the agreements with Mauritania, Senegal, Guinea Bissau, Guinea, Ivory Coast, and Gabon.

Here EU fishing operations may compete directly with local ACP fishing sectors both for resources and markets. There are a number of issues arising from such competition. These include:

- by-catch and its utilisation;
- access to the EU market; and
- capacity for monitoring, control and surveillance (MCS).

Certain fishing activities, notably prawn trawling, generate significant quantities of by-catch. Such by-catch may consist of both high and low-value non-target species, and of juvenile fish of both target and non-target species. From an economic point of view, by-catch of valuable non-target species by EU vessels represents an economic loss to the ACP states. From a social and economic point of view, compulsory landings of low-value non-target species may disrupt local markets and undermine the economic viability of local artisanal fisheries. From a conservation perspective, high levels of by-catch may damage the ecosystem and undermine fisheries sustainability.

In some cases ACP states fish catching and processing sectors compete directly with EU fishery enterprises for access to lucrative value-added export markets. In such cases, particularly where there is resource scarcity and over-fishing, ACP states may find the costs of compliance with EU hygiene and food safety regulations too high. They may therefore have no choice but to enter into fisheries agreements.

Effective monitoring, control and surveillance programmes are also highly important for providing good information for fisheries management, and to regulate fishing activities. There are various methods that can be used to verify both catch size and location where catches were made, including on-board observer programmes, compulsory landing provisions, vessel monitoring systems (VMS), and log books. However, often ACP states lack the capacity to implement such programmes, and lack access to log books and 'real time' full information from VMS.

Many West African statesj have important small-scale fisheries, providing an important source

of livelihood and food security. There is evidence[16] that EU and other foreign fishing activities compete both directly (for space and resources) and indirectly (for markets) with these ACP industries.

The West African fishing grounds provide the basis of the so-called 'pay, fish and go' EU–ACP fisheries agreements[17] that are, with notable exceptions (Cape Verde has a tuna agreement with the EU), mixed agreements. The proximity of the EU (notably the port of Las Palmas in the Canary Islands) means that EU fishing fleets prefer not to land their fish locally. This in turn means that local landing provisions set up in the access agreements[18] are either not respected, or that only lower quality fish is landed.

ACP countries with no access agreements The reason why some ACP coastal countries have no fisheries access agreements with the EU is that there is not sufficient mutual interest for establishing EU vessels access to these ACP states' resources. Either, as in the case of South Africa, Namibia or Angola, the ACP Ssate has refused to sign a fisheries agreement, preferring to have another basis for its relations with the EU. Or, as in the case of the Caribbean, the limited extent of fishery resources means that EU vessels have little interest in fisheries access agreements.

The case of the Southern African region

There are two key ACP states in the Southern African region with rich fishery resources, but with no fisheries agreement with the EU. These are Namibia and the Republic of South Africa (RSA). Namibia and RSA are the top two ACP exporters of fishery products to the EU (by both volume and value) and are key players in the regional SADC grouping, with important export-oriented catching and processing sectors. In both countries, the national fisheries policies favour foreign involvement in their fisheries through private joint-venture arrangements, but not through formal bilateral fisheries agreements. In the case of RSA, though, bilateral fisheries agreements with Portugal and Spain are still in place, that pre-date these countries' EU accession.

In the case of RSA, the recent free trade agreement (the Trade Development and Co-operation Agreement (TDCA), signed in 1999) with the EU ties trade liberalisation in fishery products to the signing of a mutually beneficial fisheries agreement. To date RSA has declined to sign such an agreement, with implications for market access to the EU for its fisheries products. This means that either South Africa will need to explore alternative markets, find alternative (e.g. regional) avenues to the EU market, or yield to EC pressure to sign an agreement if it wants tariff-free access to the EU market.

Box 5. Tanzania: The 'discovery' of a tuna fishery promotes the negotiation of a fisheries partnership agreement with the EU

Until recently, Tanzanian waters were considered poor in tuna resources. But, over the past three years, the training of Tanzanian fisheries inspectors, thanks to the Monitoring, Control and Surveillance (MCS) programme, funded by the SADC and the EU, has revealed the existence of tuna resources that could be worth as much as 200 million US$.

Already, the highly visible patrols have resulted in a massive increase in licensing revenues. In 2002, 12 foreign tuna boats were licensed to fish off Tanzania. That number jumped to 84 when the foreign fishing fleets realised that Tanzanian authorities have regular patrols in their EEZ. One of the key interventions of the MCS programme has been to persuade the EU registered purse-seiner fleet to report its catches to the Tanzanian fisheries authorities. This has revealed that, during the peak fishing season, up to 10,000 tons of tuna is being caught in Tanzania's EEZ weekly.

The revealed existence of such rich tuna resources and the fact that EU fishing boats are highly active in Tanzanian waters have probably been instrumental factors in the negotiations that are now ongoing for the signing of a Fisheries Partnership Agreement between the EU and Tanzania.

The case of the Caribbean

In the case of the Caribbean, the limited extent of their fishery resources and the geographical proximity of the USA restrict the importance of their fishery relations with the EU. To date there is no fisheries agreement between a Caribbean country and the EU. However, the Bahamas and Surinam have significant annual export earnings from their trade in fishery products with the EU, placing them in the league of the top twenty fish exporting ACP states to the EU.

Key issues where broad all-ACP consensus could be built

Areas where broad all-ACP consensus could be built in fisheries have been explored on various recent occasions.[19] They include:

A. The need for improved fisheries management: Two particular aspects where consensus could be reached are:

- **Fisheries research for sustainable management of resources** Given the scarcity of human and financial resources in ACP countries, fisheries research needs to focus on providing information to be used for fisheries management, both at ACP national and regional level. This practically oriented fisheries research must contribute to formulating the regulatory mechanisms necessary for adjusting fishing capacity in line with available resources and stock productivity. It should also help address policy issues arising for the sector, such as the allocation of access rights to resources and the integration of artisanal fisheries into national economy.

  Common challenges facing ACP fisheries research include: primary data collection (qualitative and quantitative aspects); the development of an understanding of marine eco-systems, and an ecosystems approach to fisheries management; harmonisation of systems for data analysis at regional level and the capacity to disseminate the research results on a regular basis; the incorporation of social, environmental and economic data into fisheries analysis and management decision taking; and the setting up of structures and mechanisms to enable dialogue between researchers, fishery managers and the professionals (in particular the men and women from coastal fishing communities).

- **Monitoring, control and surveillance** Many coastal ACP countries have sizeable EEZs to police, particularly island states. But they often lack the capacity to do so in an efficient way. This leads to IUU (Illegal, Unreported, Unregulated) fishing. It also creates difficulties for ACP states to assess the quantities and value of the fish caught by local and distant-water fishing fleets in its EEZ.

  The harmonisation of measures to fight IUU fishing at regional level is a priority for most ACP coastal countries, including: agreement on the right to pursue,[20] joint surveillance missions (at sea and aerial surveillance), regional register of offending fishing vessels, and the harmonisation of legislation on technical measures (prohibited fishing gears, infractions and sanctions).

B. The need to create an enabling environment for maximising benefits from the fisheries sector:

Particular attention needs to be given to small and medium-scale enterprises (SMEs), including the artisanal sector,[21] both in the catching and processing sub-sectors, as these SMEs form the vast majority of ACP enterprises in the fisheries sector.

Two aspects deserve special attention:

- **Improvement of value adding operations** In general, ACP countries have an interest in developing joint ventures with European operators in fish processing, in order to create a local added value, rather than develop projects in the catching sector. Through joint ventures Europeans can bring capital and know-how, which is needed to create new processing plants or rehabilitate existing ones for the processing of fisheries products.

- **Improving access for ACP fish products to EU markets** There is a general ACP concern that, as preferences are eroded:

  – Some EU tuna fleets may be replaced by other fleets with low running costs and poor labour

conditions, which tranship on the high seas, and therefore do not land in ACP harbours.

- ACP states, especially small island states, would be the net losers as they will not be able to compete, and the value adding will be done elsewhere.

Key issues where divergences are likely to exist between ACP countries

Key areas of divergence between ACP countries will depend on:

- the extent to which ACP populations depend on fishery resources for food and livelihood, and the extent to which ACP states depend on the foreign exchange earnings from the fishery. For example, although Mauritania is not a large fish-consuming country, an important export-oriented artisanal fishery for octopus has developed. It also depends to a large extent on revenues from fisheries agreements and fish exports for debt service. Neighbouring Senegal is highly dependent on fish as a source of food and needs to balance its requirement for foreign exchange from fish exports and fishery access agreements with the requirements of its population for fish as food and livelihood;
- the nature of the fishery resources. Some countries, like Cape Verde, have rich tuna resources. Others, like Senegal, have a rich variety of other resources. The nature of the resource and the state of stocks will determine the level of interest in the EU for having a fisheries agreement (or not), thus necessitating different approaches to negotiating with the EU;
- the policy decisions of the ACP state with regard to the development of the local fisheries sector, and in particular the attitude on value-added processing. Several ACP states have invested in tuna canning and other export-oriented processing operations. Yet other ACP states have formed joint-venture arrangements.
- the response of ACP states to the ROO established by the EU. In many ACP states the local fishing sectors are either not capable of catching fish to the specifications required by export markets, or are not geared up to process it. These countries, particularly those with tuna-canning industries, have to rely on EU vessels to catch the

Box 6. In short ...

In their fisheries relations with the EU, ACP countries are faced with a double challenge: managing their fisheries resources sustainably and increasing/redistributing the benefits derived from these resources.

ACP countries have an opportunity to address such challenges through their fisheries relations with the EU. Issues to be resolved in that context include: organisation of the access to ACP fish resources for the various users, fight against IUU fishing, the improvement of regional market access for fisheries products, sanitary and phyto-sanitary issues, rules of origin requirements, etc.

The high diversity of ACP fisheries profiles (nature and extent of their resources, development of the national fisheries sector, political priorities) have resulted in a variety of fisheries relations with the EU, often depending on the interests of EU fleets to access ACP resources through fisheries agreements.

Taking into account this diversity of relations, it's however possible to define key issues where all-ACP consensus could be built, such as the need for improved fisheries management (research, Monitoring, Surveillance and Control) and the need to create a favourable environment for the profitable exploitation of their resources (improvement of value adding operations, improvement of ACP fish products' access to EU markets).

One needs also to recognise that divergences may arise between ACP countries, on issues such as the signing of access agreements with the EU, the choice of development model for their national fisheries, the review of the ROO.

fish and EU-based companies to process the catch ashore. Such countries may take a laissez-faire approach to negotiations on ROO. Others, who want to develop their fleets and the fisheries within their EEZs, may want to re-negotiate ROO so that any locally processed fish that is caught within their EEZs (and not just that caught by EU member states or ACP state vessels) qualifies for originating status.

Relevance of fisheries to the EU and its likely position

Key issues for the EU (and its member states) in fisheries

The two main features of EU fisheries of relevance for ACP states are:

- resource depletion in EU waters, where there has been a failure to achieve a sustainable balance between resources and their productivity on the one hand and fishing effort on the other; and
- increasing EU dependence on external fish supplies to meet the demands of both its market (processing and consumption) and fishing sectors (employment and investment).

The declining stock levels in EU waters, and the growing supply deficit in the marketplace are the main forces driving EU external fishing policy. Its fishing policy for ACP countries is therefore driven by the need to gain access to ACP fishery resources (both fishing grounds and fishery products). The fishery situation in the EU today (over-capacity, depleted resources, supply deficit, etc.) is both potentially promising and perilous for ACP states.

Today about 60% of fish consumed or processed in the EU comes from outside EU waters. The growing demand for fish is for both quantity and quality. Food safety standards have been established, and strict controls are applied to ensure compliance with sanitary and phytosanitary standards. These standards provide a strong check on the potential for

Box 7. EU communications in relation to fisheries relations with ACP countries

Communication from The Commission to the Council and The European Parliament on Fisheries and Poverty Reduction Brussels, 8.11.2000 COM(2000) 724 final
http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2000/com2000_0724en01.pdf

Council Resolution on Fisheries and Poverty Reduction. Brussels, November 2001.
http://register.consilium.eu.int/pdf/en/04/st11/st11485-re01.en04.pdf

Green Paper on The Future of The Common Fisheries Policy. Brussels, 20.3.2001 COM(2001) 135 final
http://europa.eu.int/comm/fisheries/greenpaper/green/volume1_en.pdf

Communication from The Commission on the reform of the Common Fisheries Policy ('Roadmap') Brussels, 28.5.2002 COM(2002) 181 final
http://europa.eu.int/comm/fisheries/doc_et_publ/factsheets/legal_texts/docscom/en/com_02_181_en.pdf

Communication from the Commission. Community Action Plan for the Eradication of Illegal, Unreported and Unregulated Fishing, COM(2002) 180 final,
http://europa.eu.int/comm/fisheries/doc_et_publ/factsheets/legal_texts/docscom/en/com_02_180_en.pdf

Communication from the Commission on an Integrated Framework for Fisheries Partnership Agreements with Third Countries. Brussels, 23.12.2002. COM(2002) 637 final. Commission of the European Communities.
http://europa.eu.int/comm/fisheries/doc_et_publ/factsheets/legal_texts/docscom/en/com_02_637_en.pdf

Council Conclusions on an Integrated Framework for Fisheries Partnership Agreements with Third Countries. Brussels, 19.07.04, final (see page 22)
http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/agricult/81505.pdf

ACP states to benefit from any value addition to its fishery products. These standards may also encourage the export of fish in a raw or semi-processed form, where, given the reduced number of fish handling operations, it may be less costly for ACP producers to ensure compliance with SPS standards.

Key fisheries provisions in existing EU agreements[22]

Existing EU agreements address three main issues:

1. fishery access for EU vessels (as in the case of all bilateral fisheries agreements/fisheries partnership agreements);
2. market access for third country products on the EU market (as in the case of the EU–RSA TDCA agreement, and the EU–Mexico and EU–Chile agreements); and
3. reciprocal arrangements for investment in fishery enterprises (as in the case of the Chile Association Agreement).

Until recently, there was no direct or otherwise overt linkage between agreements negotiated for fisheries access and agreements governing trade relations. Whilst successive Lomé Conventions and the Cotonou Agreement contain provisions on fisheries agreements, these are not tied to market-access conditions for ACP states. However, in its most recent free trade agreements with countries that have important fisheries resources (RSA and Chile), the liberalisation of trade in fisheries products is linked to the opening up of third-country waters to EU fleet access (through fisheries agreements and/or investment).

Bilateral fisheries agreements

As part of the compensation payment negotiated under bilateral fisheries agreements, a certain proportion may be set against mutually agreed 'targeted actions'. These often include a number of important management and research provisions, and also occasionally provisions for fishery development (artisanal fisheries, upgrading fish processing to comply with EU standards, etc.). However, there is no obligation on the part of the ACP state to report on how these funds are spent. This lack of transparency is a major constraint to promoting good governance and to ensuring that fishery development objectives are met. To date no bilateral fisheries agreement has included provisions for trade in fishery products.

The Euro-Mediterranean Association (MED) Agreements

Since the first Euro–Mediterranean Conference held in November 1995, the EU and 12 Mediterranean countries have been involved in talks on 'Association Agreements'. To date, ten bilateral Association Agreements have been concluded with ten countries: Turkey (1995), Tunisia (1995), Israel (1995), Morocco (1996), Jordan (1997), the Palestinian Authority (1997), Algeria (2001), Lebanon (2002), Egypt (2004), and Syria (initialled 2004, pending Council signature).

In those agreements where fisheries form a part (Algeria, Morocco and Tunisia), the main provisions are included under the broader area of Agricultural and Fishery Products or under Agricultural, Fisheries and Processed Agricultural Products. These cover two main areas:[23]

- liberalisation of trade in agricultural, fisheries and processed agricultural products (tariff concessions and tariff rate quota concessions) and
- co-operation in agriculture and fisheries.

The fishery products to be imported to the EU free of customs duties include salmon, herring, tuna, and various shellfish (crab, shrimp and prawns, lobster, mussels, etc.).

The main aims of the co-operation aspects of the agreements are the modernisation of agriculture and fisheries, the development of sea fishing and aquaculture, diversification of output, promotion of environmentally friendly forms of fishing, evaluation and rational management of fish stocks, modernisation of infrastructure and equipment, co-operation on sanitary and phytosanitary techniques, development of packaging and storage techniques, and the improvement of private distribution and marketing chains.

The EU–Mexico Economic Partnership, Political Coordination and Cooperation Agreement (Global Agreement)

The Economic Partnership, Political Coordination and Cooperation Agreement, also known as the Global Agreement, between the EU and Mexico was signed on 8 December, 1997 and came into force in October 2000.

For Mexican fishery products imported into the EU, and with the notable exception of tuna loins, tuna steaks and canned tuna, trade is to be fully liberalised by 2010. Four schedules of timetables establish the periods over which tariff concessions are to be implemented (3–10 years). Special conditions apply to tuna loins and tuna steaks/canned tuna (tariff-quota concessions). Likewise, tariff concessions and timetables are set for the import of fishery products from the EU to Mexico.

The Global Agreement states that: 'In view of the socio-economic importance of their respective fisheries sectors, the Parties undertake to develop closer co-operation in this field in particular through the conclusion of a sectoral fisheries agreement, in accordance with their respective legislation, if deemed appropriate.' To date (September 2005) no such agreement has been concluded.

The TDCA with RSA

In the EU–RSA TDCA there is an explicit link between liberalisation of trade in fisheries products and the signing of a fisheries access agreement. Article 62 on Fisheries states that: *'Co-operation in this area shall aim at promoting sustainable management and use of fisheries resources... This will be achieved by exchange of information... These arrangements will be set out in a mutually beneficial fisheries agreement which the Parties undertake to... complete as soon as possible'*. In Title II and Annex V it is made clear that the elimination of EU tariffs on South African fisheries exports will only come into effect once a fisheries agreement with the EU has been concluded.

Even then tariffs are not immediately removed. Schedules are established for the progressive removal of tariffs on South African fisheries exports over a 10-year period, with the future of tariffs on the most valuable South African fisheries exports, hake, monkfish and anchovy, being determined 'in the light of the content and continuity of the fisheries agreement'. Thus South African fish exporters will continue to face tariffs of between 8% and 15% on products exported to the EU, **unless South Africa concludes a fisheries agreement that is wholly acceptable to EU fishing interests.**

The EU–Chile Association Agreement

The FTA with Chile, signed in November 2002, is one of the most recent free trade agreements concluded by the EU. The agreement contains reciprocal provisions for the liberalisation of trade in fishery products. In the case of Chile, for most fishery products, with the notable exception of hake and some salmon and tuna products, tariff barriers are reduced to zero within four years, with a maximum transitional period of 10 years for 95% of fisheries products exported from Chile to the EU. For the rest (hake, salmon and tuna products), a system of tariff quotas applies.

In the case of the EU, customs duties for all listed fishery products are reduced to zero on the entry into force of the agreement. There is also a similar schedule of tariff quotas established for various fresh hake products, processed salmon products (dried, salted, smoked), and processed tuna (excluding loins) and hake products of EU origin for import to Chile.

In addition to these provisions, there is a separate Protocol on Fishing Enterprises. This establishes conditions for European investment in the Chilean fisheries sector. It sets out provisions under which the European owners of Chilean companies may register their vessels, buy licenses and quotas, and transfer vessels to Chile. The conditions are fully reciprocal, according to the national laws of member states.

The Protocol on Fishing Enterprises has four main components:

- Conditions governing ownership and control, which on the one hand authorise EU companies to own a major stake in, and to control and manage new or existing fishery enterprises in Chile; and on the other authorise reciprocal rights for Chilean companies in EU member states.

- Conditions governing registration and operation of fishing vessels. These entitle EU companies owning Chilean companies to apply for, register and operate fishing vessels in Chile, under the same conditions as Chilean companies. Reciprocal rights apply to Chilean companies owning companies registered in EU member states.
- Conditions governing fishing permits, which entitle EU companies to obtain fishing permits and their corresponding individual quotas (with reciprocal rights for Chileans).
- Conditions governing the transfer of licences and vessels, which entitles EU companies to receive, by means of transfer, fishing authorisations and vessels under the same conditions as Chilean companies. Reciprocal rights apply for Chilean companies (provided they comply with the capacity management objectives of the Common Fisheries policy).

Likely EU strategy in EPA negotiations

It should first be noted that there is significant institutional complexity for dealing with international fisheries issues in European institutions. In the context of EPA negotiations, unlike general issues regarding trade in goods, DG Trade has no unique competence on fisheries matters; DG Fish is also involved.

From a fisheries point of view, the EU is increasingly dependent on external fish supplies to meet both its market (processing and consumption) and fishing sector (employment and investment) demands.

Therefore, in the context of EPAs, EU fisheries concerns that are likely to have an influence are:

- the interests of the EU catching sector for direct resource access (including investment in local fishing enterprises); and
- the interests of EU processing and trade sectors for tariff-free access to EU markets for both raw fish and certain value-added fish products.

The European Commission did not include fisheries in its 'Directives for the negotiations of Economic Partnership Agreements with ACP countries and regions', adopted in June 2002.[24] However, some key elements of the EU position for dealing with fisheries matters in EPAs were presented in December 2004.[25] DG Trade reiterated that general EPA objectives will also apply to fisheries: reciprocal market access, South–South integration, gradual integration of the ACP countries into the global economy, using trade policy as an instrument for development (carefully managed reciprocal liberalisation, services and trade-related areas – e.g. SPS).

Specifically, in EPAs the focus on supporting the ACP countries' fisheries development will be:

- competitiveness (to manage erosion of preference) and improvements in overall trade performance;

Box 8. EU FTA and related documents

CFFA-CAPE (2005) Comparing EU Free Trade Agreements : Fisheries. ECDPM InBrief 6J. Maastricht : ECDPM with CTA – the Technical Centre for Agriculture and Rural Cooperation ACP-EU. www.ecdpm.org/ftainbriefs and http://agritrade.cta.int

EU–MED Agreements:
http://europa.eu.int/comm/external_relations/euromed/med_ass_agreemnts.htm

EU–Mexico Agreement:
http://europa.eu.int/comm/trade/issues/bilateral/countries/mexico/fta_en.htm

EU–Chile Agreement:
http://europa.eu.int/comm/external_relations/chile/assoc_agr/text.htm

EU–South Africa TDCA:
http://europa.eu.int/scadplus/leg/en/lvb/r12201.htm

EU–CPA:
http://europa.eu.int/comm/development/body/cotonou/index_en.htm

EU–ACP Fisheries Agreements:
http://europa.eu.int/comm/fisheries/doc_et_publ/factsheets/facts/en/pcp4_1.htm

- improvement in supply-side capacity (issues like SPS should be addressed);
- duty-free access for fisheries products will be maintained and there will be an opportunity to look again at rules of origin; and
- development of regional markets and regional trade (trade facilitation, customs, integrated markets).

In terms of broader EU–ACP fisheries relations, it is therefore likely that the EU will adopt a two-pronged approach. On the one hand the EPA framework agreements will set out the broad conditions under which trade, development, and investment may take place. On the other the EU will negotiate separate bilateral Fishery Partnership Agreements (FPAs), which include the possibilities for public support to the transfer of technologies and vessels to the ACP countries involved. The signing of FPA may, like in the case of RSA, be part of the deal for the ACP to benefit from free access to EU markets.

Other elements will also condition the 'free access' to the EU market, such as the compliance with the ROO and SPS measures. Given the importance of both catching and processing activities for certain European countries and the EU policy choices on consumers' safety, it is unlikely that the EU will agree to a substantial revision of the existing ROO and SPS conditions, though these clearly place significant constraints on the access of ACP fishery products to the EU market.

Negotiation options for the ACP countries

The following general recommendations and specific issues should be considered.

General recommendations

These recommendations will apply differently in different ACP contexts according to the diversity of characteristics and existing fisheries relations between ACP countries and the EU.

- **The need for ACP to have a national/regional fisheries policy**

A prerequisite for ACP countries to enter into fisheries negotiations with the EU is to have a well-defined fisheries policy, with clear priorities within their national fisheries development plans, taking into account the long-term needs of the local (catching and processing) sectors. If not, then past experience shows that the local fisheries sector development will always be afforded second priority to the signing of a fisheries partnership with the EU, and short-term benefits ('cash for access' arrangements) will be privileged over long-term sustainable development.

Improved fisheries management in ACP countries should lead to more sustainable and equitable use of its fish resources, guaranteeing future supplies of fish to both local populations and to regional and international markets. In the future, funds paid by the EU for access to ACP fishing grounds through FPAs should also increasingly be allocated for such purposes.

- **The importance of developing an understanding of the fisheries sector and promoting fishery sector participation in the negotiating processes**

ACP states should develop their fisheries based on an understanding of the fragile nature of their tropical fishery ecosystems; the existing fishing sector and the social structure of the coastal communities

Box 9. In short ...

Recent experience in South Africa and Chile suggest that the EU's negotiating strategy for fisheries in the context of EPAs will be to:

make EU market access for ACP fishery products conditional on granting the EU access to ACP fishery resources; and

press for favourable conditions for direct EU investment in ACP fisheries sectors.

The EU is also likely to press for the maintenance of the status quo as regards the ROO, as these strongly favour their own domestic processing industries and (as noted below) confer strategic advantages to their distant water tuna fleet.

Box 10. The role of RFMOs

Regional fisheries organisations, particularly the Regional Fishery Management Organisations (RFMOs), have an important role to play in the management of fishery resources, including high-seas resources, resources that migrate between ACP EEZs, shared stocks, and straddling stocks.

There are more than twenty regional and sub-regional fishery bodies worldwide. Some have full regulatory powers while others play an advisory role on management issues. The functions of these bodies vary from dealing with a single species or group of closely related species, to those based more on a region and covering a whole range of species within their areas of competence. The activities of these organisations have important implications for both ACP coastal states and EU distant-water fishing fleets.

RFMOs of importance for ACP states include:

- for West Africa: the International Commission for the Conservation of Atlantic Tunas (ICCAT);
- for Indian Ocean: the Indian Ocean Tuna Commission (IOTC); and
- for Pacific: the Commission for the Conservation of Southern Bluefin Tuna (CCSBT) and the Western and Central Pacific Tuna Commission (WCPTC).

that depend on fishing; the natural capital that fisheries represent; and the potential long-term benefits to be realised from sustainable fisheries resource exploitation. ACP countries should therefore build up, through appropriate independent research, an in-depth understanding of their fisheries sector.

Full transparency, provision of appropriate information, and well-prepared participation of the local ACP fisheries sector to the negotiating process are important in promoting the sustainable development of ACP fisheries.

- **Pursue the development of a regional approach**

A number of regional groupings of ACP countries,[26] are developing a regional approach for bilateral dealings with distant-water fishing nations and access to markets for fish like the EU. These include the SADC (Southern African Development Community), the Common Market for Eastern and Southern Africa (COMESA), SRFC (Sub Regional Fisheries Committee-West Africa), and the FFA (Forum Fisheries Agency – Pacific).

Such efforts should be strengthened, taking particular account of the importance of participating in Regional Fisheries Management Organisations (RFMOs). It should be noted that all ACP coastal countries are not members of their relevant RFMOs. This is a major constraint for developing a regional approach to negotiations with the EU. In the short term, it should be a priority of all ACP coastal states to become active members in these RFMOs.[27]

Joint approaches for the negotiation of EPAs and FPAs could be developed through such regional frameworks, based on the work and recommendations of RFMOs with the following objectives:

- the harmonisation of minimum terms and conditions for access for third-country vessels to their EEZ (level of access, joint initiatives for fisheries management, research, monitoring and control, etc.);
- the development of a common set of standards and criteria to guide the setting up of joint ventures and investments in the ACP fisheries sector. This is important because EPAs may include provisions for EU enterprises to become registered in ACP states (for both catching and processing fish), and for the transfer of EU vessels to these enterprises. The drawing up of a common code of conduct and criteria for joint ventures and vessel transfers could greatly assist ACP states in avoiding the problems of stock depletion and fleet over-capacity, problems that beset the fisheries in the community waters of the EU.
- the elaboration of joint negotiating positions on such issues as ROO, where current arrangements discriminate against ACP states; and
- resources conservation issues.

Specific elements to consider when negotiating fisheries aspects of EPAs

The need to achieve coherence between the provisions of EPAs and those of bilateral Fisheries Partnership Agreements

The signing of an FPA can have important repercussions on the trading capacity of an ACP country, and therefore on the implementation of an EPA. The following aspects in particular need to be given careful consideration by ACP states in order to achieve coherence between regional EPAs and bilateral FPAs, and to secure long-term benefits for the ACP coastal communities and fisheries sectors.

- The main fisheries issue facing ACP countries today is declining fish catches due to over-fishing by both national and foreign fleets. If an FPA provides access to resources and/or ecosystems that are already fully exploited or over-exploited, it will hamper the long-term prospects for resources renewal and will undermine the basis for developing sustainable trade in fish and fisheries products.
- As mentioned above, the restrictions imposed by ROO force ACP tuna processors to purchase from EU suppliers in order to produce originating products. Some ACP states are therefore encouraged to grant EU vessels preferential access to their EEZs so as to ensure that their tuna canneries are supplied with 'originating tuna'.
- The financial compensation of an FPA can be used to address trade-related issues such as SPS. Support to fight IUU fishing, provided through an FPA, can also promote fish trade, in as much as it can help avoid trade sanctions against fishing products coming from IUU sources.

The basis for bilateral Fisheries Partnership Agreements

Whilst it may be possible to define some minimum general conditions for EU fisheries access to ACP fishing grounds, ACP states as a group may be better advised to negotiate the fisheries components of EPAs on a bilateral/regional basis and not a multilateral basis, given the diversity of situations.

Some common essential elements for future bilateral ACP–EU partnership agreements could be defined at regional level. Consulted on that topic,[28] ACP stakeholders mentioned the following:

- Sustainable exploitation of eco-systems, where the strengthening of institutional capacity for research, management, control and surveillance are particularly important.
- A more effective contribution to be provided by the EU fisheries sector for the social and economic development of ACP countries, through the creation of joint ventures, mainly for value adding activities.
- Better education and training of people involved in the sector (catching and processing), on various aspects: catching techniques, hygienic handling of fish, management of micro-enterprises, but also on the importance of preserving marine environment (avoiding behaviour that causes marine pollution, like servicing engines at sea), basic health education (HIV prevention, etc).
- Transparency and good governance.

The main aspect highlighted in the discussion was the importance of stakeholder participation in the decision-making process of ACP–EU FPA negotiations, and several proposals were made to improve this, including:

- Consultation mechanisms need to be set up that improve linkages between ACP administrations, researchers, the fishing sector and civil society. FPAs should support the establishment of consultative bodies for fisheries management and development. Contacts should also be established with EU consultative committees to facilitate co-operation in the area of fisheries management.
- Meetings need to be organised between the ACP and EU fisheries sectors to prepare for the signing up of an FPA. The ACP sector development constraints, the access of ACP fish products to the EU markets, and possible collaboration for adding value activities in ACP countries should be discussed in such forums. Such discussions need to take into account the level of develop-

ment of local ACP enterprises, and recommendations arising from them should feed into official FPAs negotiations. Final agreements for an FPA should be reached with the full participation of the private sector on both sides.

Investment/establishment of fishery joint ventures

ACP states should carefully consider what is being proposed by the EU, in both EPAs or FPAs, for promoting fisheries sector investment and setting up joint enterprises.

From the ACP point of view, joint ventures should be promoted, 'particularly in the processing sector where they offer the most potential benefits for ACP countries'.[29]

For what concerns joint ventures in the catching sector, 'the primary issue is conservation of fisheries resources and joint ventures should only be concluded when there is scientific data showing that these will not contribute to over-fishing or disrupt local harvesting, marketing and processing activities'.[30]

However, on the EU side, the strong EU fishing industry lobby, mainly from the catching sector,[31] wants to secure support for establishing fishery enterprises in ACP countries in order to secure access to ACP fish resources for its vessels.

This was confirmed by the European Parliament last July, when it asked for the reintroduction of subsidies for joint ventures, to be provided only for the catching sector, and the transfer of boats.

In ACP countries, investments are particularly needed in infrastructure – basic infrastructure (roads, water, electricity) as well as fish processing infrastructure – in order to increase the value ACP countries can derive from their fishery resources. The improvement of value-adding operations for fish requires an understanding of the dynamics of markets, at regional and international level, and improving ACP regional integration.

The promotion of sustainable ACP–EU fisheries relations requires particular investment in:

- improving infrastructures and services to be used by EU fleets (harbour, landings, transporting the fish to the processing plants, etc.)
- enhancing ACP capacity to address EU sanitary and phytosanitary measures (SPS) and traceability requirements; and
- developing ACP regional markets for fisheries products, and other alternatives to the European market, so that ACP exporters will be less dependent on EU markets for selling their products.

In cases where EU investment is promoted in ACP fisheries sector, it is important to develop a policy framework for the working environment and for environmental regulations (for discharges, use of toxic chemicals, antibiotics, etc.) in the enterprises set up. In that context ACP should look at the OECD guidelines for multinational enterprises.[32] These guidelines provide recommendations from governments to multinational enterprises operating in OECD member or adhering countries, such as the EU. They provide voluntary principles and standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation.

Market access for fishery products under EPAs

ACP countries have to deal with market-access issues both at regional and international level, in particular to access the EU market.

- **Issues for regional market access**

Regional fish trade in ACP countries has not yet realised its full potential. It should be encouraged with a gradual dismantling of existing barriers to trade, including the lack of transport infrastructure, import tariffs and burdensome bureaucratic measures.

- **Issues for EU Market access**

Tariffs elimination – Erosion of preferences

ACP should negotiate for longer implementation periods for the liberalisation of fish trade or for compensation mechanisms. There is also a need to negotiate a reduction of the tariff escalation structure between raw fish and processed fish products, in order to lessen the impacts of the ROO on ACP fish-trade capacity. This is particularly important for

Box 11. Information sources

www.acp-eu-trade.org
Agritrade portal – fisheries (CTA):
http://agritrade.cta.int/fisheries/index.htm

Market Access section:
http://agritrade.cta.int/fisheries/market_access/

WTO section:
http://agritrade.cta.int/fisheries/wto/index.htm

ACP-EU Fisheries relations
http://agritrade.cta.int/fisheries/agreements/index.htm

EU Common Fisheries Policy
http://agritrade.cta.int/fisheries/cfp/index.htm

FAO SOFIA 2004:
www.fao.org/documents/show_cdr.asp?url_file=/DOCREP/007/y5600e/y5600e00.htm

FAO GLOBEFISH website
www.globefish.org/entry_infopeche.htm

Detailed fish trade regulations (health and safety) for the EU market can be found on the Globefish website

www.globefish.org/presentations/rulesandregs/health%20and%20safety/regional/Europe/eu/hseu.htm

The Codex Alimentarius and the international food trade
www.fao.org/docrep/W9114e06.htm#TopOfPage

EU trade issues
http://europa.eu.int/comm/trade/issues/index_en.htm

Publications

Report of the study on the impact of international trade in fishery products on food security
www.globefish.org/index.php?id=2168

EC Green Paper on the future of the common fisheries policy, Brussels, 20.3.2001 COM (2001)
http://europa.eu.int/comm/fisheries/greenpaper/green/volume1_en.pdf

Communication from the EC on an integrated framework for FPAs with third countries
http//europa.eu.int/comm/fisheries/doc_et_publ/factsheets/legal_texts/docscom/en/com_02_637_en.pdf

EC submission to WTO negotiating group on rules (public document)
http://trade-info.cec.eu.int/doclib/docs/2003/april/tradoc_113000.pd

ACP fish products like tuna, that can't meet the rules of origin requirements, and then have to pay high tariffs.

Technical barriers – Sanitary and phytosanitary issues
ACP countries and exporters should seek support for effectively implementing WTO agreements on Technical Barriers to Trade and on Sanitary and Phytosanitary issues.

Appropriate support should be sought from the EU, through the variety of instruments available (Development Cooperation, Centre for the Development of Enterprise and FPAs – provided this support is not linked to unsustainable levels of access to ACP fishery resources). In particular emphasis should be put on supporting small and medium-scale ACP fisheries enterprises.

Rules of origin (ROO) requirements
There is a need to revise current rules of origin applicable to fisheries products in order to make them less restrictive and more development oriented. In order to be able to negotiate appropriate changes, there is a need for better interaction between ACP administrations and private sectors, and for a more proactive approach in formulating and promoting alternatives.[33]

Endnotes

1. *The State of World Fisheries and Aquaculture 2004*, (SOFIA), FAO, Rome www.fao.org/documents/show_cdr.asp?url_file=/docrep/007/y5600e/y5600e00.htm.
2. The difference between the costs of imports and the total value of exports.
3. Through the United Nations Convention on the Law of the Sea (UNCLOS).
4. A recent example of such a conflict was the EU complaint to the WTO against Chile for closing its ports to EU vessels fishing in international waters. Chile responded by challenging the EU under the conservation provisions of the United Nations Convention on the Law of the Sea (UNCLOS).
5. Products from competing countries may benefit from special free trade arrangements (as in the case of fish products from Chile under the 2002 Chile–EU Association Agreement), or other arrangements (including special GSP provisions).
6. The Exclusive Economic Zone (EEZ) is a belt of sea and seabed, of 200 nautical miles, adjacent to the national boundaries where the state claims preferential fishing rights and control over the exploitation of mineral and other natural resources.
7. The first targeted actions were introduced at the signing of the 1994 EU–Senegal fisheries protocol, after strong campaigning by a Senegalese artisanal fishworker's organisation, supported by European NGOs.
8. 'Review of Impacts of Illegal, Unreported and Unregulated Fishing on Developing Countries', MRAG, June 2005. Downloadable at www.dfid.gov.uk/pubs/files/illegal-fishing-mrag-synthesis-report.pdf
9. Demersal fish species are species living close to the sea bed.
10. Pelagic fish species are species living in the open sea, away from the sea bottom. They are often highly migratory and travel between several countries' Exclusive Economic Zones.
11. These groupings do not necessarily coincide with existing trading blocks involved in EPA negotiations, or with UN classifications (Least Developed Countries, Small Islands Developing States). However, these groupings may have a particular relevance for negotiation of fisheries relations with the EU, as these relations need to envisage not only trade and market access issues but also issues arising from the EU fleet's access to ACP fish resources.
12. A mixed fisheries agreement establishes fishing opportunities for a variety of fish stocks, such as crustaceans, small pelagic species, demersal species and tuna.
13. A type of fishing net used to surround and catch large schools of fish, particularly tuna species. The net (or seine) is pulled in a circle to surround the school then drawn shut at top and bottom, much like a purse.
14. A man-made floating object set at sea to attract pelagic fish such as tuna.
15. The main relevance of these agreements is that they provide an opening for the EU to legitimately expand its tuna fishing activities in the Pacific. The EU has recently signed the 'Convention on the Conservation and Management of Highly Migratory Fish Stocks in the Western Central Pacific Ocean (WCPTC)', and these agreements will provide it with the necessary catch histories for future quota allocations.
16. See for example OECD publication 'Extracts from the Development Cooperation review series concerning policy coherence', p.48. www.oecd.org/dataoecd/23/16/25497010.pdf
17. Given the proximity of EU landing ports, West African fisheries' access agreements have been described as 'pay, fish and go', in as much as the EU fishing vessels, once the financial compensation is paid to the West African country, come to fish and go away, without landing in the ACP country.
18. Most of the fisheries access agreements have provisions for landings, but very rarely are these landings obligatory since there are also provisions in the agreement that allow EU boat owners to default on their obligations to land fish if they make a compensation payment. The quality of the landings is not stipulated, and EU boats tend to land lower value fish (both in quality and species).
19. These include an electronic consultation on ACP–EU fisheries relations, organised by the CTA in November 2004, and a ACP/COMSEC/CTA meeting on the same subject, organised in December 2004.
20. In this case, the 'right to pursue' refers to the right granted by a government to another to pursue and apprehend vessels engaged in illegal fishing activities if and when they escape into its waters.
21. See FAO paper COFI/2005/5 'Supporting Small-scale Fisheries Through an Enabling Environment' www.fao.org/documents/pub_dett.asp?lang=en&pub_id=168492 and comments in *Samudra Magazine*. http://icsf.net/jsp/publication/samudra/pdf/english/issue_40/art15.pdf
22. For a detailed discussion, see CFFA–CAPE (2005), 'Comparing EU Free Trade Agreements : Fisheries', *ECDPM InBrief 6J*, ECDPM with CTA – the Technical Centre for Agriculture and Rural Cooperation ACP–EU, Maastricht. www.ecdpm.org/ftainbriefs and http://agritrade.cta.int
23. Fisheries access to third-country waters in the Mediterranean for European vessels is not an issue. The reason is that there are no 200-mile EEZs in the Mediterranean. Thus there is little need for the EU to enter into fisheries access arrangements with third countries in the Mediterranean
24. Available at www.epawatch.net/general/text.php?itemID=71&menuID=24
25. 'Overview of Economic Partnership Agreements (EPAs) and related fisheries issues', Lisa Mackie, DG Trade, presented at the expert meeting 'ACP EU Fisheries relations – Maximising socio-economic benefits for the ACP fisheries communities' organised by ACP sec/COMSEC/CTA December 2004
26. Either related to EPA configuration or deriving from Regional Fisheries Management Organisations.
27. A proposal was made by ACP participants to an e-consultation organised by CTA in November 2004 on ACP–EU fisheries relations, that all ACP countries that have distant-water fleets active in their EEZ should be automatically made members of the relevant RFMOs.
28. E-consultation on ACP–EU fisheries relations, CTA, November 2004.www.cape-cffa.org/issues/E-report%20ACP-EU%20Fisheries%20Relations%20-%20social%20and%20economic%20benefits%20%28December%202004%29.doc
29. E-consultation on ACP–EU fisheries relations, CTA, November 2004. www.cape-cffa.org/issues/E-report%20ACP-EU%20Fisheries%20Relations%20-%20social%20and%20economic%20benefits%20%28December%202004%29.doc
30. Expert meeting on ACP EU Fisheries relations – Maximising socio-economic benefits for the ACP fisheries communities, Brussels, 13–14th December 2004, Conclusions and Recommendations.
31. Interestingly, the EU's fish-processing and marketing sectors are not very much involved in FPA/EPA negotiations, despite the fact that their interests, in some cases, may be more complementary to the ACP interests than those of the catching sector.
32. www.oecd.org/department/0,2688,en_2649_34889_1_1_1

_1_1,00.html and Foreign Direct Investment and the Environment, WWF, August 1999 www.oecd.org/dataoecd/9/48/2089912.pdf
33. Expert meeting organised by CTA–ACP Sec and COMSEC on ACP–EU Fisheries relations – Maximising socio-economic benefits for the ACP fisheries communities, Brussels, 13–14 December 2004, Conclusions and Recommendations.

24

EU Rule of Origin for ACP Tuna Products (HS Chapter 16.04)

Lindsey Block and Roman Grynberg

Introduction

This chapter considers the rule of origin (ROO) for canned tuna and tuna loins in the Cotonou Agreement, which is the preferential agreement between the EU and the African, Caribbean, Pacific (ACO) group of countries. This particular rule of origin is much more significant than it would at first appear as it is virtually identical for all EU preferential arrangements and hence the basis for 530,000 tonnes of canned tuna production and trade in the EU. The rule of origin is important for developmental and commercial reasons as it has been the basis of almost thirty years of continual trade disputes and negotiations between the EU and the ACP dating back almost to the very promulgation of the Lomé Convention[1] in 1975. The rule of origin viewed within the context of the significant margin of preference for canned tuna has been a key part of EU fisheries policy, for as we shall see the rule has been instrumental in not only providing tariff protection for EU canneries but also providing a very substantial subvention to ACP states to provide access to their EEZ for EU distant-water fishing fleets. The long dispute over the rule of origin stems from the fact that while the EU's margin of preference has in effect created the ACP canning industry while it has has limited the ability of ACP states to develop their own EEZ in an economically efficient manner.

Under the terms of the Cotonou Agreement the various ACP regions and the EU are in the process of commencing negotiations for Economic Partnership Agreements (EPAs), which are in effect free trade areas. The rules of origin governing the new trading arrangements, are to be integral to the EPA and will be crucial to their success.[2] The purpose of this chapter is to consider the rule of origin within these EPA negotiations.[3] The focus of this study is the ROO for tuna products, specifically canned tuna and tuna loins under HS Chapter heading 16.04, exported from ACP states to the EU.[4] The study also considers, in some detail, the role, consequences and apparent motives behind the EU ROO in an area of significant social, political and economic importance to both the EU and ACP group.

The chapter is organised as follows: The background section establishes the importance of the tuna sector to the EU and ACP group, providing an economic and political economy context for the paper. The ROO in the Cotonou Agreement is then reviewed as both the rules governing current trade in these products, and the likely basis for further negotiation. This section explores how the ROO for canned tuna products is not based on substantial transformation, which is fundamental to the ROO normally imposed on manufactured products. Instead, the Cotonou rule of origin focuses only on the origin of the raw material used in the manufacture of these products, and thus appears to violate the Kyoto Convention. Following this, we analyse the current ROO with respect to three objectives or functions that they may be considered to encompass. This raises questions regarding the legitimate functions of preferential ROO and the potential consequences, whether intentional or otherwise, of fulfilling these functions, on the ultimate objective of the trade preferences that ROO are purportedly designed to facilitate, namely, sustainable economic development in ACP states. The first of these functions is to prevent trade deflection and fraud, thus protecting the integrity of trade preferences by granting them only to beneficiary countries where, in the case of processed products, 'substantial transformation' has occurred. Secondly, in practise, it is difficult to distinguish between this first function and their role in serving strategic trade interests of preference-granting countries. This role may diminish the potential value of trade preferences to the beneficiary countries and this possibility is examined in the final section, which considers the role of ROO in augment-

ing, or at least preserving, the potential developmental impact of trade preferences in beneficiary countries.

This chapter provides no easy resolution to what has become an intergenerational dispute over the tuna rules of origin.[5] The resolution remains economic rather than legal or technical. Only once the EU recognises that there is a need for a fundamental repositioning of its commercial interests in fisheries following the decline of fish stocks in community waters and that its ongoing fisheries policy of exporting its excess fishing capacity to ACP states by negotiating access agreements is unsustainable, will there be a resolution of the issue. The EU needs to recognise that its long-term economic interests lie in a smooth adjustment out of a sector where it has lost its comparative advantage and a move, in the long term, to the supply of fish to the EU market. The EU's real long-term comparative advantage lies in exporting the commercial and technical skills and capacity to the tuna-rich ACP states to develop the ACP's ability to supply tuna fish. Like many such disputes, it is unlikely to be solved but may yet become irrelevant because of a repositioning of EU and ACP industries caused by conscious policy or, more likely, by MFN liberalisation of the tuna tariff following the closure of the Doha Round.

Background

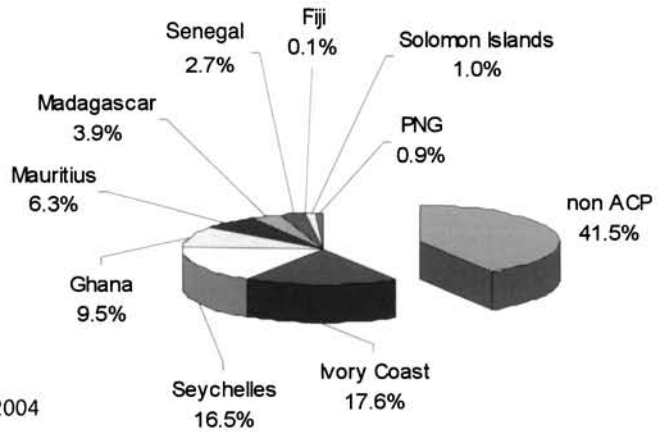
The importance of fisheries to the EU and ACP group

The European market is the leading world market for canned tuna (some 530,000 tonnes, of which 280,000 tonnes are imported) ahead of the United States (400,000 tonnes of which a large share (120,000 tonnes) are imported from Thailand) and Japan (100,000 tonnes, of which 30,000 tonnes are imported). The bulk of the EU's tuna interests are in supplying its existing facilities with raw materials and the rules of origin reflect this commercial reality. Spain remains by far the EU member with the largest interest in tuna products with a catch of approximately 400,000 tonnes in 2000, coming mostly from third country (principally ACP) access agreements.[6] Imports as a percentage of total EU canned-tuna supply are increasing and this presages several developments of importance to the ACP and the EU. First, as the community waters have never been a major source of tuna, the decreased relative importance of domestic production may facilitate an eventual shift in EU attitudes towards rules of origin for tuna. Second, but of even greater significance, is the fact that the decreased relative significance of domestic EU production of canned tuna will make it easier for the EU at the end of the Doha Round to extend even further MFN concessions to WTO members.

The key EU members with an interest in the fisheries sector are Spain, France, Portugal and the UK. With declining fish stocks in community waters combined with overcapacity of fishing fleets and/or processing plants, and the implication of this for rising unemployment,[7] there is significant political pressure to maintain access to the resources of other countries' fisheries. The two biggest EU processed-tuna producers, France and Spain, are also those with these biggest ownership stake in fleets operating in ACP Exclusive Economic Zones (EEZs),[8] indicating the significant supply-chain linkages between the two regions. The majority of the UK's market, for example, is supplied by two multinational companies that do not have vertically integrated fishing fleets but instead have exclusive agreements with companies operating in several ACP states.[9] In terms of global processed-tuna production, Spain and France are among the top 10 producing countries, as are several Asian countries such as Japan, Taiwan, Indonesia, Korea and the Philippines.[10] Consumption as well as production is significant from an EU perspective, the EU market for canned tuna being the world's largest,[11] consuming domestically produced and imported products. Annex I illustrates the current EU MFN tariffs for processed tuna imports. The tariffs for raw tuna imported into the EU for further processing are zero, but for raw tuna imported for any other purpose, and all processed tuna such as loins and cans, the tariffs are extremely high, ranging from 22 to 24%.

Several ACP states have substantial tuna resources in their EEZs. The most important for the EU are the Indian Ocean resources from the Seychelles and Mauritius. The largest segment of the EU distant-water fisheries fleet is now based in the

Figure 1. Sources of EU canned tuna imports (%), 2000

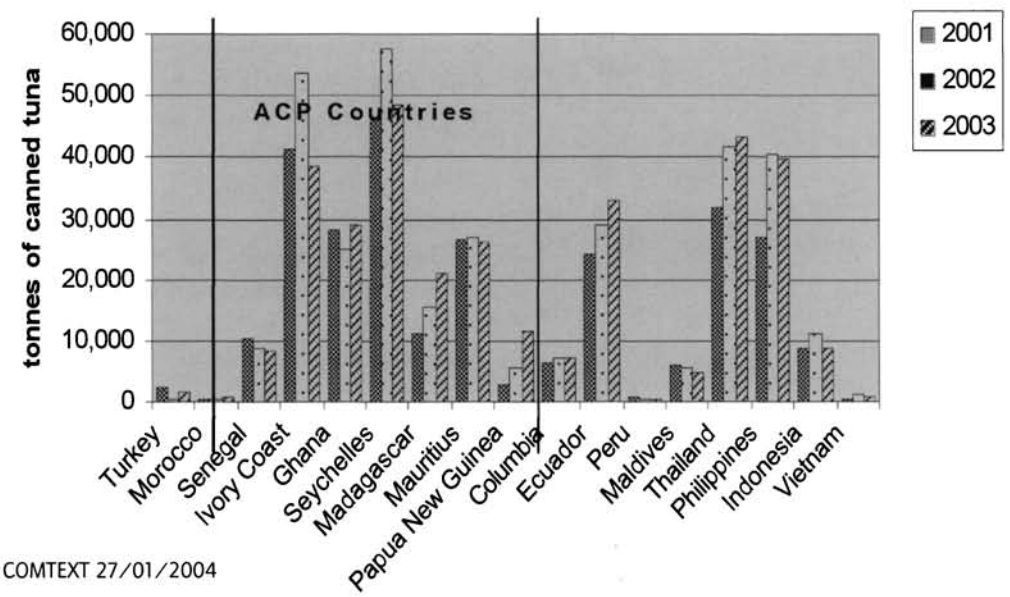


Source: COMTEXT 27 /01/2004

Seychelles. The Pacific tuna fishery in particular being the largest in the world, but the EU has only recently shown interest in this resource, negotiating access agreements with Kimbati and Solomon Islands.[12] This resource supports many locally based fleets and processing operations in the region as well as those abroad. EU interest in Pacific EEZ's has to date centred on gaining access for Spanish and French-owned purse seine vessels which are the 'engine room' of cannery and tuna loin production.[13] There are also significant ACP tuna resources and processing activities throughout coastal countries in Africa that have attracted EU vessels and investment, for example Ghana and Senegal. None of the major ACP tuna producers have the domestic fleet capacity to meet the fish supply needs of their canneries. Those ACP states with domestic processing industries and tuna-rich resources in their EEZs therefore grant access to foreign vessels in order to supply their own canneries as well as receive access fees where foreign vessels do not land their catch.

The importance of the EU market for ACP canned-tuna exports from Africa and the Pacific is illustrated in Figures 1 and 2. The specific relation-

Figure 2. Sources of EU canned tuna imports (tonnes), 2001-03



Source: COMTEXT 27/01/2004

ship with EU fisheries varies between each ACP state depending on country-specific characteristics such as colonial history, tuna resources, location, and the existence and structure of domestically owned fleets and processing industries. What is significant is that the ACP producers remain by far the largest suppliers, but are by no means the most competitive.

Cotonou ROO for fisheries products and the Kyoto Convention

The current ROO governing preferential access for ACP exports into the EU are detailed in the Cotonou Agreement, Annex V, Protocol 1 and its related annexes. The 'wholly obtained' rules governing raw fish (including tuna) are contained in Article 3 of the Protocol, of which the relevant paragraphs are reproduced in Box 1. It should be noted that this is the same rule of origin (with the exception of manning requirements) for wholly originating fish in all EU preferential arrangements, with the notable exception that the manning requirements (normally 75% qualifying area content) are more stringent in non-ACP arrangements. While there have been minor changes with regard to several issues such as derogation, this rule has remained in place since the beginning of the Lomé Convention in 1975.

Subparagraph 1(e) clearly states that fish caught 'there' by any vessel, regardless of its ownership, will be originating within the ACP state. 'There' is taken to mean the territorial sea of the ACP state over which it has sovereignty, which international law[14] defines as the sea within 12 miles of its coast. Complexities arise with the concept of 'their vessels' and 'their factory ships' which are introduced in subparagraphs 1(f) and (g). Fish caught outside the ACP's territorial waters but within and outside its EEZ,[15] will only be granted originating status if the vessels that caught the fish comply with the stringent registration, ownership, flag and employment conditions of paragraph 2. Thus fish caught by an ACP-owned vessel outside its territorial waters and exported under the Cotonou Agreement will be originating, as would be fish caught by an EU vessel. However, fish from an ACP state's EEZ caught by a vessel owned by a third country will not be originating (unless there is significant joint ownership with either an ACP or EU state as detailed in paragraph 2, or the EU has already declined this particular fishing opportunity and several other stringent conditions have been met as required in paragraph 3). It is therefore clear that these wholly originating ROO for fish discriminate between the EU and any third country that may have an interest in fishing in the EEZ or beyond the EEZ of an ACP state. Of key interest is whether, and how, this discrimination distorts the ROO in such a way as to undermine the value of trade preferences and therefore justify their substantive renegotiation under EPAs.[16]

For processed tuna products the ROO are contained in Annex II to Protocol I which lists the working or processing required for non-originating materials to become originating. In the case of processed tuna products (HS Chapter 16 which includes tuna loins and canned tuna) Box 2 below illustrates how the rules require that the starting materials must be raw fish (HS Chapter 3) that is already wholly originating. The stringent conditions for granting wholly originating status to raw fish are therefore paralleled with respect to the originating status of processed tuna products. Prescribing ROO to manufactured products is fundamentally a matter of defining the process through which 'substantial transformation' has occurred. For canned tuna entering the EU market under MFN tariffs there are no restrictions on where the fish comes from.[17] Yet to obtain preferential access to the EU market, the same ACP products must satisfy complex and restrictive criteria regarding the source of their materials that are unrelated to the degree of 'substantial transformation' that the product has undergone.

The rule of origin set out in Box 2 raises serious questions regarding its compatibility with the Kyoto Convention[18] and the EU's obligations to abide by its terms.[19] Annex D1 of the Convention defines the rules pertaining to what remained – until the Uruguay Round agreements the only significant international instrument in this area.[20] Annex D1 and subsequent agreements differentiate between wholly originating products such as unprocessed tuna and products of mixed origin.

Box 1. Cotonou Agreement, Annex V, Protocol I, Article 3 – Wholly Obtained Products

1. The following shall be considered as wholly obtained, in the ACP states or in the Community, or in the overseas countries and territories defined in Annex III, hereafter referred to as the OCT:

(a) mineral products extracted from their soil or from their seabed;

(b) vegetable products harvested there;

(c) live animals born and raised there;

(d) products from live animals raised there;

(e) products obtained by hunting or fishing conducted there;

(f) products of sea fishing and other products taken from the sea outside the territorial waters by their vessels;

(g) products made aboard their factory ships exclusively from products referred to in subparagraph (f);

(h) used articles collected there fit only for the recovery of raw materials, including used tyres fit only for retreading or for use as waste;

(i) waste and scrap resulting from manufacturing operations conducted there;

(j) products extracted from marine soil or subsoil outside their territorial waters provided that they have sole rights to work that soil or subsoil;

(k) goods produced there exclusively from the products specified in subparagraphs (a) to (j).

2. The terms 'their vessels' and 'their factory ships' in paragraph 1(f) and (g) shall apply only to vessels and factory ships:

(a) which are registered or recorded in an EC Member State, in an ACP State or in an OCT;

(b) which sail under the flag of an EC Member State, of an ACP State or of an OCT;

(c) which are owned to an extent of at least 50 per cent by nationals of States party to the Agreement, or of an OCT, or by a company with its head office in one of these States or OCT, of which the Chairman of the Board of Directors or the Supervisory Board, and the majority of the members of such boards are nationals of States party to the Agreement, or of an OCT, and of which, in addition, in the case of partnerships or limited companies, at least half the capital belongs to those States party to the Agreement or to public bodies or nationals of the said States, or of an OCT; and

(d) of which at least 50% of the crew, master and officers included, are nationals of States party to the Agreement, or of an OCT.

3. Notwithstanding the provisions of paragraph 2, the Community shall recognise, upon request of an ACP State, that vessels chartered or leased by the ACP State be treated as 'their vessels' to undertake fisheries activities in its exclusive economic zone under the following conditions:

- that the ACP state offered the Community the opportunity to negotiate a fisheries agreement and the Community did not accept this offer;
- that at least 50% of the crew, master and officers included are nationals of States party to the Agreement, or of an OCT;
- that the charter or lease contract has been accepted by the ACP–EC Customs Cooperation committee as providing adequate opportunities for developing the capacity of the ACP State to fish on its own account and in particular as conferring on the ACP State the responsibility or the nautical and commercial management of the vessel placed at its disposal for a significant period of time.

Box 2. Cotonou Agreement, Annex V, Protocol I, Annex II, Chapter 16 (and 3)

List of working or processing required to be carried out on non-originating materials in order that the product manufactured can obtain originating status

HS Heading No	Description of product	Working or processing carried out on non-originating status materials that confers originating status
Chapter 16	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	Manufacture of animals of Chapter 1. All the materials of Chapter 3 must be wholly obtained
Chapter 3	Fish and crustaceans, molluscs and other aquatic invertebrates	Manufacture in which all the materials of Chapter 3 used must be wholly obtained

The Convention states:[21]

> '... *where two or more countries have taken part in the production of the goods, the origin of the goods shall be determined according to the substantial transformation criterion.*'

Clearly, this applies to the case of canned tuna, which often includes components from a number of countries. Thus, in order to determine the origin of a can of tuna, as opposed to the tuna fish itself, one must determine whether and where 'substantial transformation' has occurred. While the Kyoto Convention does not offer a definitive answer to the question of what is 'substantial transformation', nor is it legally binding like the WTO agreements, it does state that in practice the criterion shall be determined in one of three ways:[22]

1. by a rule requiring a change in tariff heading in a specified nomenclature with lists of exceptions; and/or
2. by a list of manufacturing or processing operations which confer, or do not confer, upon the goods the origin of the country in which the operations were carried out; and/or
3. by the *ad valorem* percentage rule, where either the percentage value of the materials utilised or the percentage of the value added reaches a specified level.

These three criteria, which are normally applied by all signatories of the Kyoto Convention, do not appear to apply to the Cotonou rule of origin for canned tuna. The only criteria for conferring origin for canned tuna is the wholly originating status of the tuna which is logically akin to defining the country of origin of an automobile. From the nationality of the owners of the mine extracting the iron ore and the nationality of those employed in the mine were of the contracting parties. As the criteria employed by the EU for determining origin of canned tuna which is not a wholly originating product does not appear to conform to any of the three alternative provisions found in the Notes to Provision 3, the European Commission should explain how the rule of origin for canned tuna is understood to comply with, the spirit if not the letter of, its obligations as a contracting party to the Kyoto Convention.

ACP tuna processors have found some reprieve from the restrictive ROO in the value tolerance provisions that allow a certain percentage of non-originating material in an originating manufactured product. This percentage has gradually increased through the history of the Lomé Agreements to 15% under the Cotonou Agreement.[23] Implementation of value tolerance on processed fish products has proved highly contentious, requiring significant negotiation between the ACP and the EU. The EU was initially reluctant to allow value tolerance to apply to canned fish as the manufacturing process dictates that each can contains the meat from only

one fish. Value tolerance with respect to each product (can of fish) should therefore not apply as the fish in one can is either originating or not, percentages are not possible. The EU therefore considers it a concession that they permit this rule to apply on a consignment such that within each consignment, per type of product and per type of fish, 15% of the cans can be made from non-originating fish yet still obtain originating status. This implementation method was the result of a difficult negotiation process between the EU and ACP. The ACP argued for implementation over a specific time period within a given year rather than per consignment, or at least solely per species within a consignment, rather than per product as well. The EU rejected these proposals.[24]

Derogation available to processed tuna producers is also contentious. Paragraph 8 of the derogation provisions[25] enforce global annual quotas of the maximum amount of tuna loins and canned tuna that will be granted derogation, i.e. regarded as originating despite containing non-originating tuna: 2,000 metric tonnes for tuna loins and 8,000 metric tonnes for canned tuna. These quotas provide automatic derogation and as such the normal derogation procedures are waived. However, the non-automatic procedures for processed tuna products are no longer available for derogation requests in excess of the quota amounts. Responsibility for allocating this quota among ACP states has been recently transferred from the EU to the ACP group in an attempt to increase its utilisation. The ACP Secretariat divides the quotas equally between those ACP states that register their interest, and transfer of under-utilised quotas to other countries is easier to facilitate than under the previous procedure which was governed by the European Commission. The global quota allocations under the new procedure are detailed in Annex II.

Cumulation provisions of the Cotonou Agreement[26] further illustrate the unique and stringent treatment of processed tuna products. The general cumulation provisions of the Cotonou Agreement are the most 'generous' of the EU's preferential ROO, including those governing the Generalised System of Preferences (GSP) and the Everything But Arms (EBA) initiative.[27] The Cotonou Agreement provisions allow cumulation between the ACP states, the EU, Overseas Countries and Territories (OCT),[28] South Africa and neighbouring developing countries. However, with respect to tuna products these generous cumulation provisions are severely curtailed. Cumulation with South Africa[29] is 'temporarily inapplicable' to hundreds of fishery products,[30] of which fresh and processed tuna products are included. This is because the EU and South Africa failed to negotiate fish products into their free trade agreement.[31] Expected elimination of this measure 'temporarily' applied to prevent trade deflection of South African fish products through ACP states will only occur if and when the EU grant sufficient tariff concessions to South African fish products. At the request of ACP states the Cotonou Agreement also permits cumulation with other developing countries.[32] Specifically though, this provision 'shall not apply to tuna products classified under Harmonised System Chapters 3 or 16.'[33]

This issue of fisheries rules of origin have also been addressed at the now-stalled WTO (non-preferential) Rules of Origin Committee.[34] The EU, among other countries, has recommended that the origin of fish taken from an EEZ should be based on the country of the flag of that vessel. The ACP declaration in the Cotonou Agreement, however, lends support to the WTO position of India and Ecuador, which contend that fish 'taken from the sea outside the territorial sea of a country but within its EEZ, are considered to be wholly obtained in that country.'[35] Even though a resolution of the existing disagreements between WTO members on non-preferential rules seems unlikely at this point and this would not directly produce a resolution, it would certainly facilitate discussions on rules of origin in preferential agreements

Analysis of the ROOs

Trade deflection, fraud and protection

Preferential ROO play a legitimate role in preventing trade deflection – countries outside preferential trading arrangements circumventing MFN tariffs by diverting their exports through preference-receiving countries. However the dividing line between measures aimed at addressing legitimate concerns

pertaining to deflection and fraud are at times confused with domestic commercial interests of the preference-giving country. Trade deflection has two major implications for preference-granting countries. It reduces tariff revenues, and more significantly in the case of high MFN rates (which create a larger incentive for trade deflection), the protectionist function of tariffs disappears. In preference-receiving countries, trade deflection can nullify the intended competitive export advantage created by preferences. Central to the difficulty in reaching consensus on ROO for processed tuna products is the implicit interpretation of trade deflection created by the ROO. This shifts the analysis from the legitimate and uncontroversial role of preventing trade deflection firmly into the political arena.

Both the EU and ACP have incentives to ensure tuna caught by foreign-owned vessels in ACP EEZs and manufactured by these same countries do not receive EU trade preferences. This could happen for example with foreign-owned factory ships operating within ACP EEZs. This clearly constitutes trade deflection and as such the ROO should protect against it. However, the current ROO for processed tuna implies that a third-country-owned vessel catching fish in an ACP's EEZ and supplying it to a (domestically or foreign-owned) cannery in the ACP country for processing also constitutes trade deflection, as does the ACP processing fish that was caught outside their EEZ. Evidently, if these finished products were granted originating status part of the value of the preference would be channelled to the third country that owned the vessel that caught the fish, and possibly the cannery that processed it. In reality many of the canneries supplying tuna to the EU market are of US and Asian origin and very often the margin of preference is captured by such vertically integrated companies.[36] However, that the manufacturing activity occurred within an ACP state implies that 'substantial transformation' of the tuna fish occurred there, creating considerable positive spillover effects in the economy (employment, etc.), precisely the phenomena that trade preferences are supposed to encourage.

Trade deflection generally refers to assembly industries with little value added being established in preference-receiving countries. Fundamentally it is a process that occurs when the act of substantially transforming raw materials into a manufactured product has not been undertaken in the country which is claiming origin on the final product. This is however, not the case with fish caught by a non-ACP or EU vessel but processed within an ACP state. This linking between the implied definition of 'substantial transformation' to the sourcing of raw materials in the current ROO for processed tuna products distorts the examination of trade deflection.

This observation also complicates the analysis of ROO fraud for processed tuna products. Fraud undisputedly occurs when no transformation, substantial or otherwise, has taken place and rent-seeking behaviour leads to declarations of origin in order to obtain preferences. This can be referred to as criminal fraud induced by the preference rather that the rule of origin. In other words it is the margin of preference *per se* that induces the fraud rather than any specific rule of origin. However, the implied definition of trade deflection with these ROO creates a form of 'ROO-induced' fraud whereby an ACP cannery is sourcing its raw material from a non-EU or ACP source in order to substantially transform it into a manufactured product. This is not to excuse or deny any intended 'ROO-induced' fraud but that the fraud would not have occurred if the rule of origin were based on another definition of 'substantial transformation' of the unprocessed tuna rather than the origin of the vessel catching that tuna. In other words there is a strong grounds to support the argument that the observed 'ROO-fraud' in the sector are a by-product of the EU using the rule of origin as a trade instrument that facilitates EU fisheries' access into the EEZ of ACP states.

It is essential that the relevant authorities within both preference-receiving and granting countries install adequate defences against ROO fraud and trade deflection, intentional or otherwise, through establishing and maintaining adequate 'management procedures and supervisory and safeguard mechanisms'. However, in the recent EU Green Paper (consultation document)[37] on preferential ROO the acute focus on these mechanisms is questionable. The paper fails to adequately acknowledge the significant costs of ROO compliance and verification on exporters and resource-

constrained customs authorities within ACP states. These costs should be kept to a minimum and be as consistent as possible with the real risk of fraud and trade diversion.

The well-documented[38] under-utilisation of Lomé trade preferences may indicate these risks are not as grave as the EU fear. After all, 'deflected trade would request preferences'.[39] The reality of preferential trade between the EU and the ACP states is that the apparently low rate of preference take-up observed most recently by the EU, with only 18.8% of ACP exports receiving preferences,[40] indicates that the ACP has remained confined to a narrow range of primary, base metal and oil exports where margins of preference either do not exist or are so low that the compliance cost does not warrant their commercial use. However, the preferences for processed tuna products are highly valuable and heavily used. Especially during the 1990s the EU reported several incidents of ROO fraud of processed tuna from ACP states.[41] The existence of fraud still raises the question as to whether it is best dealt with through simplification of the ROO, improved compliance and verification procedures, or both. The ACP states argue that fraud is primarily due to knowledge or resource gaps rather than the criminal circumvention of MFN tariffs. This is difficult to prove as simplification of the ROO to alleviate this problem would reduce the incentive for fraud.

Compliance with preferential ROO is ultimately a cost–benefit decision made by each ACP exporter regarding the administrative and production costs of compliance relative to the value of the preference. Any increases in the monetary and real resource costs to both the ACP public and private sectors of compliance and verification procedures must be carefully balanced with the declining value of preferences as the EU proceeds with multilateral liberalisation.[42] The inability to predict the magnitude of the eventual decline in margins of preference following the completion of the WTO Doha Round creates an uncertain, and therefore potentially costly, context in which the EU and ACP must assess possible reforms of ROO compliance and verification procedures. The decline in margins of MFN tariff rates will also decrease the incentive to the incidence of either criminal or ROO-induced fraud.

ROO as a strategic trade policy tool for preference-granting countries

This section examines how the ROO are used to protect the EU's strategic trade interests in the fisheries sector. The high margins of preference read in light of the rules of origin indicate that there are two distinct aspects to this trade interest, the first being the protection of the EU's domestic canneries and second, the provisions of subventions to access to the EU's distant-water fleets. In turn, both these interests are served by maintaining EU access to foreign fishery resources. As one source observes, 'the EU is becoming increasingly dependent on external fish supplies to meet both its market (processing and consumption) and fishing sector (employment and investment) demands.'[43] The strategic importance of tuna to the EU, combined with the substantial trade preferences available to the ACP states, explains the EU's motive for highly restrictive ROO which limit any possible conferring of preference to third countries, while conferring maximum benefit to themselves. After all, effective trade preferences only exist where domestic protectionist pressures, in the donor country, have resulted in high MFN tariffs.

The ROO grants the EU protection through preventing trade deflection of fish from ACP EEZs that have been caught by a third country. However there is nothing in the ROO that prevents third countries from owning processing facilities and hence the EU is willing to see investment deflection for the canneries but not the capture fishery. Indeed many of the canneries that do operate in ACP states are owned by non-ACP/EU interests. That the benefits from the canning process, which provides the bulk of the value addition, do not accrue to ACP/EU interests has raised no concern from the EU indicates precisely where the EU interest lies in this particular product. The MFN rates offer direct protection to EU canneries through the MFN tariffs applied to imports from these third countries. This protection is extended, through the stringent requirements of Article 3, which prevent ACP states using fish caught by foreign (non-EU) vessels to produce originating tuna loins or canned tuna. This protects EU fleets through creating an incen-

tive for ACP states which have canneries or sell to ACP canneries in the region, to grant EEZ access to EU vessels over those from third countries, so as to facilitate the supply of originating fish to their domestic canneries. The 24% preferential margin offered to the ACP states can therefore also be considered a form of subvention to EU vessels via fisheries access agreements. The ROO for the final processed good therefore also protects the EU's intermediate producers (where the intermediate product is the fish and the 'producer' the country whose vessels caught them). This is a direct result of the overly restrictive ROO which inexorably links the substantial transformation rule for processed tuna to the sourcing of its raw material.

This link also provides a more opaque form of protection to EU-produced and processed tuna. The EU does not require that their domestically processed tuna products use EU caught fish. Instead, through zero MFN tariffs on fish imported for further processing (refer to Annex I), EU producers are granted full flexibility in sourcing their supply from the most competitive source available. However, for ACP-processed tuna products to enter the EU duty free and therefore, with respect to market access, 'on a level playing field' with EU produced products, they have to have used EU/ACP-caught fish. This may not have been the most competitive supply source available and therefore reduces the competitiveness of the ACP product relative to the EU one. It is therefore evident how the EU uses the ROO to protect their domestic fleets without creating a disadvantage for their domestic canneries by obliging ACP canneries to use EU/ACP fleets. This raises the question of how ACP canneries, which are frequently not owned or managed by ACP/EU interests, are disadvantaged by a rule of origin which forces them to purchase fish from ACP/EU-owned vessels. If tuna is purchased by canneries based on world market reference prices such as those available for Bangkok or Pago then a cannery that is not vertically integrated should not be commercially disadvantaged by the ROO. However, for those canneries that are based on fully integrated operations the rule of origin would result in a diminution of profitability as the value addition of the capture fishery activity would be taken up by EU vessels. More significantly, as we shall see below there is some anecdotal evidence that EU fleets are able to obtain a premium for fish because of the margin of preference. In such cases this would diminish the profitability of the cannery and transfer a portion of the margin of preference to the EU distant-water fleet.

The complexity of existing ROO compliance and verification procedures may also afford additional protection to EU domestic canneries through acting as non-tariff barriers to the import of competing ACP products. Significantly, the risk of non-compliance with such complex rules of origin falls on the importer who will only risk such trade where there can be assurance that the exporter will agree to bear some of that risk and ensuing cost. There are additional protectionist dimensions to the ROO. The EU argues that the derogation quotas for tuna products should be regarded as a concession to ACP states due to their automatic nature. However, these binding quotas create an EU-imposed maximum limit for the amount of fish caught by third countries that can benefit from preferences. Additionally, the exclusion of fish from cumulation provisions with neighbouring developing countries[44] appears to be a protectionist measure in the face of actual and potential developing-country competitors in this sector.

A further protectionist spin-off is that the ROO, combined with the substantial trade preferences available, is the ability of the EU fleets in some ACP states to obtain a higher price for fish supplied to ACP canneries from EU vessels compared with those from third countries. ACP canneries may still benefit from absorbing this higher cost in order to obtain the preferential tariff.[45] This price differential is due to EU labour, environmental, sanitary standards and other regulations that EU vessels must comply with compared to third countries.[46] In this situation a share of the preference is transferred from the ACP state to subsidise the EU for the higher cost of operating their fleet. The need to qualify with the ROO, to obtain preferences, through supplying ACP canneries with EU-caught fish that is not always the most competitive source, is articulated by an advisor of the Seychelles Fishing Authority who states that 'the benefit to Seychelles

in granting fishing licences to EU vessels may be reduced if the country benefits from fewer commercial advantages from the EU'.[47]

The heart of the protectionist role of the ROO for processed tuna products is found in the ROO for wholly originating tuna. The allocation of ownership rights of the fish in an EEZ dictates what ACP states can consider as 'their fish'. Declarations XXXVIII[48] and XXXIX[49] in the Cotonou Agreement reflect the disagreement between the ACP and EU in this regard. Both interpretations are consistent with the UN International Law of the Sea. The EU insists that only fish within an ACP state's territorial waters will be considered originating regardless of who caught the fish. The ACP, however, believe that while they only have sovereign rights, rather than sovereignty, over fish within their EEZ, they should have the same rights regarding originating status of fish caught there as in their territorial waters.

The European Commission argues that agreeing to ACP demands on the recognition of the fish caught in the EEZ would not necessarily increase value-added activities in ACP fisheries, for example through increasing the activity of factory ships in ACP's EEZ, putting immense pressure on the sustainability of fishing within the EEZ, with little in return. However, the ACP Declaration XXXIX specifically alludes to granting wholly originating status to fish caught by foreign vessels within their EEZ, which is 'obligatorily landed in ports of the ACP states for processing.' The EU's legitimate environmental concerns[50] would be better tackled through caveats such as that suggested by the ACP in the wholly originating criteria, improved management of EEZs, and fisheries partnership agreements which may include such obligatory landing provisions, rather than using those environmental concerns as justification of current fish-ownership rights within EEZs.

The EU view on this issue serves its commercial interests. Amending the definition of wholly originating fish in line with ACP demands would effectively eliminate the subvention to EU vessels in the current ROO as fish caught by any vessel within an ACP state's EEZ would be wholly originating in the spirit of ROO Article 3(1) subparagraph (e). Article 3 paragraphs 2 and 3 which serves EU protectionist purposes in the form of providing ACP states with an incentive to grant EU vessels access to their EEZs would become worthless.

In summary, the complex ROO for preferential tuna products is due to its legitimate role in preventing trade deflection and somewhat less legitimate role in protecting EU strategic trade interests, between which a fine line exists. In the next section this fine line is crucial in determining how the developmental implications of these ROO should shape the ACP negotiating strategy for preferential ROO under EPAs. While trade-deflection concerns are legitimate they must be defined as distantly as possible from protectionist motives to ensure that they do not become a form of 'tied trade'[51] that impedes the objective and dynamic value of the trade preferences.

ROO to encourage economic development in preference-receiving countries

The overarching economic objective of the current Economic Partnership Agreements that are being negotiated with the EU is to foster trade-induced economic growth and development in ACP economies. It follows from the development objectives of Cotonou that those ACP states with an abundance of fish (including those in their EEZs) should export this resource (in a sustainable manner) and the ROO should provide these states with the flexibility to do so as efficiently as possible. However, the current wholly originating criteria for fish within EEZs does not provide this flexibility. The EU and ACP clearly have diverging views on this issue, each in line with their commercial interests in exploiting their particular area of actual or perceived commercial advantage. The EU has a long historic commercial interest in the fisheries sector (processing and fishing), while the ACP has an abundance of the natural resource. However, the EU, as well as the ACP, is facing rising competition both in canning and in the capture fisheries from highly competitive producers in Asia who are eroding any comparative advantage they may have in these sectors. It is difficult to justify the EU's position on fisheries ROO from a developmental

perspective as the current ROO constrains the ACP states in exploiting their comparative advantage without an investment relationship with the EU.

To fully understand the development implications of the ROO for tuna it is necessary to understand the global market for canned-tuna products. Thailand and Philippines are presently amongst the world's most competitive canned-tuna producers and few analysts doubt that without significant margins of trade preference both the ACP and the EU canneries would be under extreme commercial pressure. Yet the paradox of their competitive advantage is that neither of these countries are particularly resource rich in tuna fish. Having a natural abundance of tuna in close proximity to one's land mass does not necessarily confer a competitive advantage in canning tuna, just as having iron-ore deposits does not confer a competitive advantage in steel or automobile production. Both Thailand and the Philippines import skipjack tuna from the Central and Western Pacific for canning in their facilities. Their proximity to producers of cans, edible oils and salt along with low-cost productive labour and abundant water and efficient shipping links to EU markets are sufficient to overcome any commercial disadvantage faced by canners from having to import tuna. The Pacific islands , with the possible exception of Papua New Guinea, with up to 45% of the world's tuna landings, has not, even with Lomé and Cotonou preferences, been able to develop a sustainable commercial advantage in canning.[52] The shipping cost of cans, oil and other materials to the Central and Western Pacific, and the high cost of shipping canned tuna to the EU, are greater than the cost disadvantages of shipping unprocessed tuna to South-East Asia.[53]

Indeed this raises the most difficult of development questions, of whether countries so inherently disadvantaged by size and remoteness should necessarily abandon attempts at down-stream processing and confine their economic activities to the collection of rents from their natural resources as was advocated by the Bretton Woods institutions and the WTO in the 1990s. The disadvantages faced by the Pacific in processing tuna are identical to those faced in other extractive sectors in the region and in most of the ACP. No simple response to so profound a development problem is possible except that a trade policy aimed at making such an economic transformation is costly, difficult and has usually been unsuccessful. Nevertheless, for those ACP states that decide that they have few realistic alternatives to attempting this difficult transformation, minimising the economic cost of imports to the industry is essential for any chance of long-term survival. There is little in the rule of origin for canned tuna that enhances the flexibility needed to make this transformation from raw material supplier to processor. While the EU's margin of trade preferences have without doubt created the canning industries in the ACP, the rule of origin has diminished the industry's ability to become competitive because it has raised costs at the one stage of the value chain where ACP states have a demonstrable commercial advantage, i.e. the unprocessed tuna.

It could be argued that the ROO do not comprehensively prohibit ACP states granting foreign vessels access to their waters to catch fish for processing into originating products. However, in reality the highly restrictive conditions of Article 3(2), means they are unlikely to be met. For example, the seemingly simple condition regarding crew nationality is a sheer impossibility for several small-island coastal ACP states.[54] ACP-processed fish caught by foreign vessels is therefore either exported under derogation quotas or to another market. Derogation allowances combined with such valuable trade preferences have proved to be valuable in this regard, providing a significant stimulant to inward investment from third countries in order to gain access to the EU market.[55] A study on tuna canneries within several key ACP states found that 'without the derogation to the ROO, production would be very difficult.'[56]

The ROO creates a bias between sources of investment in ACP states, providing an incentive for ACP states to grant EU access to their EEZ over other countries. There may be circumstances, however, where the EU is not interested in such opportunities. The remoteness of most ACP states from the EU, particularly those in the Pacific with substantial tuna resources, have in the past represented such instances. This may effectively exclude these countries from the trade preferences to which they are eligible.[57] However, the recently concluded

bilateral EU fisheries agreements with Kiribati and the Solomon Islands reduces the likelihood of this situation occurring. Despite this trend, the possibility that the EU may withdraw from an EEZ in which its vessels currently fish presents a constant threat to the viability of ACP-processing operations that export to the EU. ROO-induced bias towards granting access to EU vessels may also reduce the leverage ACP states have over subsequent EU investment,[58] for example possibly contributing to the difficulties some ACP states experienced in enforcing appropriate monitoring systems on EU vessels within their EEZ's.[59]

The ROO do not discriminate between the type of investment in ACP states which, similar to the fact that they do discriminate between the source of investment, favours EU fishery interests over those of the ACP. The ROO bias creates incentives for ACP states to grant EU access to their EEZs but in return provides little promise of any benefits to an ACP state which has or is hoping to develop shore-based value-added processing activities. The negligible developmental impact (beyond the collection and use of access fees by the ACP states) from this form of EU investment has been noted with respect to Senegal.[60] Similarly, it has been observed that the development of further tuna-processing activities in the Seychelles would be constrained by limited supplies of EU-caught fish because despite the presence of EU vessels in its EEZ, the landings of these vessels has not grown with the increased canning capacity of the Seychelles. The majority of their catch supplies EU canneries.[61] This may prevent the actual establishment of further processing activities in the Seychelles.

The current ROO therefore contributes to trade and investment diversion and reduced trade creation within a preferential trading area, undermining their purpose as a 'building block' to achieving competitiveness on the global market. This effect may be exacerbated in the smaller and least-developed of the ACP states as these are the least likely to be able to develop domestically owned fishing fleets to assist in supplying any domestic canneries with originating fish.

The ACP group has objected to the one clause in the ROO that specifically relates to development. Article 3(3) states that if an ACP state catches fish within its EEZ with a leased or chartered vessel from a third country the fish caught will only be originating if the ACP–EU Customs Cooperation Committee has accepted the lease or charter as 'providing adequate opportunities for developing the capacity of the ACP state to fish on its own account.' The EU argue that this paragraph was intended for temporary situations where an ACP state was developing sufficient capacity to fish its own EEZ. Such a provision permits the EU to in effect decide on what basis leasing or chartering a foreign vessel would contribute to the development of ACP domestic capacity. The first requirement of this provision requiring that 'the ACP state offered the Community the opportunity to negotiate a fisheries agreement and the Community did not accept this offer' perhaps indicates the EU's prioritisation of securing fisheries access for its vessels over development concerns in ACP states. It has indeed been the contention of this chapter throughout that a central intention of the fisheries ROO is to provide a subvention to EU fisheries access. This provision states this openly and unambiguously.

The desirability of FDI is a decision to be made solely by the recipient country, based on their national economic, political, social and cultural objectives, and without pressure from external sources such as ROO. Developmental objectives relating to fisheries should be conveyed through national investment policy and fisheries agreements, some measures may be justifiably incorporated into the ROO such as linking wholly originating criteria for fish within an ACP EEZ to its obligatory landing in an ACP state. Indeed had development concerns been an overarching consideration in the crafting of these rules of origin the EU could well have made compulsory landing a key component of helping the ACP to 'grow' their commercial advantage in fisheries and extend the economic benefits beyond the payment of access fees.

The EU stresses that the automatic derogation procedures for tuna products represents a concession to the ACP states. To the extent that, in the absence of these quotas, the EU would not grant derogation to volumes any higher than the quota amounts, the automatic nature of the quotas over

the non-automatic and burdensome derogation procedures[62] do indeed provide a form of concession. However, the increase in the quota-based derogations under the Cotonou Agreement were accompanied by a withdrawal of the option to use normal derogation procedures for these products. Quotas may also reduce the uncertainty of being granted derogation which could impede long-term production decisions. Despite the improved quota allocation process, quota recipients still face uncertainties over their quota share as there is always the possibility that an another ACP country will request a share in the global quota. More fundamentally, the highly migratory nature of the tuna species makes it difficult for ACP producers to predict whether the supply arrangements in their EEZ will be sufficient in a particular time period and so may require additional derogation to account for supplies of tuna from outside their EEZ. The unpredictable and short-term annual nature of these quotas may therefore contribute to their under-utilisation. Such under-utilisation, however, masks the forgone trade creation (potential investment not realised or the bypassing of the EU market) that the ROO may have induced in the past or will do so in the future. Fundamentally, derogation presents a second-best option to appropriate ROO. For the efficient development of their domestic industries ACP states must have full flexibility in their sourcing decisions, central to which is the use of competitive 'non-originating' fish in the production process.

The complexity of the ROO undoubtedly raises the related administrative and production costs for ACP exporters. Although the new derogation quota allocation system should be less burdensome than the one it replaced, it still requires administrative procedures and the opportunity cost of the ACP Secretariat administering this quota rather than using its resources to serve its members elsewhere must be considered. Moreover, the current implementation of value tolerance required by the EU creates a higher burden on ACP producers than would be necessary under the ACP proposed reference period method.[63] One of the reasons the EU grants trade preferences is the recognition of the supply side constraints and inherent cost disadvantages that producers in many of the ACP states face. It is therefore ironic that the administration of these preferences through the ROO appears to be more costly than is necessary due to the role of the ROO in protecting EU strategic trade interests. Simplification of the ROO, for example to a Change in Tariff heading (CTH) criteria, would reduce the role and cost of both derogation and value tolerance from ACP production processes and also simplify and therefore reduce the cost of compliance and verification procedures to all parties.

One of the central challenges for the ACP states will be in how to apply special and differential treatment (SDT) principles to EPA ROO.[64] The EU point to existing SDT in the current ROO through relaxation of specific provisions. For example the Cotonou ROO contains a 50% local-crew composition requirement while in many other preferential trading arrangements the corresponding requirement is 75%. The Cotonou ROO also allows 15% value tolerance for fisheries products while the corresponding figure in the EU–South Africa Trade Development and Cooperation Agreement (TDCA) is only 10%. The ACP states must consider whether these minor concessions are sufficient in the face of their specific constraints in developing globally competitive industries. The EU also regards the derogation quotas as an example of SDT due to their automatic nature, but perhaps SDT concerns should be used to tackle the issues at the heart of derogation, the degree to which ACP states should be allowed to use non-originating fish or the very definition of originating fish. The issue of ROO harmonisation is also important in this context. The EU has nearly accomplished its objective of harmonising the preferential ROO across all its regional trading agreements. This harmonisation reduces EU ROO-related costs and facilitates cumulation provisions but to what degree does it reduce the scope for introducing SDT-type provisions in EPA ROO?

In conclusion, discrimination between the EU and third countries in the ROO is not conducive to the developmental role of trade preferences. Developing coastal states that seek to efficiently develop their marine resources should be provided with full flexibility to do so in a manner that develops a competitive domestic industry. It is not suggested that

the ROO have been constructed specifically to impede this process, but that the EU's use of the ROO for protectionist purposes has had unintended negative consequences on the potential of trade preferences to facilitate trade-induced economic growth and development in ACP states. The biases created in the ROO limits the flexibility of ACP production and sourcing decisions, raising production costs and impeding the long-term competitiveness of their industries. Further reducing the possibility that these industries will reach a point where they no longer need trade preferences. The welfare loss of third countries due to trade diversion created by these ROO must also be considered, especially as some of these third-country producers are developing countries themselves. While the current ROO may appear justifiable on the basis that it is the EU market to which these ROO provide preferential access, the open and export-oriented regional trading arrangements, such as EPAs, that developing countries are being encouraged to join as a 'building block' towards global trade integration will only serve this purpose if such arrangements facilitate the development of globally competitive industries within its developing-country members.

Conclusions

The erosion of trade preferences is a reality arising from multilateral liberalisation and the increasing need for WTO compatibility of existing preferential trading arrangements.[65] The EU has put in place a rule of origin for processed tuna products that at very least violates the spirit of the Kyoto Convention. Moreover, the purpose of the rule of origin is to provide an indirect subvention to EU fishing vessels by providing further incentives for ACP states to provide access. This is of course most significant where those ACP states are both tuna rich and have canning capacity. While the margin of preference has been instrumental in creating the ACP canning sectors, the rule of origin has retarded its development by imposing what are in effect EU-caught fish for ACP canneries. Moreover, there appears to be anecdotal evidence from ACP states that some canneries are willing to pay higher prices for EU-caught fish, which raises costs and decreases profitability.

Significantly, the incidence of ROO-fraud in the sector stems from the way in which rules of origin have been written to provide these subventions to the EU's distant-water fishing fleets. Had the rules of origin for canned tuna been written in a manner more consistent with that normally found for manufactured goods, i.e. based on a change in tariff heading, then the use of non-originating tuna fish in canneries would have been less of an issue than it has been over thirty years. It is significant that ACP canned tuna would be originating even at a 2-digit level using the CTH criteria.

The current negotiations for Economic Partnership Agreements between the EU and the ACP regions constitutes an excellent opportunity for ACP states to rectify the many trade- and investment-diverting effects of the current rule of origin. The only question that arises is whether the EU would countenance a wholesale reform of the rule of origin for canned tuna given the impact that such an arrangement would have upon access agreements between EU distant-water fleets and tuna-rich ACP states such as Papua New Guinea, Seychelles and Senegal. As an interim measure leading to eventual wholesale reform of the rule, a progressive liberalisation of the rule of origin through an annual expansion of automatic derogation quotas would facilitate the competitive development of the ACP tuna-canning industry given the inevitable decline in MFN tariffs at the end of the Doha round. However, as long as the EU maintains a strategic interest in gaining access for its fleets into the EEZ of ACP states the fundamental character of the rule of origin which defines the origin of the canned tuna by the nationality of the vessels catching the fish is unlikely to change.

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Annex I. Selected EU MFN tariffs on tuna products

		Product description	HS tariff classification	MFN tariff
fresh fish		**Fish and crustaceans, molluscs and other aquatic invertebrates**	**Chapter 3**	
	for processing	Fish, fresh or chilled, excluding fish fillets and other fish meat of , heading 0304	0302	
		Albacore or longfinned tunas (Thunnus alalunga)	0302 31 10	0%
		Yellow fin tunas	0302 32 10	0%
		Skipkack or stripe-bellied bonito	0302 33 10	0%
		Bigeye tunas (Thunnus obesus)	0302 34 10	0%
		Bluefin tunas (Thunnus thynnus), for the industrial manufacture of products falling within heading 1604.	0302 35 10	0%
	not for processing	Fish, fresh or chilled, excluding fish fillets and other fish meat of heading 0304,	0302	
		Albacore or longfinned tunas (Thunnus alalunga)	0302 31 90	22%
		Yellow fin tunas	0302 32 90	22%
		Skipkack or stripe-bellied bonito	0302 33 90	22%
		Bigeye tunas (Thunnus obesus)	0302 34 90	22%
		Bluefin tunas (Thunnus thynnus), for all other uses.	0302 35 90	22%
processed fish		**Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates**	**Chapter 16**	
	loins	Prepared or preserved fish - whole or in pieces, but not minced	1604 11	
		Tunas and skipjack 'loins'	1604 14 16	
		Bluefin tunas (Thunnus thynnus) - for industrial manufacture or other	1604 14 16 20/25	24%
		Atlantic bigeye tuna (Thunnus obesus) - for industrial manufacture or other	1604 14 16 30/35	24%
		Other fish of 1604 14 11 not listed above – for industrial manufacture or other	1604 14 16 95/99	24%
		Prepared or preserved fish - whole or in pieces, but not minced	1604 11	
		Tunas and skipjack, not in cans or loins (other)	1604 14 11	
		Bluefin tunas (Thunnus thynnus) – Preserved	1604 14 18 20	24%*
		Bluefin tunas (Thunnus thynnus) – Other (not preserved)	1604 14 18 25	24%
		Atlantic bigeye tuna (Thunnus obesus) – Preserved	1604 14 18 30	24%*
		Atlantic bigeye tuna (Thunnus obesus) – Other (not preserved)	1604 14 18 35	24%
		Other fish of 1604 14 11 not listed above - Preserved	1604 14 18 95	24%*
		Other fish of 1604 14 11 not listed above – Other (not preserved)	1604 14 18 99	24%
	cans	Prepared or preserved fish - whole or in pieces, but not minced	1604 11	
		Tunas and skipjack in vegetable oil	1604 14 11	
		Bluefin tunas (Thunnus thynnus) – Preserved	1604 14 11 20	24%*
		Bluefin tunas (Thunnus thynnus) – Other (not preserved)	1604 14 11 25	24%
		Atlantic bigeye tuna (Thunnus obesus) - Preserved	1604 14 11 30	24%*
		Atlantic bigeye tuna (Thunnus obesus) – Other (not preserved)	1604 14 11 35	24%
		Other fish of 1604 14 11 not listed above – Preserved	1604 14 11 95	24%*
		Other fish of 1604 14 11 not listed above – Other (not preserved)	1604 14 11 99	24%

		Product description	HS tariff classification	MFN tariff
		Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	**Chapter 16**	
	other	Other prepared or preserved fish of tunas	1604 20 70	
		Bluefin tunas (thunnus thynnus) - Preserved	1604 20 70 30	24%*
		Bluefin tunas (Thunnus thynnus) – Other (not preserved)	1604 20 70 35	24%
		Atlantic bigeye tuna (Thunnus obesus) - Preserved	1604 20 70 40	24%*
		Atlantic bigeye tuna (Thunnus obesus) – Other (not preserved)	1604 20 70 45	24%
		Other fish of 1604 14 11 not listed above - Preserved	1604 20 70 95	24%*
		Other fish of 1604 14 11 not listed above – Other (not preserved)	1604 20 70 99	24%

*denotes product for which the Asian tariff quota (EC Council Regulation 957/2003 of 5 June 2003) of 25,000MT at 50% of the MFN rate applies.

Source: EU TARIC database, accessible at: http://europa.eu.int/comm/taxation_customs/dds/en/tarhome.htm

Annex II. Table of allocation of the automatic derogation quotas

Country	Quantities (metric tonnes)		Period
	Cans	Loins	
Côte d'Ivoire	1,000	333	01/10/02 – 30/09/03
	1,000	400	01/10/03 – 30/09/04
	416	176	01/10/04 – 28/02/05
Fiji	1,000	0	01/10/02 – 30/09/03
	1,000	0	01/10/03 – 30/09/04
	416	0	01/10/04 – 28/02/05
Kenya	0	333	01/10/02 – 30/09/03
	0	400	01/10/03 – 30/09/04
	0	167	01/10/04 – 28/02/05
Madagascar	1,000	0	01/10/02 – 30/09/03
	1,000	0	01/10/03 – 30/09/04
	416	0	01/10/04 – 28/02/05
Mauritius	1,000	333	01/10/02 – 30/09/03
	1,000	400	01/10/03 – 30/09/04
	416	167	01/10/04 – 28/02/05
Papua New Guinea	2,000	0	01/10/02 – 30/09/03
	1,000	0	01/10/03 – 30/09/04
	416	0	01/10/04 – 28/02/05
Seychelles	1,000	1,000	01/10/02 – 30/09/03
	1,000	400	01/10/03 – 30/09/04
	416	167	01/10/04 – 28/02/05
Senegal	1,000	0	01/10/02 – 30/09/03
	1,000	0	01/10/03 – 30/09/04
	416	0	01/10/04 – 28/02/05
Ghana	0	0	01/10/02 – 30/09/03
	1,000	400	01/10/03 – 30/09/04
	416	167	01/10/04 – 28/02/05

Source: Information provided by ACP Secretariat, Brussels.

Endnotes

1. The Lomé Convention was replaced by the Cotonou Agreement in 2000.
2. The aim of Economic and Trade Cooperation between the ACP and EU as detailed in Article 34(1) of the Cotonou Agreement is 'fostering the smooth and gradual integration of the ACP states into the world economy, with due regard for their political choices and development priorities, thereby promoting their sustainable development and contributing to poverty eradication in the ACP countries'. Article 34(2) states the ultimate aim of this co-operation as being 'to enable the ACP states to play a full part in international trade' and for co-operation to be directed at 'enabling the ACP states to mange the challenges of globalisation and to adapt progressively to new conditions of international trade thereby facilitating their transition to the liberalised global economy'. This will include enhancing the production, supply and trading capacity of the ACP countries as well as their capacity to attract investment (Article 34(3)). Finally, article 34(4) requires that this co-operation be 'implemented in full conformity with the WTO, including special and differential treatment'.
3. The EU and ACP have agreed to continue Phase I all-ACP–EU negotiations on a limited number of issues throughout 2004. The possible inclusion of ROO in these negotiations will be discussed after a ROO experts meting scheduled for February 2004 in Brussels. See ACP document *Proposed Subjects for Initial Discussion at the "All ACP" Phase of the EPA Negotiations*, 10 December 2003, Reference ACP/00/125/03. There is therefore at present uncertainty as to whether the ROO for EPAs will be negotiated on an ACP-wide or regional level.
4. There have been suggestions from some ACP states that given the reciprocal nature of the EPAs there may be a need to negotiate a separate and 'asymmetric ROO' for EU products entering ACP markets if preferential access is granted.
5. There has been a long history of analysis of tuna rules of origin in ACP–EU relation see, McQueen, M. (1982) *Lomé and the Protective Effect of Rules of Origin*, Journal of World Trade Law, Vol. 16, No.2; Bourgeois, J. *Rules of Origin: an Introduction* in Vermulst (1994) et al. *Rules of Origin*, University of Michigan Press, Ann Arbor, p.3.
6. This made Spain the third-largest tuna-fishing nation after the USA and Thailand.
7. Between 1990 and 1998 there was a 22% decrease in employment in the EU capture fisheries sector and a 14% decrease in the employment processing sector. Gorez, B. and O'Riordan, B. (2003) *The Future of European Union-ACP Countries Fisheries Relations, in Fisheries Issues in WTO and ACP–EU Trade Negotiations*, Grynberg, R. (ed), Commonwealth Secretariat, London, pp.8.
8. IDDRA UK Ltd (2004) *Impact of the Opening up of the European Market for Canned Tuna from Asia – The Cases of Ghana, Senegal, Seychelles and Mauritius*, study commissioned by the Commonwealth Secretariat and CTA , London. pp.23.
9. ibid. pp.28
10. ibid pp.14.
11. ibid pp.20
12. Cartwright, I. (2003) *A Preliminary Negotiating Framework for Economic Partnership Agreement Negotiations with the European Union : Fisheries*, Study commissioned by the Pacific Island Forum Secretariat, Suva, pp.vi.
13. ibid.
14. UN Convention on the Law of the Sea (UNCLOS). Part II, Section II, Article 3.
15. The UN Convention on the Law of the Sea (UNCLOS) defines the Exclusive Economic Zone (EEZ) of a country as its waters within 200 miles of the coast but beyond the 12-mile limit of the Territorial Sea. Any fish caught beyond the EEZ is undisputedly the origin of the country whose vessel caught the fish.
16. As a result of the rule of origin ACP processors are required to not only note the location of where each of their fish is caught they are also required to physically separate tuna caught in the territorial sea, from originating and non-originating tuna caught outside the Territorial Sea. Thus tuna, a highly migratory species which traverses hundreds and often thousands of kilometres of ocean, must be separated according to the place of its capture and the ownership of the vessel used in its capture.
17. The source of the tuna used for processing is only relevant where the tuna is exported to another region with which the EU maintains preferential access such as EFTA. Thus the origin of the tuna used in processing in the EU is not significant in conferring origin if the product is exported from say Italy or Spain to Germany, but if the tuna used for processing is not of EU origin it would not have EU originating status if exported to Switzerland under EFTA, (perscom DG Trade, February, 2004)
18. International Convention on the Simplification and Harmonization of Customs Procedures concluded in Kyoto (Kyoto Convention), 18th March, 1973, entered into force 25th September 1974
19. European Communities signed Annex D1 without reservation, 26th June 1974
20. See WTO Agreement on Rules of Origin
21. Provision 3, Annex D1, Kyoto Convention, 1973
22. See Notes to Provision 3, Annex D1, Kyoto Convention, 1973
23. Cotonou Agreement, Annex V, Protocol I, Article 4, Paragraph 2.
24. European Commission and ACP Secretariat, (perscom).
25. Cotonou Agreement, Annex V, Protocol I, Article 38.
26. Cotonou Agreement, Annex V, Protocol I, Article 6.
27. Brenton, P. (2003) *Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything But Arms*, International Trade Department, The World Bank, Washington DC, pp.4 and 21.
28. A full list of the OCTs can be found in the Cotonou Agreement, Annex V, Protocol I, Annex III.
29. Cotonou Agreement, Annex V, Protocol I, Article 6.3.
30. Cotonou Agreement, Annex V, Protocol I, Annex XIV.
31. The EU–South Africa Trade, Development, and Cooperation Agreement (TDCA) Agreement which came into force in 2000.
32. Cotonou Agreement, Annex V, Protocol I, Article 6.11.
33. Cotonou Agreement, Annex V, Protocol I, Article 6.11.
34. WTO document (2002) *Committee on Rules of Origin – Report by the Chairman of the Committee on Rules of Origin to the General Council*, G/RO/52, pp.6
35. Footnote, G/RO/52
36. In the late 1990s when the Solomon Taiyo canning facility in the Western province of the Solomon Islands was owned (51%) by the Solomon Islands government but operated by Taiyo Gaigyo (49% – subsequently Maruha) tuna was exported through a Taiyo Gaigyo subsidiary in the UK which set the price of tuna to wholesalers based upon the price of Thai substitutes plus 24%. Thus the wholesale price in the UK was determined by the price established by what was then the market leaders plus the margin of preference and without reference to the CIF price. In other words the margin of preference did not benefit UK consumers.
37. Commission of the European Communities (2003) *Green Paper on the Future of Rules of Origin in Preferential Trade Arrangements*, Brussels, COM(2003)787 final.

38. See Brenton, P. (2003) *Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything But Arms*, International Trade Department, The World Bank, Washington DC.
39. Brenton, P. (2003) *Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything But Arms*, International Trade Department, The World Bank, Washington DC, pp. 17.
40. See Green Paper, op cit. p.31. While the commission does not provide a breakdown of the rate of preference up-take by HS chapter for ACP states, the volume of preferential trade is only 7% of total trade. This indicates that non-preferential trade is more significant by weight than value.
41. Various reports of the OLAF, European Anti-Fraud Office available at http://europa.eu.int/comm/anti_fraud.
42. The WTO non-agriculture market access (NAMA) within the Doha Round have not yet progressed to members specific offers on individual products. However, the EU's lack of indicative figures for fisheries products, and very high existing MFN rates, suggest value erosion of preferences due to this factor will occur at a slow pace.
43. Gorez, B. and O'Riordan, B. (2003) *The Future of European Union-ACP Countries Fisheries Relations*, in *Fisheries Issues in WTO and ACP-EU Trade Negotiations*, Grynberg, R. (ed), Commonwealth Secretariat, pp.4.
44. Cotonou Agreement. Annex V, Protocol I, Article 6(11) on Cumulation with neighbouring developing countries states that 'this paragraph shall not apply to tuna products classified under Harmonised System Chapters 3 or 16'.
45. The ROO-related constraint to source the cheapest raw materials (non-EU or ACP caught fish) for canneries, and the identification of this as a constraint to their competitiveness, has been noted with respect to Ghana, Seychelles and Mauritius. IDDRA UK Ltd, (2004) *Impact of the Opening up of the European Market for Canned Tuna from Asia – The Cases of Ghana, Senegal, the Seychelles and Mauritius*, study commissioned by the Commonwealth Secretariat, London. pp. 74, 84 and 90 respectively.
46. Michaud, P. (2003) *Experience from the bilateral fisheries access agreement, impact on the economy and implications for Seychelles of the outcome of the WTO mediation on the case of tuna between the EU and Thailand and the Philippines*, available at http://www.cta.int/events2003/fisheries/Michaud-full-EN.pdf, pp.10.
47. Michaud, P. (2003) Experience from the bilateral fisheries access agreement, impact on the economy and implications for Seychelles of the outcome of the WTO mediation on the case of tuna between the EU and Thailand and the Philippines, available at http://www.cta.int/events2003/fisheries/Michaud-full-EN.pdf, pp.11.
48. Cotonou Agreement DECLARATION XXXVIII – Community Declaration relating to Protocol 1 of Annex V on the extent of territorial waters. 'The Community, recalling that the relevant acknowledged principles of international law restrict the maximum extent of territorial waters to 12 nautical miles, declares that it will take account of this limit in applying the provisions of the Protocol wherever the latter refers to this concept'.
49. Cotonou Agreement DECLARATION XXXIX – Community Declaration relating to Protocol 1 of Annex V on the origin of fishery products. 'The ACP States reaffirm the point of view that they expressed throughout the negotiation on the rules of origin in respect of fishery products and consequently maintain that following the exercise of their sovereignty rights over fishery resources in the waters within their national jurisdiction, including the exclusive economic zone, as defined in the United National Convention on the Law of the Sea, all catches effected in those waters and obligatory landed in ports of the ACP states for processing should enjoy originating status'.
50. The EU has never undertaken a systematic review of the effect that the current rules of origin may have on marine habitats in the 12 nautical mile territorial sea. Indeed in many ACP states the Territorial Sea attracts a disproportionate amount of fishing effort from both artisanal and foreign commercial fishing vessels. It could as well be argued that the current rule of origin further compounds the unsustaianability of the in-shore fishery.
51. McQueen, M. (1982) *Lomé and the Protective Effect of Rules of Origin*, Journal of World Trade Law, Vol. 16, No. 2, pp. 131.
52. Both Solomon Islands and Fiji have canneries. Solomon Islands production has been dramatically curtailed since the civil conflict of 2000–03 and Fiji only exports to the EU under derogation provisions. PNG is greatly expanding its capacity given it very large EEZ and abundant tuna resource.
53. In the late 1990s it was estimated that the cost advantage of Pacific islands over Thai and Philippines producers stemming from proximity to the tuna grounds was approximately US$150/tonne of tuna i.e. the cost of shipping tuna from the Central Pacific to Bangkok. As against this advantage was the cost of shipping all components to the pacific islands and then shipping the final product to the EU from the Pacific as opposed to Bangkok.
54. For example the tuna resource rich Pacific States of Tuvalu and Kiribati which have EEZ's of 900,000km^2 and 3,550,000km^2 respectively but populations of just 10,1000 and 86,900 respectively. Information downloaded from the Secretariat of the Pacific Community (SPC) Fisheries address book 2003, available at: http://www.spc.int/coastfish/News/Address_Book_2003/Address_book_2003.htm
55. For example the ownership (in conjunction with the national government) of the second largest tuna cannery in the world by Heinz (and American owned company) in the Seychelles. Michaud, P. (2003) *Experience from the bilateral fisheries access agreement, impact on the economy and implications for Seychelles of the outcome of the WTO mediation on the case of tuna between the EU and Thailand and the Philippines*, available at http://www.cta.int/events2003/fisheries/Michaud-full-EN.pdf, pp. 5 and 9.
56. IDDRA UK Ltd, (2004) Impact of the Opening up of the European Market for Canned Tuna from Asia – The Cases of Ghana, Senegal, The Seychelles and Mauritius, study commissioned by the Commonwealth Secretariat (London), pp.90.
57. Fiji tried unsuccessfully to attract Spanish fleets and this failure is at least partly attributable to its distance from the EU market. Fiji's one national cannery eventually formed a partnership with an American company and as a result none of its canned tuna products (beyond those covered by its derogation quota) are granted trade preferences. However, the future of this types of situation may be changing with the recently concluded bilateral fisheries agreements between the EU and Kiribati and Solomon Islands and declared intention of the EU to examine the possibilities of similar arrangement with the Cook Islands and Papua New Guinea. (Perscom).
58. See McQueen, M. (1982) 'Lomé and the Protective Effect of Rules of Origin', *Journal of World Trade Law*, Vol. 16, No. 2, pp. 129 with respect to investment in ACP state's manufacturing sectors.
59. For an example see Gorez, B. and B. O'Riordan (2003) *The Future of European Union-ACP Countries Fisheries Relations, in Fisheries Issues in WTO and ACP-EU Trade Negotiations*, Grynberg, R. (ed), Commonwealth Secretariat, London, pp. 31 with respect to EU vessels in the Seychelles EEZ. However, it does appear these Monitoring/Control/Surveillance issues are being

increasingly addressed through fisheries agreements between the relevant Parties.

60. ibid, p.13.
61. ibid, p.30.
62. See Cotonou Agreement, Annex V, Protocol I, Article 38.
63. ACP Secretariat, (Perscom).
64. The principle of asymmetrical ROO that may be argued from a SDT perspective is not considered here as this study is concerned with improving the ROO of ACP products into the EU *per se*, rather than relative to the ROO for EU exports entering the ACP group. However, any possible impacts of these issues on the actual ROO faced by ACP products under an EPA should be examined in the preparation of an ACP negotiating strategy.
65. This led to the introduction of an annual 25,000-tonne tariff quota of 12% (50% of the MFN rate) for Asian canned tuna from 1 July, 2003.

VI
Services

25

The Development Dimension of Services Negotiations in the Cotonou Partnership Agreement

Dirk Willem te Velde

Introduction

This chapter reviews the development dimension of services negotiations in the Cotonou Partnership Agreement (CPA) between EU and ACP states. The CPA differs from its immediate predecessor, the Lomé IV bis agreement for 1995–2000, as it allows for the first time for the negotiation of reciprocal services agreements between the EU and African, Caribbean and Pacific (ACP) regions.

The importance of services to the development of ACP states is not new to EU–ACP relations. For example, the Lomé IV bis Convention, Title IX 'Development of Services', includes four chapters on services. Article 114.3 states that the:

> *'object is to ensure that the ACP States derive maximum benefit from the provisions of this Convention, at national and regional level, and to enable them to e.g. participate under the most favourable conditions in community, domestic, regional and international markets by diversifying the range and increasing the value and volume of ACP States' trade in goods and services'.*

Other articles discussed services that support economic development, tourism, transport, communications and information technology. So provisions to support services have long existed in EU–ACP relations.

So what exactly is new then? The main difference lies in the expectation (1) that the EU and ACP regions will negotiate reciprocal trade agreements to be WTO consistent after the waiver for EU–ACP preferences runs out in 2008; and (2) that such negotiations may cover trade in services. The CPA also pays additional attention to the special needs of the ACP economies, e.g. by including a provision for the need to develop supply capacity in ACP suppliers.

An important question for the ACP regions is whether to regard services as an integral part of EPAs or not? And if so, how this should be done? This chapter focuses on what ACP countries may want to ask for in services negotiations; it is not discussing in detail services liberalisation in ACP countries themselves, though clearly this will also be an important discussion (if only that services liberalisation can lead to significant welfare increases in ACP countries when the conditions are right), and should be looked at under a more general GATS heading, rather than an EPA heading alone. In fact, much will depend on the outcomes of current services negotiations in the Doha Round.

The structure of this chapter is as follows. The second section will discuss the export services capacity of the ACP on the basis of available data, followed by a review of the services provisions in the CPA with a development dimension, such as provisions for special and differential treatment (SDT) for ACP suppliers of services. It will also discuss possible broad objectives for the ACP with respect to the development dimension. Two further sections will discuss the scope and possibilities of including SDT measures (new to the EU–ACP relations) and capacity building needs and resources for CARIFORUM service suppliers.

ACP export-services capacity

There are significant data limitations when it comes to the analysis of trade in services in ACP countries. In particular, data on bilateral trade flows are of

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notoriously bad quality and are frequently not published in detail. It would be desirable to get a more detailed picture of bilateral services trade data, and we will present some limited data. However, in the absence of adequate data, more emphasis should be placed on collecting data.

It is important to distinguish between sectors of services and modes of delivery. There are around 165 sub-service sectors defined under GATS, which can be grouped as:

- infrastructure services: communications, financial services, transport services, energy services ; social services: education, health;
- business type services: distribution, professional, tourism, construction, engineering, environmental; and
- other services: recreational, cultural.

Unfortunately, published data are not available in this sectoral format. Roughly speaking, developing countries have a strong capacity in tourism and transport services, medium-level capacity in such services as financial and cultural services, and weak capacity in capital-intensive services such as communications (except countries such as South Africa).

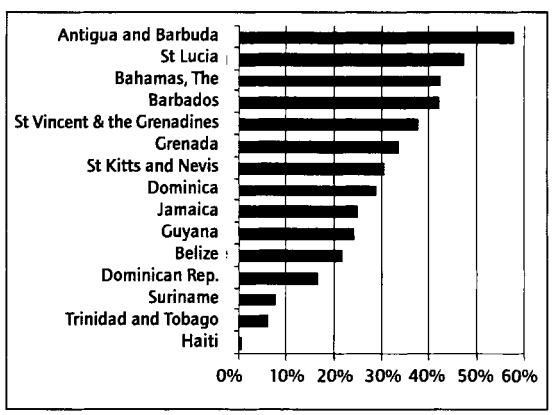
Services can be delivered in four ways or modes:

- **Mode 1.** Cross-border supply: when a service crosses a national border. An example is the purchase online of insurance or software by a consumer from a producer abroad. This is measured on a Balance of Payments (BoP) basis; world trade in this mode amounted to US$1,000 billion in 2000.
- **Mode 2.** Consumption abroad: when a consumer travels abroad to consume from the service supplier, such as in tourism, education, or health services. This is measured on a BoP basis; world trade in this mode amounted to $500 billion in 2000.
- **Mode 3.** Commercial presence: when a foreign-owned company sells services (e.g. foreign branches of banks). This is not included in BoP data but sometimes in so-called FATS (foreign affiliate trade in services) statistics; world trade in this mode estimated to be $2,000 billion in 2000.
- **Mode 4.** Temporary movement of natural persons: when independent service providers or employees of a multinational firm temporarily move to another country to provide the services. This is not captured by trade data, but is often proxied by compensation of employees and remittances in BoP statistics. World trade in this mode estimated to be $2000 billion in 2000.

Generally speaking, developing countries will have a comparative advantage in (low-skill) labour and hence Mode 4 delivery, and of course Mode 2 (tourism). They will have a competitive disadvantage in Mode 3 because this Mode requires a commercial presence abroad which is capital intensive. Mode 1 delivery would require good-quality telecommunications, which is also capital intensive.

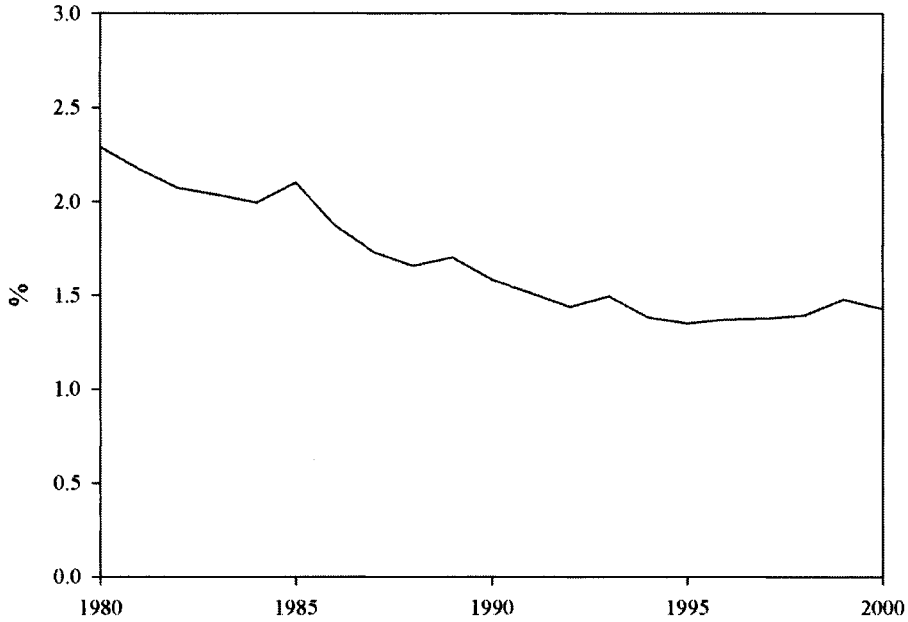
According to WTO data, the value of trade in commercial services has quadrupled from 1980 to 2002, and the share of services on world trade in goods and services has increased from 16% in 1980 to 20% in 2002, so clearly services are growing in world trade. The share of services in GDP in low and middle-income countries has increased from a little over 40% in 1980 to close to 55% currently. Services are important in some countries but not all. At one extreme, the importance of services trade in GDP in most Caribbean countries is well known (see Chart 1). On the other hand, some African countries have a very low share of services in GDP, despite the importance of tourism services.

Chart 1. Services exports of Caribbean countries (% of GDP)



Source: WDI (2004)

Chart 2. World share of ACP services exports



Source: OECD

Despite strong growth in the value of ACP exports of services ($8 billion in 1980 to $20.8 billion in 2000), the world share of the ACP dropped from 2.4% in 1980 to 1.5% in 2000 (see Chart 2).

According to OECD data, the ACP exported services worth $21bn in 2000, around a quarter of total exports; between half and three-quarters of all ACP services exports went to the EU (see Table 1).

National publications in key European countries offer further details, but their quality and coverage is also poor. Developing countries' share of total imports of services is around 15%. This is evidence for a substantial capacity to supply the EU market. About half of UK services imports from developing countries are in the travel category; about half of German imports of services come from travel and transport. A closer examination of the data presented before reveals that developing countries are weakly represented in several sectors or modes. For instance, developing countries are responsible for just 2.5% of total UK expenditure imports of royalties and research and development (R&D), and 2% for financial services into Germany. However, there are of course countries that have managed well, but which may not be clearly visible in aggregated EU import of services data (and perhaps would fall outside Mode 1 and 2 measures by the BoP).

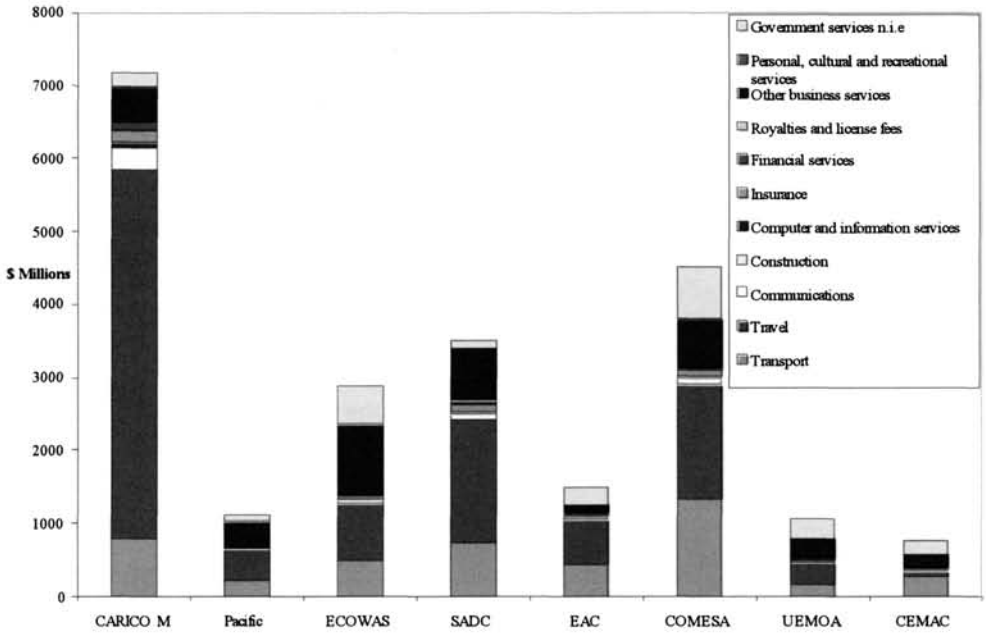
We can also look at sectoral-level data to get a more detailed picture of substantial services exporters, as reported by UNCTAD (Te Velde et al., 2004).The travel category covers all spending by travellers abroad, including purchases of goods.

Table 1. ACP export services export to the EU ($bn, 2000)

	Total	Transport	Travel	Government services	Other
African ACP	8.863	2.483	3.487	0.647	1.224
Caribbean (incl. Central America)	5.241	1.267	1.460	0.157	2.136
Pacific	0.201	0.074	0.082	0.003	0.047
Total ACP exports to EU	14.305	3.824	5.029	0.807	3.407

Source: Te Velde et al, 2004, based on OECD data; Data are best available proxies: African ACP = Africa-Maghreb-South Africa-Egypt; Caribbean includes Central America.

Chart 3. ACP regional exports by sector 2000



Source: UNCTAD
Note: Sectoral shares are distorted as some countries do not report value for all sectors.

Transportation consists of passenger and freight sea, air and land transport. 'Other business services' is a catch-all for all unreported sectors. 'Communication services' groups together postal, courier and telecommunication services. A few ACP countries have a high share of exports in total ACP services exports across a number of sectors: Jamaica (tourism, transport, communications); Barbados (tourism, communications, insurance, financial services); Mauritius (tourism, transport, other business services, insurance, financial services); Kenya (transport, government services); Trinidad and Tobago (transport, insurance); and Côte d'Ivoire (other business services, communications, insurance, financial services).

The composition of services exports from the various ACP regional groupings is illustrated further in Chart 3. With the exception of ECOWAS, the largest export sectors are travel and transport which, combined, are responsible for between 45% (CEMAC) and 69% (SADC) of total services exports. The largest services export sector for UEMOA and ECOWAS is business services (because of its importance to the Côte d'Ivoire and Nigeria, respectively).

We should mention two important types of services export. Tourism is a very important export earner in several countries, responsible for most of services trade in the Caribbean. Tourism comprises several services such as travel and transportation services, but may also lead to e.g. health services exports (health tourism).[1] The tourism market in several Caribbean countries is heavily dependent on the European market. For instance, Suriname depends on the Netherlands for 84% of total tourist arrivals; Dominican Republic on Germany for 15%, Grenada on UK for 25%, Guadaloupe on France for 70%, etc.

Mode 4 'exports from the ACP' is also important, but it is difficult to find detailed data on this, or even a classification of what falls under Mode 4 trade. WTO (2004) shows that Mode 4 services UK imports by non-EU-15 temporary workforce amounted to $2.5 billion, or 0.2% of the UK GDP in 2000. Newly arrived foreigners represented 2% of employees. The number of work permits is increasing rapidly and amounted to 132,418 in 2002, of which 29,658 from India, 13,217 from South Africa, 12,742 from Philippines, but there were also increases

from ACP countries. It is possible that some of this is counted as Mode 4 exports, though strictly speaking workers with work permits will only be counted as Mode 4 if they work temporarily for foreign firms.

Another example of developing-country services to the UK in Mode 4 includes nurses or health associate professionals. This sector accounts for 93.4% of immigrants from the Philippines (which is responsible for half the amount of work permits for non-EU nurses) and 42% from South Africa. Zambia sends 200 nurses a year to the UK.

Development-oriented services provisions

The CPA contains the following main provisions on services (see Box 1 on those with a development dimension):

- Extending EPAs to encompass the liberalisation of services in accordance with provisions of GATS (CPA, Art. 41.4).
- Reaffirmation of GATS commitments (Art. 41.2), progressive liberalisation (Art. 41.3) and EC support for ACP export capacity, and it mentions the following sectors specifically: labour (i.e. Mode 4), business, distribution, finance, tourism, culture and construction (41.5).
- The need for SDT for ACP suppliers (41.2 and 41.3).
- Special sectors: Maritime transport (Art. 42), ICT/ Telecommunications (Art. 43), Tourism (Art. 24), Cultural services (Art. 27).

The CPA Arts 41–43 deal with negotiations on trade in services, in particular Art. 41.4, in which the EU and ACP agree to extend EPAs with the liberalisation of services in accordance with provisions of GATS. It should be noted that they do not oblige the ACP to conclude a 'trade in services' component to any EPA.

CPA Arts 41.2 and 41.3 provide for an affirmation of GATS commitments and crucially underline the need for SDT for ACP suppliers of services, and the need to give sympathetic consideration to the ACP states' priorities for improvement in the EC schedule. Art. 41.2 is the clearest indication of the need for SDT measures. It is however not clear from this article whether SDT should be provided to ACP in GATS negotiations or in EPA negotiations. We assume the latter. Article 41.3 is a clear example of SDT in services in its simplest form: the EU should liberalise sectors in which the ACP have an interest, without necessarily requiring the ACP to do the same.

CPA Art. 41.5 states that the EC shall support the ACP states' efforts to strengthen their capacity in the supply of services. Particular attention shall be paid to services related to labour, business, distribution, finance, tourism, culture and construction and related engineering services with a view to enhancing their competitiveness and thereby increasing the value and the volume of their trade in goods and services. It does not state how this should be achieved. It is not clear whether the implementation of Art. 41.5 requires traditional SDT measures in a possible service EPA or whether this article should be viewed from a wider perspective: that it requires measures to support the ACP export supply capacity.

The articles on specific sectors in the CPA, which are not very different from past conventions, include a development dimension. Article 24, dealing with tourism, states that 'co-operation programmes and projects will support the efforts of ACP countries to establish and improve the countries' legal and institutional framework and resources for the development and implementation of sustainable tourism policies and programmes'. Article 27d aims at 'developing cultural industries and enhancing market access opportunities for cultural goods and services'. And in Art. 43, the 'parties agree that they will take measures that will enable inhabitants of ACP countries easy access to information and communication technologies'.

Services negotiations in Phase 1

Preliminary discussions on the development dimension of EPAs in the area of services have taken place in Phase 1 negotiations, see 'Joint Report on the dedicated session on the development dimension of EPAs in the area of services' held on 25 June, 2003. Both parties (EU and ACP) agreed to the importance of the services sector to their economy. But

Box 1. Main services provisions with development dimension

ARTICLE 41

General provisions

1. The Parties underline the growing importance of services in international trade and their major contribution to economic and social development.
2. They reaffirm their respective commitments under the General Agreement on Trade in Services (GATS), and underline the need for special and differential treatment to ACP suppliers of services.
3. In the framework of the negotiations for progressive liberalisation in trade and services, as provided for in Article XIX of GATS, the Community undertakes to give sympathetic consideration to the ACP states' priorities for improvement in the EC schedule, with a view to meeting their specific interests.
4. The Parties further agree on the objective of extending, under the economic partnership agreements, and after they have acquired some experience in applying the Most Favoured Nation (MFN) treatment under GATS, their partnership to encompass the liberalisation of services in accordance with the provisions of GATS, and particularly those relating to the participation of developing countries in liberalisation agreements.
5. The Community shall support the ACP states' efforts to strengthen their capacity in the supply of services. Particular attention shall be paid to services related to labour, business, distribution, finance, tourism, culture and construction and related engineering services with a view to enhancing their competitiveness and thereby increasing the value and the volume of their trade in goods and services.

there was some disagreement over the development issue. The report states that:

- The ACP requested support for tackling their capacity and supply-side constraints; strengthening their immediate services; increasing the efficiency and competitiveness of their domestic services and services suppliers; and developing appropriate policies as well as legal and regulatory frameworks. EPAs should include provisions for resources additional to funds from the European Development Fund, which was found to be too slow to provide a boost to the services sector on time.
- The European Commission responded that funds should not be additional, but that concrete programmes should be designed for the development of the services sector. It also mentioned the set-up of an additional €20 million facility for EPA negotiations, as well as a new €50 million intra-ACP facility for trade-related needs.
- The ACP thought it could not liberalise sectors unless they had become competitive. The EC would not force the ACP to liberalise services trade, but thought it was in the best interest of the ACP.
- The Parties should undertake to start negotiations in services in 2006 at the latest.

The 'Joint Report on ACP–EU negotiations on Economic Partnership Agreements, of the 7th all-ECP–EU Ambassadorial level meeting' on 11 July, 2003, states that:

- Support for services sector has to be seen in context of CPA Art. 34.[2]
- Objectives for the services sector under EPAs should include: (a) to strengthen capacity, efficiency and competitiveness of ACP services; (b) to improve access to the EU of services originating in ACP countries (particularly Mode 4); and (c) to increase ACP participation in world trade of services through access to technology, and access to distribution channels and information.

Negotiations, if it is decided to have them, based on CPA Art. 41.4, could start during or after Phase 2, depending on whether national assessments of the services sector in ACP have been carried out. Liberalisation should be based on SDT, asymmetry and positive discrimination and should include balance-of-payments safeguards.

Liberalisation of trade in services should be based on the following modalities: it should: (a) be progressive depending on the level of development; (b) be based on a positive list; (c) include a special safeguard mechanism; and (d) include measures to deal with anti-competitive behaviour.

The ACP proposed that the EU should remove barriers to entry into the EU of ACP service providers in Mode 4; the EU should be more transparent, and use less time-consuming visa procedures for ACP services suppliers; and mutual recognition agreements should be negotiated.

The EC replied that the proposals and objectives were defensive, but it stressed that it was willing to discuss the issue of Mode 4 liberalisation within EPA negotiations, as it was an issue of mutual interest. The EC was willing to apply asymmetric transition periods, to maintain intra-regional preferences, but it stressed the technical difficulties in achieving safeguard measures.

Negotiations in Phase 2 have continued for all ACP regions. Some regions have moved on from Phase 2 negotiations (Caribbean, in November 2004) to Phase 3 negotiations (October 2005), see original plan below.

Potential ACP options and broad objectives in a services EPA

Services liberalisation might entail costs and benefits. The ACP countries might be interested in negotiating an EPA with the EU because it might:

- enhance the capacity, efficiency and competitiveness in the supply of ACP services;
- increase the value and the volume of their trade in services, and with it growth, jobs and the potential to reduce poverty; and
- diversify the ACP economies away from agriculture and industrial products that face preference erosion and newly emerging competitors.

The ACP could secure these criteria by negotiating *inter alia* on the following issues:

- Liberalisation of EU services in sectors and modes of supply of export interest to ACP, e.g. greater access in Mode 4 (temporary presence of natural persons) for ACP service suppliers.
- Liberalisation of ACP services sectors consistent with development goals, with possible inclusion of conditions and safeguard measures, but consistent with GATS Art. V.
- Recognition of the professional credentials in ACP states as equivalent to EU credentials for the following professions: accountants and bookkeepers, architects, engineers, lawyers, teachers, doctors, midwives, and nurses.

Table 2. Schedule for Phase 2 negotiations

Phase I	Phase II	Phase III	Phase IV
4/2004–9/2004	9/2004–9/2005	9/2005–12/2006	1/2007–12/2007
Establishing the priorities of EPA negotiations	Convergence on strategic approach to CARIFORUM regional integration	Structuring and consolidating of EPA negotiations	Completing EA negotiations
Negotiating structure (RPTF)	• services and investment • trade-related areas	Agreement on structure of EPA and approach to liberalisation	
Facilitating non-state actor (NSA) participation			

Source: Plan and Schedule for CARIFORUM-EC Negotiation of an Economic Partnership Agreement.

- Establishment of a dispute settlement mechanism.
- Obtain support to improve the regulatory capacity for services in ACP regions in order to support services liberalisation, and address constraints to further exports of services such as human resource, technological and other constraints.
- Obtain technical assistance to (1) assess the services sectors; (2) assess ex ante the impact of possible ACP services liberalisation; and (3) assess ex post the impact of concluded negotiations as and when they appear.

Discussions on support for the services sectors are less well-developed than discussions on support for industrial development or agriculture. This is also true for discussions of the development dimension in multilateral settings. SDT in GATS is not yet operational (apart from contact centres and the inherent flexibility of voluntary sectoral commitments – see next section), and unlike multilateral bodies for agriculture and industry, there is no multilateral body advocating services in its entirety (there is of course the WTO, mirrored by regional equivalents).

Yet, in the Cotonou context it does seem to be important to remind us of the development dimension. The development dimension of services-related provisions in the CPA stems from two principles:

1. Specifically, the need to incorporate SDT (Art. 41.2) and to give sympathetic consideration to the ACP states' priorities (Art. 41.3) in any services EPA, (see note in next section).
2. More generally, support for the ACP services sectors is required for the integration of the ACP into the global economy (a key aim), as embodied in e.g. Arts 24, 27, 43, and 41.5 which refers to capacity building.

Whatever the trade contents of EPA negotiations, there is the need to discuss support measures for the service sectors. If there is a services component to an EPA, then there will also be a need for additional (SDT) measures, but it is not clear whether they need to be purely trade related, or whether they can also be support measures (cf Art. 34) additional to planned support. Conversely, the ACP needs to ensure that **existing** support by the EU in the ACP services is not used to force through EPA negotiations in services.

We suggest there are at least four ways forward for EPA services negotiations:

1. **No services agreement.** Restatement of partnership character as in CPA Art. 41.4. Channelling of current EDF resources to strengthen ACP capacity in the supply of services related to labour, business, distribution, finance, tourism, culture and construction and related engineering services (CPA Art. 41.5).
2. **No services agreement, with some SDT options,** such as additional resources, to satisfy 41.2 allowing for SDT of ACP suppliers.
3. **Limited services agreement.** No ACP commitments beyond GATS (CPA Art. 41.2), but with (significant) new EU commitments and inclusion of other SDT options while possible services EPAs satisfy the requirements of GATS Art. V as well as SDT in CPA Arts 41.2 and 41.5.
4. **Advanced services agreement,** with both the ACP and EU participating and giving more commitments than under GATS.

Scope and possibilities for including SDT provisions in EPAs

Services and SDT options

SDT in WTO

The WTO (www.wto.org) describes nine special and differential treatment provisions in the GATS, broken down as follows:

- Provisions aimed at increasing trade opportunities: Art. IV.1 and Art. IV.2.
- Provisions under which WTO members should safeguard the interests of developing country members: Art. XIX.3.
- Flexibility of commitments, of action and use of policy instruments: Art. III.4 (enquiry points), Art. V.3 (MFN exemptions and RTAs), Art. X.:1 (use of subsidies), and Art. XIX.2 (coverage).

- Technical Assistance: Art. XXV.2 and Paragraph 6 of the Annex on Telecommunication.
- Provisions relating to least-developed country (LDC) members: Art. IV.3.

There are several GATS articles that are relevant for discussing the role of technical assistance. For instance, technical assistance in the area of services seeks to fulfil the General Agreement on Trade in Services, Art XXV Guidelines and Procedures for the Negotiations in Trade in Services (S/L/93), para 14:

> *'The Council for Trade in Services in Special Sessions shall continue to carry out an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of the GATS and of Article IV in particular. This shall be an ongoing activity of the Council and negotiations shall be adjusted in the light of the results of the assessment. In accordance with Article XXV of the GATS, technical assistance shall be provided to developing country members, on request, in order to carry out national/regional assessments.'*

The LDC modalities adopted by the Special Session of the Council for Trade in Services on 3 September 2003 referred to the above paragraph 14.

Paragraph 8: Members shall take measures, in accordance with their individual capacities, aimed at increasing the participation of LDCs in trade in services. Such measures could include:

- strengthening programmes to promote investment in LDCs, with a view to building their domestic services capacity and enhancing their efficiency and export competitiveness;
- reinforcing export/import promotion programmes;
- promoting the development of LDCs' infrastructure and services exports through training, technology transfer, enterprise-level actions and schemes, intergovernmental co-operation programmes, and where feasible, financial resources; and
- improving the access of LDCs' services and service suppliers to distribution channels and information networks, especially in sectors and modes of supply of interest to LDCs.

Paragraph 12: Targeted and co-ordinated technical assistance and capacity-building programmes shall continue to be provided to LDCs in order to strengthen their domestic services capacity, build institutional and human capacity, and enable them to undertake appropriate regulatory reforms. In pursuance of Paragraph 14 of the Guidelines and Procedures for the Negotiations on Trade in Services (S/L/93), technical assistance shall also be provided to LDCs to carry out national assessments of trade in services in overall terms and on a sectoral basis with reference to the objectives of the GATS and Article IV in particular.

LDCs have called for the Implementation of Modalities for the Special Treatment of Least Developed Country Members in Trade in Services Negotiations, (WTO Job 05/114). They have called for technical assistance and capacity building to assist them to identify critical areas of potential competitiveness and to build regulatory institutions and legislation, so as to enable them to effectively participate in services trade. So there are several references in GATS to capacity building and to general support for trade in services, in the guidelines and in the adopted LDC modalities. The main challenge does not appear to be one of language, but of following up on commitments. On the other hand, the current text does not include binding commitments to make technical assistance (TA) automatic, e.g. in the case of taking services commitments, and that is something that could be taken up in EPA negotiations (and possibly for all ACP countries).

There is also an issue on how to treat non-LDC, but small and vulnerable ACP countries. LDCs would be granted the most SDT in the WTO. The Caribbean countries are not LDCs (with the exception of Haiti). Some authors favour a special category for small countries (but non-LDC, and not 'large' developing countries) to which SDT can be granted in the WTO (Bernal, 2005):

> *'Small developing economies, i.e. over $1,000 in per capita income and small based on a combination of criteria of population, land area, GDP and vulnerability.'*

The debate on whether and how to accord SDT in the WTO generally and on how to apply services is far from over.[3] However, SDT in a services EPA could take another dimension. EPAs coincide with the disbursement of European Development Fund (EDF) funds for development co-operation and so a co-ordination of aid and trade policies (EU programmes already support the service sector). Furthermore, provisions in the CPA encourage the EU to accord SDT to all ACP countries, whether LDC or not, so the definitional issues of smallness matter less (and only with respect to WTO consistency, see below).

SDT and EU services trade agreements

We discuss differential treatment within the EU and between the EU and third parties (Te Velde et al. (2004) discusses services agreements in developing country regions). An interesting observation is that the EU itself does not have a single market in services. There are EU-wide regulations in the form of individual directives when services have been liberalised/harmonised internally, e.g. directives for insurance, TV, financial services, electronic communications services and transport services. However, in addition to this there are country-specific regulations for several sectors, many of which involve 'beyond the border' regulations. Te Velde et al. (2004) discuss these for the EU-15 based on its (draft) consolidated GATS schedule. For instance, in business services many individual member states require a university degree, professional qualifications and several years' professional experience for accountants, lawyers, etc. For construction and related engineering services, there are EU member-state nationality requirements in market access under Mode 3 and qualification requirements in Mode 4, while Mode 1 is largely unbound. There are country-specific regulations in health services in Modes 3 and 4 (economic-needs tests) and many EU health sectors are unbound or uncommitted.

Member states have discussed a new services directive proposed by the EC. This directive includes three issues:

- Freedom of establishment of services providers ('The formalities and procedures that service providers wanting to establish have to comply with are too complex and administered by too many different authorities').
- Free movement of services ('To provide services in another Member State on a temporary or occasional basis, services providers have to comply with formalities and rules there which add another layer of regulation and complexity to those in our home Member State').
- Establishing mutual trust between services suppliers and consumers.

Service providers should be able to obtain information and complete formalities through a **single point of contact** (Art. 6, Chapter II) in any member state. This should also function online. The **country of origin principle** (Art. 16, Chapter III) should ensure that service providers who operate legally in one member state could operate temporarily or occasionally in another member state without meeting further requirements. There are a number of exceptions from this principle, e.g. to protect workers and consumers and public health and safety. There are also safeguards for use in exceptional circumstances. The **posting of third-country nationals** would be simplified (Art. 25, Chapter III). The member state to which the posting of third-country nationals (from another member state) occurs will no longer be able to require the service provider or the worker posted to undergo administrative requirements such as work permits, without affecting those immigration controls that are still allowed between member states. The member state of origin will be required to ensure that service providers post only workers who are resident and lawfully employed within their territory.

It is also relevant to note that derogations to the country of origin principle are due to differences in national approaches or an insufficient level of Community integration. In certain cases, the proposed directive cannot achieve harmonisation in standards or establish cooperation, e.g. in activities such as notarial acts, postal services, electricity, gas and water distribution services.

Hence, it is clear that the EU services market will remain fragmented for some time. Because of

existing fragmentation, the combination of EU-wide directives and individual country commitments appear as commitments in GATS or regional trade agreement (e.g. EU–Mexico). This route is also open to ACP–EU negotiations to deal with asymmetry and different levels of income, and seems a way to achieve variable SDT according to countries' needs.

It is also relevant to discuss the external services negotiations of the EU. The EU has signed several free trade agreements that have included provisions on trade in services, and differences amongst these might inform options for ACP. There are EU association agreements: with the Central and East European countries (CEECs), also called Europe Agreements;[4] with the Mediterranean countries, also called EU–Med agreements;[5] and with South Africa,[6] Mexico[7] and Chile.[8] The EU agreements vary substantially with respect to several important services provisions (see Table 3 below):

- **Depth of commitments:** from not including services liberalisation above GATS (EU–South Africa is confirmation of GATS) to making substantially deeper commitments and more liberalised principles (EU–Chile).
- **General provisions related to cross-border supply of services and consumption abroad (Modes 1 and 2):** MFN is a general provision in EU–CEECs, some EU–Meds and EU–Mexico, and not the others; NT is a general provision in EU–Chile and EU–Mexico, but not in the others.
- **Treatment of investment (Mode 3):** commercial presence is included in the definition of services (e.g. in EU–Mexico and EU–Chile) but is also included in a separate chapter on establishment. EU–South Africa includes only a desire to ensure free movement of capital. Only the Europe agreements and EU–Chile include provisions for entry of investors (in addition to post establishment).
- **Treatment of movement of natural persons (Mode 4):** deeper liberalisation under Europe Agreements (employment of key personnel; temporary movement of natural persons related to provision of service) than in EU–Mexico (managerial and set-up personnel in conjunction with investment, Mode 3), or EU–South Africa (where no provisions on Mode 4 are included and no commitments beyond GATS). The EU will eventually grant access to the labour market to the CEECs.
- **Government procurement of services:** only explicitly included in EU–Mexico and EU–Chile, and the latter includes procurement of government works and for the first time for EU bilateral agreements, a substantive list of sectors.
- **Technical/Economic Cooperation.** EU–Jordan (title V) and the Trade Development Cooperation Agreement (TDCA) (title IV) includes special measures to stimulate co-operation in e.g. financial services, ICT, transport and tourism (e.g. exchange of information), but there is little in the EU–Mexico agreement. There is one article on co-operation on services aimed at diversification and competitiveness of Chile's services agreement (Art 20).

The Europe agreements and EU–Chile are the most liberal in terms of market access commitments and the liberalising framework. This is followed by EU–Mexico which has scheduled to liberalise all restrictions within ten years and where the liberalising principles (on services, public procurement and investment) guarantee predictability and access for EU exporters and investors equivalent to suppliers from NAFTA countries. Provisions on services in the EU–Med and EU–South Africa agreements are least liberal in terms of commitments (e.g. GATS commitments) and framework (handful of articles). Services agreements concluded by the EU thus vary considerably with respect to key aspects. And even within a similar set of EU–MED agreements, the services chapter can differ by MED country. For instance only Jordan (Art. 30) includes the right of establishment subject to reservations. It is possible to conceive of country-specific EPAs within a broader regional context and with country-specific details (e.g. on technical or economic co-operation), which offers scope for applying different levels of SDT.

Table 3. Services provisions in regional trade agreements involving the EU

	EU–Med association agreements (Algeria, Jordan, etc.) – Title III	EU–CEECs Europe Agreements (e.g. EC–Poland, EC–Hungary)	EU–Chile	EU–Mexico	EU–South Africa
Sectoral coverage	Universal	Universal	Universal (except audio visual air services, services and maritime cabotage)	Universal (over two stages, and except audio visual services, air services and maritime cabotage).	To be determined 5 years after entry.
Negotiating modality	Agree to widen scope of commitments under GATS, assessed after five years (Morocco).	Progressive liberalisation based on negative list approach	Positive listing	Negative-list approach	If further liberalisation occurs, there will be elimination of all discrimination (Art. 30).
Most favoured nation	Yes, general provision in e.g. in Art. 30.2 in Algeria, but for Jordan for establishment.	General provision	Not included as general provision	General provision (Art. 5)	Only for commitments under GATS
National Treatment	For Right of Establishment, only in Jordan (Art. 30), and subject to reservations in Annex VI; For maritime transport (Art. 39).	Scheduled sectors subject to bound commitments	General provision (Art. 98)	General provision (Art. 6)	Only for commitments under GATS
Market access	No	Scheduled sectors subject to bound commitments, no general provision.	General provision (Art. 97) banning several reservations on market access.	General provision (Art. 4)	Not mentioned
Transparency	Assessment of achievement after five years	Not mentioned	Each party shall respond promptly to information requests by other parties; list of commitments required after 10-year transitional period (Art. 7).	List of commitments required after 10-year transitional period (Art. 7).	Not mentioned
Treatment of investment		Chapter II, Title IV on Establishment. Clauses on establishment for Mode 1 and 2 in e.g. Art. 55 for Poland-EC.	Separate chapter on establishment, but this does not cover services. Indirectly covered by provisions on market access of services providers.	Covered as commercial presence and under a separate investment chapter.	Art. 33: Members should ensure free movement of capital.

Table 3 (continued)

	EU–Med association agreements (Algeria, Jordan, etc.) – Title III	EU–CEECs Europe Agreements (e.g. EC–Poland, EC–Hungary)	EU–Chile	EU–Mexico	EU–South Africa
Safeguards	No	No	No	No	No
Government procurement	No	No	Separate chapter on government procurement, including public works. Includes substantive list in Annex XI and XII.	Title III, separate chapter on government procurement including for sectors listed in Annex VIII. Primer for EU agreements.	No. Art. 45, parties agree to co-operate for a fair, equitable and transparent system.
Movement of natural persons	Provisions vary. No general provisions for Algeria ; reaffirm GATS commitments for Morocco and Tunisia (Art. 69 provides for dialogue on movement of workers; and bilateral agreements with member states possibly more liberalised, Art. 68)	Under establishment, Art. 53 (Bulgaria and others), right to employ key personnel covering period of employment; Art. 56 permits temporary movement of natural persons related to provision of services (except for direct sales)	Art. 101: Two years after the entry into force, the Parties shall review the rules and conditions applicable to movement of natural persons (Mode 4) with a view to achieving further liberalisation.	Art. 3ci only managers and set up personnel in conjunction with investment; no access to labour market; key personnel and managers in financial services can be of any nationality, subject to exception (Art. 16 and 17)	Not included
Mutual recognition agreements	Art. 35 (Jordan): to agree on steps for negotiations MRAs	Art. 46 (Poland): to agree on steps for negotiations MRAs	Art. 103: Encourages mutual recognition	Art 9: to agree on steps for negotiations (MRAs. Agreement reached at professional level)	Not included
Dispute settlement			Dispute settlement for financial services	Yes, separate title on dispute settlement.	Article 104 on dispute settlement
Restricting non-conforming measures	Standstill to all modes of supply	Standstill on covering commercial presence		Standstill	
Special provisions		Selected: Maritime transport (Art. 56 1) in Hungary–EC and Poland–EC, Romania–EC (Art. 57 1) etc., granting unrestricted market access, and traffic on commercial basis	Separate section on Maritime transport, Telecommunications Services, Separate Chapter on Financial Services,	Maritime transport, Financial Services	Maritime transport (Art. 31), unrestricted access and fair competition

Table 3 (continued)

	EU–Med association agreements (Algeria, Jordan, etc.) – Title III	EU–CEECs Europe Agreements (e.g. EC–Poland, EC–Hungary)	EU–Chile	EU–Mexico	EU–South Africa
Future liberalisation of trade in services				Progressive liberalisation within 10 years.	View to further liberalisation (Art. 30)
Services agreement beyond GATS?	Not yet, but Morocco and Tunisia have requested services negotiations.	Yes, but subsequently under *acquis* of the EC, and part of consolidated EC schedule. Now, new arrangements for labour mobility. (Bulgaria and Romania have not yet acceded)	The services agreement goes beyond GATS, but initial Mode 4 provisions not noticeably different.	Mode 4 provisions not very different from GATS but some additional provisions for key personnel in the case of financial services	No

Source: Te Velde et al. (2004)

Possibilities for inclusion of SDT

There are two issues related to the possibility of including SDT. First, EU and ACP states differ in development levels, and may need different types of SDT. As discussed before, this is parallel to the EU by not yet having a single market in services (both services and investment fall to some extent under the shared competencies of the European Commission and its member states). Both EC and member states' commitments appear in schedules of international services agreements, and thus the same should be possible for ACP regions and countries.[9] On the other hand, it might be useful to think of regional integration and harmonisation first at the level of the ACP.

Secondly, SDT in regional services agreements needs to be WTO consistent. In particular SDT needs to satisfy the conditions of GATS Art. V. In order to be compatible with GATS Art. V, an agreement must fulfil two basic conditions:

1. It must have 'substantial' sectoral coverage, in terms of sectors, volume of trade, and modes of delivery, V:(1a).
2. It has to provide for national treatment for services providers of the parties eliminating 'substantially' all discrimination, V(1b).

GATS Art. V.3 provides for flexibility with respect to these two requirements in two cases:

1. GATS Art. V.3(a) provides that where **developing countries** are parties to an agreement, flexibility shall be provided regarding conditions set out in GATS Art. V:1a and V:1b.
2. GATS Art. V.3(b) stipulates that **more favourable treatment** is to be accorded to legal persons of developing countries in the GATS of Regional Trade Agreements (RTAs) that involve ***only*** **developing countries**.

Thus, while the ACP can be accorded flexibility (and therefore SDT), coverage of services needs to be wider in scope than in GATS. Subject to this, SDT in an EPA context to non-LDC developing countries with respect to services offers can be WTO consistent. As with all WTO provisions, the interpretation of GATS Art. V depends on the views of the member states and can only be clarified by a dispute.

There is one important argument that would support a more flexible approach in GATS article V

than in GATT article XXIV. Both articles should ensure that the region is trade creating, not diverting. However, because at least one mode of services, temporary migration, is heavily restricted in different contexts, loosening up this one category is less likely to lead to trade diversion away from other categories, than in the case of relatively unrestricted trade in goods where tariff preferences may lead to a shift away from the most efficient imports; instead, it might displace or complement host-country labour; there is also no serious loss in tariffs in the possible event of trade diversion. Hence, we argue that the problem of trade diversion is much smaller when using trade in services preferences. It is also more politically acceptable to liberalise sensitive services sectors regionally with ACP regions, than globally.

Some would argue that mutual recognition agreements (MRAs) should also be seen in the context of GATS Art. V, while others argue that MRAs also need to be consistent with GATS Art VII. GATS Art. VII (Recognition) allows a member to recognise the education or experience obtained, requirements met, or licenses or certifications granted in a particular country, without breaking the MFN (Most Favoured Nation) rule. However, to ensure transparency, negotiations should allow third parties to be present during negotiations. Another way is to regard MRAs as part of notifying an RTA under GATS Art. V (Nielson, 2003). It is probably because of this possibility that the majority of notifications under Art. VII have been for (old) bilateral agreements (105 of 120) while around 10 agreements notified cover more than two countries (Adlung, 2004). Thus, if MRAs can be seen as part of a services EPA consistent with Art. V, it does not seem required to notify other parties of MRA negotiations (though if diversion in the case of regions was proven, this must be compensated). The services chapter in the EU–Mexico agreement includes an article that allows for the negotiation of MRAs.

General SDT options

Te Velde et al. (2004) 'scopes in' 10 SDT options under EPA Services Negotiations. They are grouped in three areas: trade measures (SDT), services trade facilitation (SDT) and development co-operation (capacity-building, see below). Some of these SDT measures apply to the general principles of the negotiations, but others need to be more country specific. Te Velde (2005) discusses possible measures that can be taken by the EU, and they are summarised below.

1. Trade measures (these need to be WTO consistent)

(a) Full credit for autonomous ACP liberalisation of services (e.g. financial services in Trinidad and Tobago are already liberalised, so binding this would deserve credit, while the EU would be asked to start from actual levels of liberalisation.)

(b) Fewer services commitments by ACP countries (affirming GATS commitments).

(c) EU commitments over and above GATS. This could cover more liberal Mode 4 conditions (e.g. an ACP business travel card, see Box 2), safeguarding of Mode 1 supplies, and removal of restrictions in Mode 3 and Mode 4 in specific sectors such as business services, construction and related services, health and education services, recreational, cultural and sporting services, and tourism services (see Box 3). Lifting of some restrictions can be achieved more easily at ACP level than in the GATS.

(d) Including part of EU government procurement (e.g. health and IT).

(e) Operationalise emergency safeguards measures for the ACP; (difficult for certain services sectors and/or Modes, e.g. Mode 3 when the services providers have already established a presence).

(f) Flexible implementation time period, say 10–12 years for the ACP (this could apply to mutual recognition of qualifications and inventories of restrictions).

2. Services trade facilitation (needs to be WTO consistent)

(a) Facilitation of the recognition of professional

credentials by setting up one-stop shops in ACP countries.

(b) Information centres for ACP exporters of services.

3. Development co-operation (EDF programmes, EIB loans, other)

(a) Financial support for services export capacity building (e.g. integrated tourism programmes, human resource development, trade policy capacity) and trade negotiations (this should be made mandatory or else this risks being too little, as in the case of GATS).

(b) Increase in technology transfer to the ACP using 'home country measures' (e.g. PROINVEST, EIB Investment Facility).

Capacity building for ACP service suppliers

Table 4 tries to match services trade constraints with the various support measures that either already exist as part of EC programmes or could be seen as part of services negotiations. This is based on interviews relating to trade barriers, regulatory framework and productive capacities in six services sectors: tourism, financial, ICT, education, cultural services and Mode 4 of supplying services across three ACP countries: Barbados, St Lucia and Suriname. The table shows that there are some key issues that can be addressed by the EC under a CARIFORUM–EC Economic Partnership Agreement, many of which could fall under SDT options: Mode 4, mutual recognition agreements, export promotion, import centres, human resources development, access

Box 2. Introducing an ACP Business Travel Card (tailored to CARIFORUM)

The EU restricts the temporary movement of various categories of natural persons in GATS Mode 4 (while the EC does of course not have the competence over migration policies, is does act as a co-ordinating body which *is* able to put forward offers on Mode 4, temporary movement of natural persons, on the table after consultation with member states; this would not involve harmonisation of migration policies). In particular, medium to lower skilled workers from the ACP will find it difficult to enter the EU to supply services. Some higher skilled workers will be subject to quotas. Some new thinking is required so that the EU admits temporary movement of natural persons in all categories as long as some basic conditions are fulfilled. An ACP Business Travel Card may help to facilitate and operationalise market access in Mode 4. As a similar example, the APEC Business Travel Card has been successfully introduced. Under an ACP Business Travel Card there could be:

- visa-free or visa-at-border entry for business development purposes;
- creation of a multiple-entry visa;
- common service standards for processing (minimum time) of temporary entry visa;
- an expanded range of professions under 'business visitor'; and
- an expanded range of support staff, applying to less-skilled workers in particular.

There could be a pilot scheme running for a number of years (covering certain ACP countries, regions or sectors). Cardholders would be required to present their passports, but are not required to submit separate applications for business visitor visas. Participating economies would commit to implementing the scheme and would be free to maintain existing visa requirements for business visitors. They would also have the responsibility of avoiding abuse of the ACP Business Travel Cards by registering *bona fide* ACP employers (and avoiding overstaying temporary entry). All economies retain the right to refuse an individual without providing reasons, or to refuse entry to ACP Business Travel Cardholders at the border. The concept could be introduced at the ACP level, but the precise implementation could be left to regional negotiations, as ACP regions are interested in different services sectors.

Box 3. EU barriers to services imports

Te Velde et al. (2004) reviews possible benefits of EU liberalisation to the ACP by sector and type of regulation in order to provide an improved insight into SDT (1c). Space requirements allow us to mention just a few here. We need to consider EU-wide regulations (when services have been liberalised internally) and country-specific regulations, many of which involve 'beyond the border' regulations.

In business services, many individual member states include requirements for a university degree, professional qualifications and several years' professional experience, for accountants, lawyers, etc. In the case of medical and dental services, access can be restricted to natural persons and often includes economic-needs testing and a residence requirement. Removing these restrictions would benefit countries with a relevant supply capacity.

For construction and related engineering services, there are EU member-state nationality requirements in market access under Mode 3 and qualification requirements in Mode 4 (e.g. degree and professional experience in the Netherlands), while Mode 1 is largely unbound (though France has an economic needs test). Removing these restrictions would benefit those ACP countries with a relevant export capacity.

The potential for ACP exports of health services is significant. Removing restrictions in health services in Modes 3 and 4 (economic needs tests) or including it as committed sectors (as many EU health sectors are unbound, or uncommitted) should help such exports significantly.

There are also EU-wide and member-state-specific regulations relating to health tourism and cutting waiting lists that would fall under government procurement and hence not under business services negotiations. But it is clear that ACP health operations can be more competitive than EU operations.

Anecdotes suggest that removing Mode 4 restrictions in recreational, cultural and sporting services, including economic needs tests (Italy), main profession (Austria), employment contract with authorised enterprise (France), and others would facilitate ACP exports of services, including entertainment groups.

to finance, trade negotiations capacity support, public sector reform and private sector development. These findings are also applicable to other ACP regions.

Mode 4 and Mutual Recognition Agreements

There are limitations to the temporary movement of people to the EC:

- Quotas with regard to entry of certain categories of workers will need to be determined.
- Economic needs test or residency requirements apply in certain sectors (e.g. number of pharmacists, nurses, R&D services, retail trade – on a national treatment basis).
- Less skilled workers are not automatically granted access through GATS provisions (though individual countries may have their own schemes).

And limitations on post-entry treatment:

- EU and national working conditions, minimum wage requirements, and any collective wage agreements will continue to apply.
- An important limitation on national treatment (NT) in Mode 4 is that EC directives on mutual recognition of diplomas do not apply to nationals of third countries. And recognition of the diplomas that are required in order to practice regulated professional services remains within the competence of each member state.

Hence, ACP countries can ask for better Mode 4 access, over and above what can be obtained in GATS (where progress has been slow). The ACP countries might also ask to be included in and initiate mutual recognition agreements, regionally, bilaterally or at the sector level with the EU. While

Table 4. EU measures and services export capacity

	Measures by EU to satisfy services capacity building needs in Art 41.5		
	Trade rules	**Trade facilitation**	**Aid (for trade) programmes**
Tourism	Amend EU package travel directive to include Caribbean suppliers subject to Caribbean rules (St Lucia). Include Caribbean in EU reservation systems for transport and accommodation.	Import centres in new EU markets (also outside UK in case of St Lucia; outside Netherlands in case of Suriname). Provide credit for suppliers of major hotels to facilitate linkages (e.g. flowers in St Lucia), and enhance sustainable tourism development.	Support hospitality human resources development programme at SALCC; IT systems, health and safety training (to accord with EU travel directives, St Lucia and Suriname), particularly for local small hotels. Facilitate access to capital.
Financial services	Allow easier access to financial services to the diaspora in EU (remittances, savings, etc.)		Support for strengthening regulatory framework.
IT	Keep sector open for imports into EU. Avoid protective regulations in EU.	EU import centres in member states. Organise outsourcing match-making meetings (in EU and Caribbean).	Need for investment fund for new promising sector (St Lucia). CPA Art 43: take measures that will enable inhabitants of ACP countries to get easy access to information and communication technologies.
Education	Offer equality in payment of fees and access to courses and scholarships.	Develop partnerships between EU and Caribbean education institutes (Barbados, St Lucia and Suriname). Facilitate exchange of students.	Support targeted training programmes.
Cultural	Allow Caribbean as 'in quota' local content.	Strengthen or establish export centres such as national cultural foundations (Barbados, Suriname, St Lucia) – CPA Art 27.	Institutional support for marketing the sector – CPA Art 27. Develop heritage tourism.
Mode 4 (esp. inside companies).	Conclude MRAs. Access for all type of workers Obtain maximum quotas for skilled migrants.	Mode 4 facilitation: initiate ACP Business Travel Card. Support conformity to standards in MRAs (medical offshore schools).	Compensation for loss of capacity by supporting training centres for nurses, hospitality and IT sector.
Cross-cutting		Services import centres.	Private sector development (Suriname). Government capacity to co-ordinate services policy (St Lucia, Suriname).

Source: Te Velde (2005) based on interviews in Suriname, St Lucia and Barbados

it is generally acknowledged that MRAs (in professional services) can lead to significant benefits (UNCTAD, 2005), they are time consuming to negotiate and cost time. Support is needed for an adequate negotiation capacity and for the accreditation process, e.g. for ACP medical schools.

Export promotion

Many services sectors are not regarded as significant export earners. Many ACP countries (with some exceptions) have done little to encourage entrepreneurship and export across borders in sectors

such as cultural services. Export promotion initiatives have traditionally focused on trade in goods, and more recently tourism. The EC could provide more assistance for export promotion, particularly for those organisations that try to organise emerging services suppliers (such as national cultural foundations) and develop marketing strategies. This is particularly relevant for those services sectors that consist of many fragmented suppliers with little knowledge of exporting and supplying services through Modes 2 and 4 (artists, entertainers, lawyers, accountants, etc.). Such suppliers face a lack of information, e.g. on demand for their services in the EU.

Import centres

It might be better to concentrate trade facilitation on the import side in EU member states, when the services sector in the Caribbean is more concentrated (e.g. there are only a few IT enabled services suppliers in the Windward Islands) and supplying services through Mode 1 (online) or Mode 3. In the case of Mode 1 it might be relevant to organise meetings for companies in the market for offshoring (matchmaking), or in the case of Mode 3 advice on how to access the EU market (outward investment promotion). While some of this support is already occurring, there has been comparatively little attempt to do this for services sectors. There is a bilateral precedent. The Netherlands Foreign Ministry has an agency called the CBI which is tasked with stimulating imports from developing countries. As part of this, it offers advice on accessing the EU markets, including in the tourism sector.

Human resources

Often, human resources are inadequately geared towards newly emerging services sectors. Even when tourism is responsible for a substantial part of GDP, there has been insufficient attention to developing human resources for the hospitality sector. Good quality and appropriate human resource development might help to reposition the Caribbean economies in the context of globalisation and preference erosion. In all case countries there exists a lack of qualified technical skills to move up the IT ladder (only simple call-centres activities are present throughout the Caribbean). And, there is little attention to developing skills in entertainers and artists. In general terms, market and co-ordination failures constrain the achievement of sufficient and adequate skills development.

Education is also becoming a promising export sector itself. There is a need to strengthen tertiary education and training to build up competences in the sector as well as providing payments to ACP countries (it might be economically efficient to train nurses in the ACP) for the training of teaching and nursing capabilities. Foreign education institutions (e.g. in health, hospitality) have been attracted to the Caribbean from the US, but there is much less on this from the EU in ACP countries. This could be encouraged.

Access to finance

It is generally acknowledged that available credit (e.g. CDB or EIB) is not geared towards small services producers. There is a lack of financing that is quick and flexible – and this is required for dynamic services sectors. The EC could support further access to credit for specialised sectors, e.g. a Caribbean Tourism Investment Fund, or an ICT Investment Fund.

There are also other elements that may need attention under a services EPA. There is a discussion whether and how different types of tourism contribute to the local economy. One part of this debate relates to the extent to which local suppliers are connected to the big (foreign-owned) hotels. The extent of such linkages usually depends on good quality and timely supplies. However, access to finance is another factor. Discussions suggested that big hotels sometimes do not pay small local suppliers of flowers on time, so that access to credit is one of the constraints to further profitable tourism.

Trade negotiations capacity support

The trade negotiations capacity in small ACP states is often weak because of the limited number of officials available – there are exceptions. There is normally no continuous co-ordination on trade matters amongst ministries and between the private and

public sector. Some suggest that support for a national trade negotiations capacity centre in ACP countries is needed to: co-ordinate demands from ministries and industries, absorb academic knowledge, and communicate with the private sector on how they are constrained by trade-related issues.

Public sector reform

In some cases regulations are outdated, and in other cases further services exports depend on public sector reform in other (services) sectors. While there may be various reasons for this, lack of government capacity is one. Further support for public sector reform may be required.

Private sector development

There is a poor investment climate in some ACP countries, and assistance for improving the regulatory framework and for public sector reform would also help to create an improved investment climate. There is inadequate private sector development, and support for private sector development such as for the development of IT and culture services sector might help.

Conclusions

This chapter reviewed the development dimensions of possible services negotiations under EPAs. We argued that there were four options forward for EPA services negotiations:

1. **No services agreement.** Restatement of partnership character as in CPA Art. 41.4. Channelling of current EDF resources to strengthen ACP capacity in the supply of services related to labour, business, distribution, finance, tourism, culture and construction and related engineering services (CPA Art. 41.5).
2. **No services agreement, with some SDT options,** such as additional resources, to satisfy 41.2 allowing for SDT of ACP suppliers.
3. **Limited services agreement.** No ACP commitments beyond GATS (CPA Art. 41.2), but with (significant) new EU commitments and inclusion of other SDT options while possible services EPAs satisfy the requirements of GATS Art. V as well as SDT in CPA Arts 41.2 and 41.5.
4. **Advanced services agreement,** with both the ACP and EU participating and giving more commitments than under GATS.

A question that all ACP regions will have to answer is to what extent they want to negotiate in the area of services. But independent from this, significant thought will need to go into the development dimension of services. We think that development is an important aspect of the issue of services in the CPA; at the same time the trade aspects will need to respond to what has been achieved in GATS. We argued that there were a number of ways that aid measures may help to build the export capacity of the ACP, a stated aim in the CPA. We also argued that preferences in the area of trade in services (e.g. Mode 4) are actually less trade diverting than usual and hence more acceptable and more likely to be welfare enhancing.

Endnotes

1. Health tourism (surgery in combination with cruise holidays, mode 2) is well documented in the case of the Caribbean (Gonzales et al., 2001). Lyford Cay hospital in the Bahamas serves UK patients; around two percent of hospital visits in Queen Elizabeth Hospital in Barbados originated from the UK, etc.
2. CPA Art. 34 (which is more general to the Cotonou Partnership Agreement): Economic and trade cooperation shall aim at fostering the smooth and gradual integration of the ACP States into the world economy, with due regard for their political choices and development priorities, thereby promoting their sustainable development and contributing to poverty eradication in the ACP countries.

   The ultimate objective of economic and trade cooperation is to enable the ACP States to play a full part in international trade. In this context, particular regard shall be had to the need for the ACP States to participate actively in multilateral trade negotiations. Given the current level of development of the ACP countries, economic and trade cooperation shall be directed at enabling the ACP States to manage the challenges of globalisation and to adapt progressively to new conditions of international trade thereby facilitating their transition to the liberalised global economy.

   To this end economic and trade cooperation shall aim at enhancing the production, supply and trading capacity of the ACP countries as well as their capacity to attract investment. It shall further aim at creating a new trading dynamic between the Parties, at strengthening the ACP countries trade and investment policies and at improving the ACP countries' capacity to handle all issues related to trade.

   Economic and trade cooperation shall be implemented in full conformity with the provisions of the WTO, including

special and differential treatment, taking account of the Parties' mutual interests and their respective levels of development.

3. The draft November GATS text in the Doha Round says it will address concerns for small economies, but does not say how.
4. Europe Agreements are pre-accession agreements, with Bulgaria (into force 1995), Czech Republic (1995), Estonia (1998), Hungary (1994), Latvia (1998), Lithuania (1998), Poland (1994), Romania (1995), Slovakia (1995), Slovenia (1999). Most are now superseded by accession.
5. Euro-Mediterranean association agreements with Algeria (signed 2002), Tunisia (1998), Israel (1995), Jordan (1997), Lebanon (2003), Morocco (1996) and Palestinian Authority.
6. Trade Development Cooperation Agreement signed in 1999.
7. Economic Partnership, Political Coordination, and Cooperation agreement or Global Agreement, signed 2000 and 2001.
8. EU-Chile Association Agreement.
9. An alternative view is provided by Stephenson and Contreras (2002) concerning ongoing (but now stalled) EU-MERCOSUR negotiations in the area of services, where there are strong regulatory asymmetries. In the EU the establishment of the Single Market has had an impact on national regulations of many services sectors, and has led to some harmonisation of regulation. MERCOSUR, on the other hand, is in an earlier stage of integration of services markets, characterised by ongoing reforms of national regulations in specific services sectors and, to a lesser extent, regulatory harmonisation across countries. Because of these asymmetries, the authors identify a three-phase negotiating strategy departing from GATS:

   - Phase I: Identification of (potential) 'sensitive' sectors and liberalisation of 'non-sensitive' sectors (where asymmetries do not play a major role).
   - Phase II: Regulatory reform/review and political consensus around 'sensitive' sectors.
   - Phase III: Progressive liberalisation after completion of removing regulatory asymmetries through regulatory reform.

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26

Tourism Services Negotiation Issues: Implications for CARIFORUM Countries

Adam Dunlop

An overview of CARIFORUM tourism

Some brief highlights of the recent performance of the industry are presented in this introductory section, and areas of growth and decline are highlighted. Finally, a brief summary of the global context and regional responses to the current crisis in international tourism is presented.

Tourism in CARIFORUM is a mix of developed and emerging destinations

The Caribbean is regarded as the most tourism-dependent region of the world, and the industry is believed to account for one in every four jobs. Some Caribbean Forum (CARIFORUM) destinations are well established in the international market place, such as Antigua, Jamaica and St Lucia. Others, such as Belize, Guyana, Suriname, and Trinidad and Tobago, have only recently begun to aggressively promote tourism as a source of economic growth and development. As one would expect, tourism's importance to national economies differs greatly across CARIFORUM states.

The pace of tourism sector growth differs substantially across CARIFORUM states. In recent years it has been the Hispanic Caribbean, led by Cuba and the Dominican Republic, that have seen the rapid expansion of the tourism sectors through an aggressive pursuit of the mass tourism market principally through 'all-inclusive' packaged holidays. Tourism growth in the Dominican Republic has outpaced its Caribbean Community (CARICOM) neighbours. A relative latecomer to tourism, annual international arrivals to the Dominican Republic grew at three times the Caribbean average, at 10% between 1995 and 2000.[1] The Dominican Republic is the most price-competitive destination, with significantly lower operating costs than its CARICOM neighbours, particularly labour costs.

The Organisation of Eastern Caribbean States (OECS) countries (Antigua and Barbuda, Commonwealth of Dominica, Grenada, Montserrat, St Kitts and Nevis, St. Lucia and St Vincent and the Grenadines; Anguila and the British Virgin Islands are associate members) have seen little new investment in their hotel and accommodation sector during the last decade, as well as a reduction in tour-operator-generated business. According to the Caribbean Strategic Tourism Plan, 'Major tour operators have all but ceased operating to the Caribbean, other than Cuba, the Dominican Republic and Jamaica. The Eastern Caribbean countries have been the major casualties of these developments'.[2]

The leading markets for CARIFORUM tourism

The three leading markets for CARIFORUM tourism are the US, Europe and Canada. In 2002, Europe was the leading source of tourists for Antigua and Barbuda, Barbados and the Dominican Republic. In the same year, the US was the principal market for the Bahamas, Belize, Cayman Islands, Guyana, Jamaica, St Lucia and Trinidad and Tobago. Grenada and St Vincent and the Grenadines attracted almost equal amounts of European and US tourists. In all CARIFORUM tourism destinations apart from Guyana, Canada is the third largest market after either Europe or the US.[3] Whereas the European market is highly packaged, the 'free, independent traveller' – who is more inclined to package his/her own vacation experience after thorough

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research using the internet and other information sources – is accounting for an increasing share of the US and Canadian markets.

According to CTO, the growth in intra-Caribbean tourism slowed in 2001, but this market remains particularly important for Dominica, Guyana, St. Christopher and Nevis, St Vincent and the Grenadines, Trinidad and Tobago. In these countries, the Caribbean market accounted for as much as half of the total tourists in 2001.

Structural differences across CARIFORUM tourism destinations

There are also important structural differences across CARIFORUM tourism destinations, not least in relation to the size of the industries. For example, in 2001 just over two-thirds of all tourist arrivals to CARICOM countries (66.5%) were to three countries: the Bahamas, Barbados, and Jamaica.[4] The issue of scale is further emphasised by a comparison of the hotel and accommodation tourism sub-sectors within CARIFORUM, particularly room capacity. In the Bahamas, one foreign-owned hotel has the same number of rooms (2,500) as the total room inventories of St. Christopher and Nevis (1,754) and Guyana (730) combined. Yet the Bahamas also contains a small number of locally owned hotels and private villas. In Belize, the average size of hotel is no more than ten rooms: Belize's room inventory consists of 4,000 hotel rooms spread between 400 hotel and lodging establishments.

Levels of foreign ownership within the hotel and accommodation sub-sector also vary considerably across CARIFORUM, although most larger hotels – more than seventy-five rooms – have significant levels of foreign capital. Tourism is capital intensive, and large expenditures are required both to construct and operate hotels. These levels of capital are usually only available internationally and CARIFORUM companies – with one or two Jamaican and Dominican exceptions – have difficulty raising these funds in international markets.

In recent years, most CARIFORUM destinations have sought to diversify their product offerings beyond the traditional 'sun, sea and sand' beach tourism. Some destinations place a stronger emphasis on attracting business tourism (e.g. Trinidad and Tobago) or eco-tourists (e.g. Guyana, Suriname, Belize), while others are more oriented to all-inclusive holiday experiences packaged by tour operators (e.g. Bahamas, Dominican Republic, Jamaica). However, this characterisation is too simplistic, as many CARIFORUM destinations currently offer multi-faceted tourism experiences that often combine beach tourism with eco-tourism, heritage and cultural tourism (e.g. carnivals), and sports tourism (e.g. golf, scuba diving).

Areas of future growth for CARIFORUM tourism

The growth of cruise tourism to many CARIFORUM states has recently outstripped the growth of land-based tourism. For example, Belize experienced a staggering 564% increase in cruise passenger arrivals in 2002 compared to 2001.[5] In contrast, both Antigua and Barbuda and St Lucia experienced a decline in the number of cruise passenger arrivals in 2002 of 25% and 21% respectively. The importance of cruise tourism also differs markedly across CARIFORUM member states. In 2001, the Bahamas received 17.1% (2.552 million arrivals) of the total number of arrivals of all of Caribbean Tourism Organisation (CTO) member states, whereas St Vincent and the Grenadines and Trinidad and Tobago accounted for 0.5% and 0.6% of the totals respectively.

As competition intensifies in the international tourism marketplace, CARIFORUM states are combining their traditional product offer of 'sun, sand and sea' with more specialised niche marketing in newer areas such as casino and gaming tourism, spa and health tourism, eco-tourism, business and incentive tourism, adventure tourism, destination weddings, event-focused cultural tourism (including carnivals and festivals, and major sporting events such as the cricket world cup), heritage tourism, sports tourism (e.g. golf, diving and yachting), visitor attractions and multi-destination tourism.

While some CARIFORUM states have already developed gaming tourism sub-sectors (e.g. Antigua and Barbuda,[6] Bahamas, Dominican Republic), others are considering carefully the impact of gaming on

local societies and the response of religious communities. The Association of Caribbean States (ACS) has recently formed a consultative committee on multi-destination tourism in the Greater Caribbean,[7] chaired by the Caribbean Tourism Organisation (CTO) and multi-destination programmes will be developed in collaboration with small hotels, regional airlines and regional tour operators.

Cultural tourism, including festival and carnival tourism, is also considered an area of potential growth for some CARIFORUM destinations. Many CARIFORUM states (e.g. Jamaica) are already marketing their destinations on the basis of annual programmes of events relating to the arts, music festivals, and religious festivals. The Trinidad Carnival received 35,000 visitors in 2003, the highest ever inflow of tourists for a Caribbean festival.

Areas of decline within CARIFORUM tourism

There is a widespread acceptance that Caribbean tourism now needs to be repositioned through a more diversified and higher quality product offering. In some CARIFORUM states, room rates have remained static for at least five years. This points to a lack of sustainability, particularly in tour-operator-led business. The island destinations within CARIFORUM supply a specific segment of the global tourism demand: sun, sand and beach tourism. The lower value, mass-market end of this sector of the global tourism market has many of the characteristics of a commodity industry: extreme price competition and limited ability to differentiate. Tour operators also have a clear interest in the standardisation of this type of tourism products, as it enables them to switch supplier destinations while maintaining the integrity of their brands. Tour operators can exert dominant market power in some CARIFORUM tourism markets as they account for a large share of total tourism demand. They can also drive down prices where the product is easily substitutable, and because many CARIFORUM hotels have no alternative means of generating volume bookings.

The 'commoditisation' of the tourism product in some CARIFORUM destinations – whereby destinations offer standardised sun, sand and sea tourism products with limited differentiation – has led to a vicious downward spiral. Hotels that face increasing competition typically discount prices[8] to maintain occupancy rates and guarantee volume bookings for the forthcoming season. As a result of declining margins, expenditure on quality control and maintenance is reduced. As the quality of the product deteriorates, tour operators move on to new hotels. In this way, hotels can experience a cycle of initial boom, popularity and high occupancy rates, followed by price discounting, and eventual decline as newer and better quality accommodation emerges elsewhere.[9]

It should be noted, however, that international tour operators also face strong competitive pressures in their own markets, and it is the highly competitive consumer markets for package holidays that drive them. So much so that it has been estimated that if prices to one destination increase in relation to its competitors by 1%, then bookings to that destination will fall by 3–5%.[10] As Table 1 shows for selected EU states, profit margins for tour operators are not high. In response, major tour operators have been buying into all elements of the tourism value chain so as to maximise margins and revenues through vertical integration. Against this background, the only route for CARIFORUM hotels to obtain greater control over pricing is to develop a higher quality product and move out of the commodity tourism market.

Table 1. Breakdown of average EU tour operator's package prices[11]

	Belgium	Germany	UK
Travel agent's commission	11%	12%	12%
Airline costs	37%	30%	37%
Hotel costs	36%	45%	37%
Destination costs	7%	6%	6%
Overheads	7%	5%	6%
Profit margin	2%	2%	2%

Tourism: A sector characterised by low linkages and high leakages

Tourism is generally considered to be a sector where the linkages to other economic sectors are low and the leakages[12] of tourism profits are high. Estimates vary but tourism leakages have been reported to be as high as 85% for African least-developed countries (LDCs), 80% in the Caribbean, 70% in Thailand, and 40% in India (UNEP).[13] Yet even this situation also differs from country to country within CARIFORUM. Some destinations have had more success than others with integrating tourism with other sectors of their economies and retaining tourism rents. Jamaica has made some progress in linking domestic agricultural production with the local market created by international tourism. All chicken products, fruits and vegetables for tourism consumption are sourced locally in Jamaica. However, CARIFORUM states have yet to devise a regional strategy to minimise the high levels of foreign exchange leakage from tourism caused by the levels of foreign ownership of the sector.

All CARIFORUM destinations preserve some tourism activities for local companies

As well as structural differences among destinations, there are also some commonalities among CARIFORUM tourism sectors. The most important for the purposes of this report is that every CARIFORUM state preserves at least some ancillary services for national companies and local service suppliers. In some countries, the preservation of some tourism sub-sectors for nationals is enshrined in national legislation for tourism development. In others, this is unwritten policy.

These services are generally those within the investment capacity of CARIFORUM nationals. The most common that are preserved for nationals include water-sports services, diving services, tour guide services, ground-handling services, ground and marine transport services, entertainment services, travel agent services, restaurant services, destination management companies, some retail services related to tourism, and hotel development services for hotels of 75 rooms or less.

It is not always the same services that are preserved for national suppliers in each country. For example, not all CARIFORUM states share Trinidad's interest in preserving marina developments of 100 berths or less for Trinidadian nationals, which reflects Trinidad's recent success in developing a reputation for yacht repair and maintenance services. More commonly, many CARIFORUM states preserve travel-agent services, ground-transport services and tour-guide services for local companies. Most CARIFORUM travel agencies deal with out-bound tourism, including the important 'VFR' market (CARIFORUM nationals visiting friends and relatives), rather than the much greater in-bound tourism market.

The preservation of some tourism-related services, by mode of supply, for regional service providers is a major defensive element of a negotiating strategy for tourism services. CARIFORUM governments should refrain from making market access and national treatment commitments for these services, particularly on Mode 3 'commercial presence', in any services trade negotiation. At the regional level, it will be important for a list of such services to be compiled in order to ensure that these services are not liberalised further in international trade negotiations. The CARICOM Services Working Group could take the lead in this initiative. The aim of this proposal is to ensure local community involvement in the tourism sector, a fundamental pillar of sustainable tourism development.

The recent trend towards vertical integration – of developed-country companies in CARIFORUM markets – poses a direct challenge to the involvement of local companies and communities in tourism activities, and increases the leakage of tourism profits from CARIFORUM states. A regional strategy is required both to counter the effects of this trend, and to reduce the levels of foreign-exchange leakage from tourism. A starting point would be to identify which tourism-related services should be preserved for regional suppliers.

Nearly all CARIFORUM tourism companies are SMEs

With a few notable exceptions, the majority of CARIFORUM service suppliers are small and

medium-sized enterprises (SMEs). CARIFORUM SMEs provide services to the regional tourism sector (e.g. entertainers, ground and marine-transport companies, water-sports and dive operations, accounting services, security services, plumbing and maintenance services, garden and pool maintenance services) and also represent a substantial percentage of the small hotels and lodgings subsector. A US negotiating proposal on 'Small and Medium-Sized Services Enterprises' in the GATS negotiations (TN/S/W/5 of 1 October, 2002) defines small services enterprises as having up to a hundred employees, total assets of up to US$3 million, and total sales of up to $3 million. Against this definition CARIFORUM-owned tourism services suppliers would be classified as either 'micro' enterprises or 'very small'.

Paragraph 3 of the Guidelines and Procedures for the GATS services negotiations (S/L/93) at the WTO states that 'due consideration should be given to the needs of small and medium-sized service suppliers, particularly those of developing countries'. It is up to the CARIFORUM tourism sector to respond to this opportunity by formulating trade negotiating requests that would take advantage of the willingness of WTO members to address the needs of SMEs in the GATS negotiations.

CARIFORUM destinations have little control over the product distribution channels

A major issue for the industry is that the distribution channels for the CARIFORUM tourism product are controlled by a limited number of international companies. The number of intermediaries who control these channels has been steadily decreasing due to mergers and market consolidation in the main markets for CARIFORUM tourism: Europe, the US and Canada. This is true for tour operators in Europe[14] (e.g. Airtours, Tui, Kuoni), cruise operations (e.g. Carnival, Norwegian, Royal Caribbean Cruises), Computer Reservation Systems (Amadeus, Sabre, Galileo, Worldspan[15]) and even online booking engines and internet portals (Hotels.com, Expedia, Travelocity). This limits the region's control over the future development of the sector, and has created significant imbalances in negotiating power between CARIFORUM companies and the intermediaries on whom they depend for access to the market.

As a consequence, most CARIFORUM tourism service providers have only indirect market access through wholesalers or intermediaries to the principal tourist-generating markets. This is a major constraint to the increase of tourism exports via Mode 1, 'cross-border supply'. Although the internet has provided an alternative and cheaper distribution channel for the supply of tourism services, where better prices can be obtained by cutting out commissions to intermediaries and wholesalers, the number of online bookings by foreign tourists is still small compared to tourism products packaged by international tour operators.

Increasing the direct market access of CARIFORUM service providers to tourist-generating markets is a common objective throughout the regional tourism sector. Both CTO and CHA have been working to address this issue in the hotel and accommodation sector particularly, through the CHA's 'Go Caribbean' online booking engine, and through the Caribbean Hotel Association Reservation Management System (CHARMS), which aims to provides small properties with affordable access to Global Distribution Systems (GDS).

Tourism is the most liberalised sector in CARIFORUM economies

Tourism is already the most liberalised economic activity within CARIFORUM states. Governments have introduced a wide range of incentives and concessions to attract foreign investors (e.g. duty-free exemptions for certain tourism inputs, tax holidays, etc.). These government incentives go far beyond the commitments required under the GATS agreement. They also mean that, in some cases, larger international investors receive more preferential treatment from government, in the form of incentives, than smaller locally owned companies: an inversion of the normal situation regarding 'national treatment'.

It is a paradox that despite the liberal nature of the sector, government remains at the heart of all decision-making regarding new entrants into the

CARIFORUM tourism sector. The sector is heavily regulated in CARIFORUM states. Governments control the entry of new foreign companies into CARIFORUM markets through the issuance of licences or permits (e.g. in Trinidad and Tobago, any investment over one acre requires a licence), or other forms of regulatory control such as economic needs tests. Within a WTO context, many of these restrictions have *not* been inscribed in the GATS schedules of CARIFORUM WTO members.

A review of the GATS commitments of CARIFORUM WTO members also shows that CARIFORUM states did not adopt a common regional approach to scheduling in the Uruguay Round services negotiations. CARIFORUM WTO members have also made differing levels of GATS commitments on tourism services, meaning most CARIFORUM countries have different starting points in the current services negotiations under the GATS.

The global context for Caribbean tourism and the regional response

Recent global developments have emphasised the fragility of the Caribbean tourism sector to external economic shocks. The World Travel and Tourism Council (WTTC) suggested that September 11th alone caused a loss of 365,000 jobs in the Caribbean. Levels of global insecurity increased again during the build-up to the war in Iraq and the terrorist attacks in Kenya and Bali, two leading developing-country tourism destinations. These events have further undermined global confidence in air travel, with disastrous consequences for international airlines and the tourism industries that they service, including the Caribbean. In parallel, weak economic growth, recession and stagnating equity markets in the United States, Europe and Canada have continued to dampen the demand for Caribbean tourism in the main tourist-generating markets.

The response of the Caribbean tourism industry to the sequence of external shocks that began with 9/11 has been to cut costs, discount rates – and margins – and accelerate the introduction of promotional campaigns such as '*Great Places of the Caribbean*' and '*Life needs the Caribbean*'. Efforts have also been made to market the region as a safe tourism destination in the hope that this will offset the downturn.

At a public policy level, the major regional response was the agreement on a new regional Caribbean Tourism Strategic Plan. The plan was mandated by CARICOM Heads of Government at the December 2001 Regional Summit on Tourism in the Bahamas. At that Summit, heads of government and the regional private sector recognised the need for a ten-year (2002–12) Caribbean Tourism Strategic Plan to re-position the Caribbean hospitality industry through a combination of priority short-term recovery actions and long-term development measures with appropriate funding. A key element of the Plan was an agreement to market the Caribbean as a single destination. The objectives of the Plan are listed in an Annex to this report.

Surprisingly, the Caribbean Tourism Strategic Plan made no mention of international trade negotiations on services, including tourism services. As this report will show, this may have been an oversight given that many of the negotiating recommendations proposed on tourism services could help to attain the ten agreed objectives.

Tourism and the GATS services negotiations at the WTO

The WTO negotiations on services under the GATS Agreement began in February 2000. The 'request offer' process began with the deadline of 30 June, 2002 for the submission of negotiating requests by WTO members. The deadline for making initial offers in response to these requests was 31 March, 2003. However, these deadlines have been missed by a majority of the WTO membership. By early April 2003, only 30 developing countries had presented their services requests. None had presented offers.

During the initial phase of the GATS services negotiations (January 2000 – June 2002), several WTO members presented general negotiating proposals on tourism services. Almost all recognised the inadequacy of the current definition of tourism under the GATS. The GATS uses the Services Sectoral Classification list (MTN.GNS/W/120). Category 9 of this defines 'Tourism and Travel-Related

Services' as: 'A. Hotels and restaurants (including catering), CPC 641-643'; 'B. Travel agencies and tour operators services, CPC 7471'; 'C. Tourist guides services, CPC 7472'; and 'D: Other'.

This section of this chapter is divided into four parts: a summary of the negotiating proposals of WTO members in the GATS negotiations; an overview of the responses of WTO members to the Dominican Republic's GATS tourism Annex proposal; an assessment of some of the issues raised by the Annex proposal; and the negotiating options for CARIFORUM on tourism in the GATS negotiations.

A summary of the GATS proposals on tourism services

The following is a summary of these proposals, beginning with the Dominican Republic-led proposal for a new GATS Annex on Tourism, and the EC's response to this.

(a) The Dominican Republic proposes a new GATS Annex

Towards the end of the preparatory process for the Seattle WTO Ministerial Conference, the Dominican Republic, El Salvador and Honduras tabled a proposal on 'the need for an Annex on tourism' on 14 October, 1999 (WT/GC/W/372, S/C/W/127). The proposal noted that the World Tourism Organisation (WTO–OMT) had called for a GATS Annex on Tourism 'that could better handle the specificities of the sector during and after the next round of services negotiations'. The co-sponsors submitted a draft text for a new GATS Annex on tourism. In addition, the following rationale was provided:

- the current GATS definition made it impossible to deal with tourism as a cluster in line with the wider definitions of tourism adopted by the United Nations and WTO–OMT;
- it was not possible to monitor liberalisation nor compliance with commitments to meet GATS Article IV on 'Increasing Participation of Developing Countries'; and
- a GATS request–offer approach would fail to eliminate the barriers to the trade in tourism services especially in related services areas such as transportation services and travel distribution services; and
- new GATS provisions were needed to deal with the trade implications of anti-competitive conduct in the tourism sector.

The delegations also attached a list of services comprising the 'tourism cluster'. This categorised over two hundred different services as either 'tourism characteristic services', 'tourism-connected services' or 'tourism non-specific services'. The co-sponsors also attributed each of these services to the relevant sectoral headings of the existing GATS Services Sectoral Classifications headings (e.g. for 'Business Services' and 'Communications Services').

(b) The EC preferred a 'Checklist' rather than a GATS Tourism Annex

The European Community (EC) (S/CSS/W/5 of 28 September, 2000) was the only WTO member to formally submit a reaction to the proposed Annex. Although the EC stated its support for 'the main intentions' of the proposal, it did not explicitly endorse the establishment of a new Tourism Annex to the GATS. The EC agreed with the treatment of tourism as a cluster 'so long as the cluster approach is seen as a "checklist" to be used in the negotiations to assist negotiators in identifying optimum proposals for effective and complementary liberalisation related to the sector'.

The EC therefore attached a shorter 'tentative checklist' to its submission entitled 'Core Tourism and Tentative Tourism Checklist'. This listed thirty-two services sectors, in addition to the four 'core tourism sectors and sub-sectors' that are the existing GATS classification for tourism (W/120, Chapter 9). It suggested that WTO members should use this as an aide memoire to guide them in the GATS negotiations. The EC viewed the listing of sectors put forward by the sponsors of the Annex proposal as 'too broad'. It also noted that air transport services were currently excluded from the GATS negotiations, and that some of the issues raised by the sponsors could be better addressed in the WTO's Working Party on Domestic Regulation (WPDR).

The EC did suggest, though, that two issues raised by the sponsors should be further considered: tourism and sustainable development, and competitive safeguards. On competitive safeguards, the EC suggested assessing the 'basic telecommunications additional commitments' and their relevance to the 'core tourism sector'. On sustainable tourism development, the EC stressed the importance of access to high-quality environmental services – a key offensive negotiating interest for the EC (and US) in the GATS negotiations.

(c) The Dominican Republic defended its proposal ...

The Dominican Republic, El Salvador and Honduras responded to the comments received (S/CSS/W/9 of 27 October, 2000), and expanded on several areas of their proposal. On competitive safeguards, they defended their proposal by referring to the 'bewildering series of mergers and takeovers of tour operators and airlines' that had placed tourism destinations 'at the mercy of abuse of a dominant position'. They were proposing a 'sectoral solution closely based on the precedent set by basic telecommunications'. On sustainable development, the sponsors reaffirmed their proposal that WTO members take binding commitments to apply internationally agreed standards on sustainable tourism development.

The sponsors also noted that 'a large number of delegations have expressed concern at the extensive sectoral coverage' that was proposed. In response, the Dominican Republic, joined by El Salvador, Honduras, Panama and Nicaragua (S/CSS/W/19), submitted a further communication two months later entitled 'The Cluster of Tourism Industries'. This listed only 'tourism characteristic products' as agreed by the United Nations, and as defined in the Tourism Satellite Account (TSA).[16] They proposed that WTO members use this definition 'to avoid lengthy discussions on classification'.

(d) ... and proposes a revised Tourism Annex with new co-sponsors

Almost two years after the original proposal had been tabled, the Dominican Republic, El Salvador and Honduras were joined by new co-sponsors Bolivia, Ecuador, Panama, Peru and Venezuela in tabling a revised proposal for a 'Draft Annex on Tourism' (S/CSS/W/107 of 26 September, 2001). The Annex to the proposal was entitled 'The Tourism Industries'. Again the list of ninety-four 'tourism characteristic products' was set out, this time with their United Nations Central Product Classification Codes (CPC).

New emphasis was placed on safeguards to prevent anti-competitive practices such as the discriminatory use of information networks, abuse of dominance through exclusivity clauses, or misleading or discriminatory use of information.

(e) The US tabled a narrow proposal on tourism and hotels

The US tabled a negotiating proposal on 'Tourism and Hotels' (S/CSS/W/31) on 18 December, 2000. The focus of the US proposal was to 'focus on ways to help generate investment for tourism by removing obstacles to the establishment and operation of hotels and other lodging places; and by reducing the problems faced by organisers of international conferences and conventions'. The US invited WTO members to inscribe in their schedules 'no limitations' on market access and national treatment under 'A. Hotels and Restaurants'. The proposal also suggests that all WTO members should 'consider undertaking additional commitments relating to travellers and international conferences'. The US also proposed that 'a reference paper' be drafted to 'address problems faced by travellers and organisers of international conferences and conventions to make it easier for travellers to visit and make purchases in other countries; and to reduce the problems faced by organisers of international conferences and conventions'.

The main body of the US proposal is a list of thirty obstacles to the trade in tourism and hotel services. The first obstacle listed is 'overly burdensome exit fees or fees, or similar restrictions on the departure of outbound travellers'. Others listed include: 'unavailability of information for travellers on applicable duty-free allowances for returning residents'; 'limitations on the purchase or rental of real estate for this sector'; 'lack of national treatment for financing arrangements for construction and operation of hotels and lodging places'; 'denial of access

to government programmes available to domestic service providers'; 'denial of full consumer access to electronic means for making hotel reservations'; and 'lack of means to facilitate temporary entry and exit of event organisers and specialised skilled personnel needed to conduct international conferences and conventions efficiently'.

(f) The EC focuses on eliminating restrictions to FDI in the tourism sector

The European Communities (EC) tabled a proposal on 'GATS 2000: Tourism Services' (S/CSS/W/40) on 22 December, 2000. The EC placed particular emphasis on eliminating restrictions to foreign direct investment. The EC noted that the 'few classifications problems arising from the current GATS classification are not obstacles to dealing with the tourism sector in a comprehensive way'. However, the proposal also recognised that 'the classification does not reflect the broad dimension of this sector'. To address this, the EC proposed 'a cluster regrouping all tourism-related services which could be used as a checklist'.

The EC also identified 'exceptions' that may be accepted. These relate to the 'protection of areas of particular historic and artistic interest', as well as retaining controls for consumer protection. Finally, the EC identified horizontal restrictions affecting the tourism sector: unspecified approval requirements, unspecified economic needs tests, limitations on the purchase or rental of real estate, restrictions on equity holdings and residency requirements.

(g) Japan indicates interest in tourism but offers little detail

Japan also included a proposal on 'tourism services' within a general communication on 'The Negotiations on Trade in Services' (S/CSS/W/42 of 22 December, 2000). This proposal was short and lacked detail. It mentions the importance of liberalisation of hotels and restaurant services, but otherwise focused on commitments in tourist guide services.

(h) Colombia supports revision of Tourism Classification in the GATS

Colombia submitted a negotiating proposal (S/CSS/W/122) on 27 November, 2001. Colombia proposed that all WTO members should take full commitments under the consumption abroad and commercial presence modes of supply – Modes 2 and 3 – as a means to promote 'two-way' tourism. A further proposal was that market access conditions for service-providing persons in the tourism sector should be improved in order to facilitate the temporary entry of natural persons supplying services in this sector.

Colombia also proposed that the 'competent authorities should take account of professional qualifications related to tourism services acquired in the territory of another Member, on the basis of equivalency of education and using qualification recognition methods'. The Colombian proposal noted that 'anti-competitive behaviour by dominant operators can result in imbalances in the framework of liberalised trade in services', but suggested that this should be dealt with 'in a general manner' if competition is added to the Doha Agenda. Lastly, Colombia supported the revision of the 'existing classification of trade in tourism and travel-related services' to include 'all services characteristic of this sector'.

(i) Canada also supports the development of a 'Tourism Checklist'

Canada submitted an 'Initial negotiating proposal on Tourism and Travel-Related Services' (S/CSS/W/54/Rev.1) on 4 May, 2001. Canada described tourism as 'an amalgam of parts of a number of separate industries', including recreation and entertainment services. It noted that the tourism sector attracted more commitments by WTO members than any other services sector at the end of the Uruguay Round, but that significant restrictions still remain, such as 'economic needs tests, size limitations for establishments, restrictive licensing practices and fixed equity limits'.

Canada proposed that WTO members focus negotiations on the W/120 (existing) classification of Tourism and Travel-related services 'with the objective of liberalising remaining restrictions to the extent possible'. It also proposed that, in order 'to accommodate the cross-cutting, multi-industry nature of Tourism services', WTO members should 'create and utilise their own tailored checklists to assist in the negotiation of tourism-related sectors that are of particular interest to them'.

(j) Switzerland suggests creative use of sub-sector 'D. Other'

Switzerland also presented a proposal (S/CSS/W/79) entitled 'GATS 2000: Tourism Services' on 4 May, 2001. The introduction recognised that 'since tourism is extremely labour intensive, the developing countries have a strong potential comparative advantage'. Switzerland also commented that 'it is difficult to define with any precision what the tourism services sector actually covers', and that 'the Tourism Satellite Account has shown that many services which initially appear not to be specific to tourism can, in fact, be included in the tourism sector, at least partially.' Switzerland proposed that restrictions under Modes 1–3 should be removed but Mode 4 restrictions only 'evaluated'.

The Swiss proposal invited WTO members to reflect on the commitments they wish to make under 'D. Other'. The proposal notes that some WTO members have made commitments under 'D. Other' in areas such as 'tourism management services', 'tourism transport services', and 'tourism convention services'. Switzerland suggest that the range of commitments under 'D. Other' could be widened to include services mentioned in the 'cluster' proposal of the Dominican Republic, El Salvador and Honduras. Switzerland also suggests that 'it is not the right moment to draw up multilateral disciplines concerning competition-related issues' but that 'it is important to ensure that the principles of sustainable development of tourism are respected'.

(k) MERCOSUR proposes full liberalisation of tourism sector

The MERCOSUR negotiating proposal on 'Tourism Services' (S/CSS/W/125) of 29 November 2001 is among the most aggressive tabled in the GATS negotiations. Mercosur proposes that, without prejudice to 'the continuing analysis in the WTO of tourism characteristic products, all WTO members make specific commitments on market access and national treatment 'without limitations' in the subsectors included in W/120.

The purpose of MERCOSUR's proposal was to 'promote the liberalisation of this important sector in order to increase developing countries' revenues from tourism services and to contribute to increasing the participation of developing countries in trade in services'. Mercosur noted that the World Tourism Organisation is not satisfied with the current classification of tourism services, and would like it revised in the GATS negotiations. Mercosur listed examples of the type of trade restrictions that still exist in the tourism sector, such as the requirement of establishment or commercial presence (in particular for tour operators), licensing, economic needs tests, and barriers to the presence of natural persons under Mode 4.

(l) Costa Rica supports list of 'tourism characteristic products'

Costa Rica tabled a negotiating proposal on 'Tourism Services' (S/CSS/W/128) on 30 November, 2001. This included a request that the Services Council evaluate the effect of September 11th as part of its mandated review of trade in services. Costa Rica also asked the WTO Secretariat to update its background paper on 'Tourism Services' (S/C/W/51 of 23 September, 1998). The proposal also highlighted the obstacles that 'limit the sector's potential and diminish the benefits of tourism service providers, and developing countries in particular'. These included: restrictions on foreign direct investment, immigration control, documentation requirements, restrictions on currency movements and lack of transparency.

Costa Rica supported the development of a 'list of services characteristic of or related to tourism, in order to evaluate progress and achievements in the negotiations from a global perspective'. It referred to the proposals of the EC (S/CSS/W/5) and the Dominican Republic (S/CSS/W/107) as 'extremely useful starting points' for these discussions. Costa Rica also proposed that WTO members undertake broader and more in-depth commitments across all modes of supply, in particular Modes 2 and 3, and that the negotiations must include additional commitments 'regarding disciplines on the prevention of anti-competitive practices, consumer protection, and access to and use of information'.

(m) Cuba supports main thrust of Dominican Republic's proposal

Cuba tabled a negotiating proposal (TN/S/W/1) on

'Tourism and Travel-Related Services' on 14 May, 2002. Cuba aligned itself with the main elements of the Dominican Republic's proposal, such as improving access to distribution channels and the prevention of anti-competitive practices, specifically the 'elimination of discriminatory oligopolistic practices by groups of major tour operators'. Cuba also emphasised that the liberalisation of tourism services 'should not give rise to contradictions with national policies with regard to environmental preservation'.

Furthermore, the Cuban proposal underlined that 'the natural dovetailing of local culture with the provision of international tourism services should be respected'. Under 'expected outcome of the negotiations', Cuba proposes that developed countries make commitments that allow for the effective implementation of Article IV; that developing countries should make commitments in line with Article XIX.2;[17] and that the negotiations on market access and national treatment should take place on the basis of the outcome of the assessment of trade in services 'which demonstrates [to] developing countries that they will directly benefit from any commitments to be made'.

The responses to the GATS proposal for a new Tourism Annex

The proposal for a new GATS Tourism Annex was discussed at length in Geneva from early 2000 until the end of 2001. Although widely welcomed by WTO members, it failed to gain the support of a majority – or even a substantial minority – of WTO members. Much of the impetus for the Annex Proposal was lost when its main proponent, the Dominican Republic's Ambassador to the WTO, returned to capital in early 2002.

Within the 'Quad' of WTO members, only the EC offered qualified support for enhanced treatment for tourism under the GATS. Both the US and Japan opposed the Annex proposal. In their formal negotiating proposals, both the EC and Canada proposed tourism 'checklists' of tourism-related services to guide individual WTO members in services liberalisation negotiations at the WTO. Importantly, these 'checklists' would be used for reference purposes and would not imply any amendments or additions to the text of the GATS.

In addition to the nine co-sponsors, only Morocco, Kenya and Sri Lanka expressed outright support for the proposal. One of the main concerns of other WTO members was the 'cluster approach' to services liberalisation that was originally proposed by the co-sponsors of the Annex proposal. A common developing country view was that the 'clustering' of various tourism-related service sectors could lead to pressure for accelerated liberalisation. Several developing-country WTO members feared that the 'cluster approach' would signal a move to a 'negative list' approach to liberalisation, thereby reducing the ability of developing countries to undertake no or minimal liberalisation in specified service sectors, as is permitted under the 'positive list approach'.[18]

In late 2001, one CARICOM WTO member also voiced concern that the proposed 'cluster approach' was too comprehensive, and could hamper the ability of CARICOM WTO members to negotiate on a sector-by-sector basis. In general terms, developed country WTO members showed more enthusiasm for negotiating in services 'clusters', as for them this would be a means to achieve more rapid liberalisation in areas of strategic interest to them. In this respect the EC, US and Australia all highlighted energy and environmental services.

In response to developing country concerns regarding the proposed 'cluster approach', the Dominican Republic removed all references to the 'tourism cluster' in its revised proposal of September 2001. Instead they proposed the same list of services but under a different title, 'tourism characteristic products'.

Throughout the discussions on the Annex proposal, the Dominican Republic maintained that the Annex 'was the only way to ensure equitable trading conditions for the trade in tourism services, consistent with Article IV and XIX and with the needs of sustainable development.[19] The Dominican Republic stressed that while the volume of tourists entering developing countries was increasing, the revenues per tourist retained by the receiving countries were decreasing, largely as a result of anti-competitive practices.

The most controversial element of the proposed Annex were the provisions to prevent anti-competitive practices in the tourism sector, particularly regarding air transport services. Air transport services – including the so-called 'hard rights' or passenger rights – are currently outside the scope of the GATS Annex on Air Transport. Almost every developed-country WTO member objected to the inclusion of references to anti-competitive practices in the air transport sector. Within a wider context, the provisions on anti-competitive practices[20] also became caught up in the politics of whether competition policy would be added to the WTO negotiating agenda.

Within the tourism industry, the World Tourism Organisation (WTO–OMT)[21] has strongly supported the proposed Annex on Tourism. Both the WTO–OMT and UNCTAD were instrumental in the drafting of the draft Annex. The proposal has received qualified support from the World Travel and Tourism Council (WTTC), and provoked a strong negative response from the International Air Transport Association (IATA), who maintained that the proposed Tourism Annex 'would eviscerate the GATS Annex on Air Transport'.[22]

An assessment of the issues in the Tourism Annex Proposal

There are three particular issues raised in the Annex proposal that warrant greater analysis before CARICOM can make a determination whether to support the proposal. These relate to: competitive safeguards; sustainable tourism development; and the classification of tourism services under the GATS.

(a) Are GATS-competitive safeguards required for tourism?

The Dominican Republic highlighted the following anti-competitive practices, in addition to those related to air transport services, which it believed require WTO members to introduce competitive safeguards against:

- discriminatory use of information networks (including through unreasonable access charges), ancillary services to air transport, predatory pricing, or the allocation of scarce resources;
- abuse of dominance through exclusivity clauses, refusal to deal, tied sales, quantity restrictions, or vertical integration; and
- misleading or discriminatory use of information by any juridical person.

The first important consideration is that CARICOM has yet to develop a regional competition policy. Article 30 of Protocol VII (Protocol Amending the Treaty establishing the Caribbean Community) on 'Competition policy, Consumer Protection, Dumping and Subsidies' envisages the establishment of a regional Competition Commission. However, it is unclear when this will be operational. Until this is in place, CARICOM states will not have the legislative means to implement, on a regional basis, any new multilateral WTO provisions on anti-competitive practices in the tourism sector.

The second important consideration is the extent to which CARIFORUM tourism services providers are victims of anti-competitive practices. In this respect, there is certainly anecdotal evidence within CARIFORUM that some major service suppliers (e.g. cruise ships, tour operators) do engage in activities related to 'tied sales', 'predatory pricing' and 'refusal to deal'. For example, industry observers have indicated that some cruise ships operating within CARIFORUM direct their passengers only to those retail outlets where they will receive a negotiated percentage of the sales. There are also concerns that some CARIFORUM hotels linked to international tour operators are discounting rates below market value in order to guarantee volume bookings. This represents unfair competition for CARIFORUM's small, independent hotels.

What is certainly true is that the potential for anti-competitive practices in the tourism sector is increasing as a result of acquisitions and mergers in a fiercely competitive international marketplace. Industry experts predict that this trend will continue as weak equity markets combined with a global tourism downturn reduce the share prices of tourism and travel companies below asset values. Further market consolidation will concentrate the ownership of the distribution channels for the CARIFORUM tourism product in the hands of an ever-decreasing number of developed-country com-

Box 2. The consolidation of the European tour operator market: Has this produced anti-competitive effects for CARIFORUM tourism services suppliers or European consumers?

The European Commission, whose competition policy is highly focused on protecting consumer interests within Europe, demonstrated its concern about the impact of the consolidation of the European tour operator market on the European consumer when it blocked the takeover of First Choice by Airtours in September 1999. The EC Mergers Commission ruled that the 'takeover would create a market structure [within the short-haul package holidays subsector] in which the remaining three vertically integrated companies would collectively have a dominant position.' ('Commission prohibits Airtours takeover of First Choice in UK leisure travel sector', EC Spokesman Service, *Midday Express*, 22 September, 1999). However, the EU Court of First Instance overruled this decision in June 2002. The Court found that the Commission had failed to prove that a 'collective dominance' would be created. Competition policy experts suggest that this has cleared the way for a further acceleration of market consolidation within Europe. Recent UK newspaper reports have indicated that the consolidation of the European tour operator market may continue as Thomas Cook and Kuoni have entered merger talks to create the world's largest holiday company ('Thomas Cook and Kuoni plan merger', *Sunday Telegraph* 15 June, 2003).

The impact of the consolidation of EU tour operators on developing country tourism suppliers, rather then EU consumers, has never been explored, and could be raised in either the WTO or CARIFORUM–EU negotiations. One approach, informally suggested by a leading WTO trade lawyer consulted for this assignment, is that CARIFORUM destinations could argue that the consolidation of the European tour operator market has restricted European consumer choice by limiting the number of hotels that are presented in tour operator brochures.

panies in Europe, the US and Canada. This reinforces the need for competitive safeguards at the multilateral WTO level to counter the potential anti-competitive effects of this trend.

According to Souty (2002),[23] the development of multiple-retailer systems and chains in the 1990s brought a new category of business conduct to the attention of competition policy authorities and analysts: situations of abuse of buying power or abuse of a situation of dependency of a seller from its buyer. In a tourism context, a similar situation would arise when a small hotel is confronted with the market power of major operators and has to accept the pricing policies of the tour operators or be 'black-listed'. This scenario will be familiar to many CARIFORUM hoteliers. Souty notes that a 1999 OECD Roundtable, attended by all the major competition agencies of the world, 'remained ambiguous to a large extent because there is no unanimity among these agencies about how to deal with these alleged abuses'. He later emphasised that 'the presence of monopolies and dominant firm positions in markets is not illegal *per se* almost anywhere'.

Despite this, it is in CARIFORUM's interest to have the existence of anti-competitive practices in the tourism sector recognised multilaterally at the WTO. The WTO 'Reference Paper on Telecommunications' provides a precedent for the introduction of competitive safeguards on a sectoral basis. It may be that just the recognition of the existence of such practices may act as a strong incentive to companies to behave in a pro-competitive manner. The absence of a multilateral mechanism to counter the negative cross-border competition effects on supplier destinations of mergers and market consolidation, cartels, and collective dominance is clearly a major bottleneck in the world trading system. In this respect, the Dominican Republic is correct in its assertion that under the existing provisions of the GATS, 'it is not possible to deal with the trade implications of anti-competitive conduct' in the tourism sector.

(b) Sustainable tourism development in the GATS

Competition is not the only area where the proposed Tourism Annex goes beyond the current coverage of the GATS. The other is sustainable development. Article 2.56 of the revised proposal is entitled 'Co-operation for sustainable development of tourism'. The provisions urge WTO members to encourage and support co-operation efforts for the sustainable development of tourism, and to encourage all persons in the tourism industries to comply with environmental and quality standards established by relevant international organisations.

Both environmental and cultural resources are key factors of production for CARIFORUM tourism exports. They represent a vital asset in terms of the attractiveness and competitiveness of the region's tourist destinations. At present, the GATS deals only vaguely with environmental concerns under 'general exceptions' and 'exhaustible natural resources' under Articles XIV and XX. New provisions to promote the sustainable development of tourism within the GATS are clearly in CARIFORUM's interest. The rationale for including sustainable development considerations in the GATS is the imperative of safeguarding the environmental and social assets on which tourism thrives. The importance of this issue was recognised at the regional level when the 2002 Caribbean Tourism Strategic Plan listed as an objective the need to 'minimise the adverse impacts [of tourism] on the socio-cultural and natural environment and other touristic assets'.

The major asset of the CARIFORUM tourism product is perhaps the Caribbean Sea itself. In this respect, some tourism activities have recently caused concern within the regional industry, such as the environmental practices of cruise ships and anchor damage to coral reefs. During the past few years, several cruise ships have been found to be polluting the oceans in which they sail. In one of the most recent cases in 2002, engineers aboard Carnival ships were found to have repeatedly discharged into the Caribbean and other waters waste fluids from machinery, engines and shipboard operations that had illegally high concentrations of oil.

The environmental risk from certain tourism-related practices reinforces the need for provisions to promote sustainable tourism development in all international trade agreements. Unlike the competition issues previously discussed, CARIFORUM states are already party to a regional policy platform on sustainable tourism development. The Convention on Sustainable Tourism Zone of the Caribbean[24] (STZC) was signed at the 3rd Ministerial Conference of the Association of Caribbean States (ACS) in December 2001, in Margarita, Venezuela. The ACS grouping could also form a ready-made coalition of twenty-six WTO members in support of the inclusion of provisions relating to sustainable tourism development within the GATS. The elements of the Dominican Republic's Annex proposal relating to sustainable tourism development were not opposed by WTO members.

(c) Should the GATS classification of tourism be amended?

The Dominican Republic-led initiative to have the

Box 3. An example of how GATS may undermine sustainable tourism development

Of all the countries that have made market access commitments on tourism, only Eygpt has noted that some tourism sites may not have an infinite capacity for commercial activity. Eygpt states that tours down the Nile river are subject to the river's carrying capacity. However, the EU has requested that Eygpt 'remove licensing requirements and limitations on the total number of service operations' for 'Hotels and Restaurants' in the GATS negotiations. As Font and Bendell (2002) have noted 'it is very questionable whether such a request is in line with the commitments of all states mentioned, including those of the EU, at international fora such as the Commission on Sustainable Development (CSD).'

Source: Standards for Sustainable Tourism for the purpose of Multilateral Trade Negotiations, Xavier Font, Jem Bendell, 2002.

WTO membership recognise the 'specific and heterogeneous nature' of tourism demonstrated how difficult it is to define tourism adequately. As one might expect, WTO members quickly became bogged down in detailed definitional discussions. The problem is that an almost infinite list of services can, at least partially, be attributed to tourism. The proponents of the Annex argued that the definition of 'tourism characteristic products', as defined by the Tourism Satellite Account (TSA), had been agreed multilaterally by the United Nations Statistical Commission. Despite these efforts, WTO members did not reach agreement on whether the GATS definition of tourism should be expanded.

CARIFORUM WTO members would be in a stronger position to push for changes to the definition of tourism at the multilateral level if they had agreed an expanded definition for tourism within their own region. This would be a better place to start. While the rationale for a precise tourism definition at the regional level is clear – namely to ensure coherent public policy planning that recognises the diversity of the sector, it is less clear for the purposes of multilateral trade negotiations that have as their aim the full liberalisation of the international trade in services. The danger is that CARIFORUM WTO members, by seeking an expanded definition of tourism at the WTO that cuts across many economic sectors, will come under increased pressure to liberalise all tourism-related services sectors.

One negotiating option worth considering would be for CARIFORUM states to propose a 'Reference Paper' on Tourism Services, similar in purpose to the Telecommunications Reference Paper that was agreed in April 1996. Attached to this would be a list of 'tourism-characteristic products' to ensure that the crosscutting nature of tourism is adequately recognised at the WTO level, without having to reclassify some of these services as 'Tourism and Travel Related Services'. Within the Reference Paper, CARIFORUM could also refer to GATS Article XIX: 2 – which enables developing countries to open fewer sectors – to ensure that this action does not lead to pressure for increased liberalisation across all tourism characteristic products. Indeed, many of the services listed as 'tourism characteristic products' are among the services that CARIFORUM states currently preserve for local or – once the CSME is implemented – regional services suppliers.

Achieving multilateral recognition that tourism consists of more than the four sub-sectors within the current classification would be in CARIFORUM's interest, given the region's increasing dependence on the sector. It would also help to inform tourism policy planning at the regional and national levels within CARIFORUM states. The Reference Paper approach would appear to be the most realistic means to achieve this.

(d) Should cruise-ship services be re-classified as a tourism service?

Within the CARIFORUM private sector there have been recent calls to change the classification of cruise-ship services under the GATS from 'maritime transport services' to 'tourism and travel-related services'. This report recommends that cruise-ship services should be re-classified under the GATS as a 'tourism and travel related service', given the increasing importance of cruise ships to Caribbean tourism economies and the impact of their activities on land-based tourism sub-sectors (e.g. hotels, tours, attractions, entertainment, etc.).

Cruise ships compete directly with the land-based hotel and accommodation sub-sector. They also control access to the tourist for many tourism services and goods suppliers in CARIFORUM states (e.g. tour guides, entertainers, arts and crafts salesmen, retail outlets, etc.) either by selling these goods and services onboard or directing passengers to preferred retail outlets or service providers onshore. While there are diverging views on the benefits of cruise tourism to CARIFORUM destinations, it is evident that cruise tourism is a key element of the Caribbean tourism economy. The re-classification of cruise ships as a tourism and travel-related service is therefore recommended.

The cruise ship sub-sector is the only economic sector where the Caribbean is the leading global market. The Cruise Lines International Association (CLIA) noted in 2002 that 'the Caribbean represents the number one destination with almost 47% of capacity placement', followed by Europe, the

Mediterranean, Alaska, Mexico, Hawaii and South America. CTO statistics[25] for 2002 show the leading destinations for cruise arrivals in 2002 were the Bahamas (2.8 million arrivals, up 9.8% from 2001), the Cayman Islands (1.57 million, up 29.6% from 2001) and Jamaica (0.86 million, up 3% from 2001).

It should be noted, however, that in regulatory terms, the re-classification of cruise ships under the GATS will have little practical effect on the ability of CARIFORUM WTO members to regulate cruise ship activities in the region. WTO officials have indicated that CARIFORUM WTO members are already free to include market access or national treatment limitations on cruise ships in their GATS commitments on maritime transport services, should they wish to do so. The benefits of this re-classification appear more definitional rather than enhancing the capacity of CARIFORUM states to regulate cruise ship activities. This re-classification will be easier to achieve at the WTO if cruise ships are included within a regional definition of tourism. Later in this report, the development of a regional policy on cruise tourism is also recommended.

In addition to seeking the re-classification of cruise-ship services under the GATS, CARIFORUM could seek to clarify in the current negotiations where the regulatory authority for cruise ships lies. This is a complex issue as many cruise ships choose to register or 'flag' their ships outside their country of origin. The CARIFORUM land-based tourism industry has indicated that this allows them to reduce tax liabilities, use non-domiciled and often non-unionised crews, and compounds problems with environmental monitoring and control.

A recent US court case involving a cruise ship demonstrates the anomalous situation of cruise ships within the world trading system. In March 1998, during a criminal trial in Miami concerning the falsification of records and the intentional bypassing of pollution control equipment, Royal Caribbean Cruises Ltd argued that the US lacked jurisdiction in the case because the *Sovereign of the Seas* was flagged in Liberia. Royal Caribbean attorneys produced a diplomatic note from the Liberian Embassy in the US asserting that Liberia had primary jurisdiction.[26] The US court rejected Liberia's claim on that occasion.

Negotiating options on tourism services for CARIFORUM WTO members in the GATS negotiations

CARICOM WTO members have yet to submit any formal proposals on tourism services within the GATS negotiations.

The three negotiating options for CARIFORUM on tourism services

As CARICOM, and indeed CARIFORUM, is one of the most tourism-dependent regions of the world, there is a clear rationale for the region to play a leadership role in framing the global rules for international trade in tourism services. The following three negotiating options are proposed:

(a) Support the Dominican Republic-led proposal for a new GATS Tourism Annex

Given the failure of a majority of WTO members to endorse the Annex proposal during almost two years of discussions within the WTO's Council for Trade in Services, reviving this proposal would be a difficult negotiating objective. Furthermore, WTO members are unlikely to respond differently to the same proposal even if it had the additional support of CARICOM WTO members. Despite this, the Annex does highlight several issues that are in the interests of the CARICOM tourism industries, namely competitive safeguards, sustainable tourism development, and the definition of tourism under the GATS.

(b) Present an amended version of the 'Model Request on Tourism and Travel Related Services'

In late 2002, the Dominican Republic – with the assistance of UNCTAD – drafted a 'Model Request on Tourism and Travel Related Services'. This aimed to provide 'a mechanism for effective implementation of Articles IV and XIX: 2 of the GATS'. The Model Request aims to secure specific GATS commitments from other WTO members – under the 'additional commitments' column of their schedules – in areas that are in CARICOM's interest. These are A. Strengthening the competitiveness of developing countries, B. Liberalisation of market access

to developing country suppliers, and C. Cooperation for the Sustainable Development of Tourism.

The Model Request also offers CARICOM WTO members a template that they could tailor to suit the specificity of the export interests of the regional tourism sector. For example, the Dominican Republic has listed 'fishing licence services' and 'hunting services' and 'spa services' under 'D. Other'. CARICOM states could list any services sectors of particular interest to them, such as entertainment services or water-sports services. CARIFORUM could also list specific measures to strengthen SMEs in order to further their participation in tourism-originating markets. However, CARIFORUM should exercise caution when requesting full commitments without limitations in Mode 4, as proposed by the Model Request from the EC, US, and Canada. A more realistic approach may be to request that specific types of tourism professional be included within the horizontal commitments of these three WTO members.

A further benefit of following the template established by the 'Model Request' would be that it would achieve many of the same objectives of the Annex without the expenditure of negotiating capital required to revive the Annex proposal.

(c) A 'Reference Paper' on Tourism and Travel-Related Services that would establish regulatory principles for trade in tourism services

In 2000, the US proposed that a 'reference paper' be proposed to address the problems by travellers to, and organisers of, international conferences. The purpose of the 1996 Reference Paper on Telecommunications was to provide WTO members with a series of regulatory principles for a specific services sector. This amplified and clarified some of the provisions of the GATS as they applied to this sector. Over 60 WTO members have now attached it to their GATS schedules of commitments, making adherence to its regulatory principles legally binding.

A Reference Paper on tourism can seek to ensure that WTO members recognise the crosscutting nature of tourism in the national regulations, by including the list of 'tourism characteristic products'. It could also emphasise the elements of the international tourism trade that are particularly important for developing countries, such as sustainable tourism development and the need to implement GATS Article IV in the tourism sector. Lastly, the Reference Paper could propose specific measures to address the problems of SMEs in the tourism sector, principally the difficulties they have in gaining direct market access to consumers in tourist-generating markets. Special emphasis could be placed on increasing the export opportunities of SMEs in the tourism sector, a priority according to the GATS negotiating guidelines (Paragraph 3 of S/L/93). These could include regulatory measures to address the difficulties tourism SMEs have in gaining direct market access to consumers in tourist-generating markets. This option would require CARICOM/CARIFORUM to engage in coalition-building at the WTO, possibly through the establishment of a 'Friends of Tourism Services' informal working group. A 'Friends of Energy Services' working group already exists in Geneva.

Box 4. The 1996 WTO Reference Paper on Telecommunications: A model for tourism?

The WTO's Reference Paper on Telecommunications set out a series of principles for WTO members to follow in order to create the conditions for a fair and liberalised telecommunications market. These are legally binding only for those WTO members who have included the Reference Paper in their GATS schedules of commitments. So far, over half of the WTO membership have done so. The principles cover: Competitive safeguards, Interconnection, Universal Service, Public Availability of Licensing Criteria, Independent Regulators, and the Allocation and Use of Scarce Resources. The Reference Paper also includes a section on 'definitions'. The Paper was the first effort by WTO members to adopt a set of regulatory principles for one specific services sector, telecommunications. A similar approach could be followed for tourism.

How should CARIFORUM respond to the requests received from WTO members?

All CARIFORUM WTO members have received requests[27] from other WTO members as part of the 'request-offer' stage of the GATS negotiations. In at least one case, a WTO member – the EC – have presented tailored requests to each CARIFORUM WTO member taking into account the varying levels of CARIFORUM commitments on Tourism and Travel-Related Services.

The EC's sectoral requests to CARIFORUM states on Tourism and Travel Services are relatively benign. Most simply request that CARIFORUM WTO members 'take commitments' in areas where they have not yet done so. In some cases, the EC requests clarification of existing GATS commitments. The EC is not requesting that CARIFORUM WTO members eliminate existing restrictions for Tourism and Travel Related Services, or even suggesting that CARIFORUM states 'consider

Box 5. Responding to GATS negotiating requests: To commit or not to commit?

The GATS is the newest WTO agreement, coming into force in 1995. The first scheduled commitments made by WTO members represented standstill commitments rather than liberalisation. WTO members merely recorded in their schedules some of the market access and national treatment limitations that they were applying at that time. Initial GATS commitments by CARIFORUM states on Tourism and Travel Related Services followed this trend. There is no evidence that these have constrained the ability of CARIFORUM governments to regulate their tourism sectors. In other words, the impact of CARIFORUM GATS commitments in the tourism sector has, so far, been negligible. However, the GATS aims to achieve 'progressively higher levels of liberalisation' (Article XIX:1), and some CARIFORUM states have made relatively few commitments on tourism. Therefore CARIFORUM states should expect any additional limitations on market access and national treatment that they include in their schedules during the current GATS negotiations to be targeted in future rounds of multilateral services negotiations.

In many services sectors, the actual market environment of WTO members is significantly more liberal than indicated by their GATS schedules of commitments. The developed countries, led by the US and EC, are hoping that the GATS negotiations will be a means of locking in these levels of liberalisation across all services sector. The effect of making a legally binding and irreversible GATS commitment is that it limits policy flexibility for governments in the future. According to UNCTAD, 'Because markets are not perfect ... it is important to preserve a 'policy space in the new international environment. They [developing countries] should, for instance, keep room for manoeuvre when negotiating international investment agreements in order to ensure that they are able to further national economic interests' (UNCTAD, 2000, pp. 26–7).

WTO officials counter this argument by pointing out that increased policy flexibility has a price. They note that the existence of GATS commitments in tourism-related sectors can help promote both domestic and foreign direct investment, by ensuring greater stability and predictability of government regulations and policies affecting tourism. They argue that if a market access or national treatment measure is bound in a member's GATS Schedule, investors will realise that sudden policy changes are far less likely. But the importance of GATS commitments to investment decisions is often overplayed by WTO officials: the existence of GATS commitments is just one of many factors that will encourage a foreign investor to enter the market. Arguably more important factors are return on investment, political risk, currency fluctuations, foreign exchange controls and the ability to repatriate profits, revenue per available room (RevPAR) and operating costs, security, labour costs and productivity, national taxation, and incentives offered by governments.

taking full commitments, i.e. schedule none under MA and NT', as it is requesting in other services sectors (e.g. news agency services). Therefore, CARIFORUM states would be able to satisfy the EC's requests on tourism services easily by simply listing in their schedules additional market access and national treatment limitations in the four sub-sectors of Tourism and Travel Related Services. Doing so would not imply any legislative changes or further liberalisation in the tourism sector.

The US has presented standardised negotiating requests on Tourism and Travel Services to all CARIFORUM WTO members. These are more ambitious than those submitted by the EC. In addition to noting that the 'coverage of tourism services needs to be decided in WTO', the US negotiating request states:

> *'We request full commitments for market access for tourism and travel services in Modes 1, 2 and 3'.*

It is presumed that by asking for 'full commitments', the US is requesting that CARIFORUM WTO members enter 'none' under the Market Access and National Treatment columns of their schedules for all four sub-sectors of Tourism and Travel Related Services. The US is effectively asking for full liberalisation of these sectors across Modes 1, 2 and 3. CARIFORUM states should not comply with this request as at least five sub-sectors areas under the classification list for Tourism and Travel services (W/120, 9 A-D) are currently preserved for national or regional services suppliers. CARIFORUM WTO members are therefore advised to refrain from taking full commitments in these areas. They can do this by specifying the market access and/or national treatment limitations that apply. In this way, CARIFORUM's offer should improve its commitments, but stop short of the 'full' commitments requested by the US.

The following approach is advised for CARIFORUM WTO members' states when responding to negotiating requests from WTO trading partners:

(i) **Make 'full' commitments** (i.e. schedule 'none') in areas where further investment is required from trading partners such as large hotels, or where access to high-quality services is required by the tourism sector. For example, the former could be achieved by listing 'none' for Mode 3 commitments for hotels. One example of the latter is environmental services, a key area of offensive negotiating interest for the US and EC. Access to these services is essential for sustainable tourism development, and CARIFORUM has limited capacity in this services sector.

(ii) Make 'defensive' commitments – in the form of listing additional market access and national treatment limitations – in tourism services sectors that are currently preserved for national or, after 2005 and the launch of the CSME, regional services suppliers. These include five sub-sectors included in the GATS classification list for Tourism and Travel services (W/120, 9 A-D): travel agent and tour operators' services, the construction and development of small hotels, certain types of restaurants, and tourist guide services.

A further important consideration relates to the CARICOM regional market for trade in services under the CSME, which is due to come into force on 1 January, 2005. The CSME will mean that CARICOM states will no longer be able to preserve tourism sub-sectors for nationals and local companies. Instead, they will be opened to regional suppliers from CARICOM member states signed up to the CSME. In this way, the CSME is providing the regional tourism sector with its first trade-related adjustment through the creation of a single market for the trade in services within CARICOM. CARICOM states are currently committed to the removal of existing restrictions to liberalise the trade in services on a regional basis within the CSME. Any premature market opening to suppliers from third countries such as the EU, US and Canada would deny regional tourism services suppliers a transition period to first adapt to increased competition within CARICOM.

The CARICOM Secretariat lists the following national restrictions on tourism services that CARICOM members are seeking to remove before the establishment of a regional services market under the CSME by 1 January, 2005:

Box 6. The removal of restrictions on tourism services within CARICOM for the CSME[28]

Barbados	Restaurant Services (Modes 3 & 4), Lodging and Food and Beverage Services (Modes 1–4), Car Rental Services (Modes 3 & 4), Taxi Services (Modes 3 & 4), Travel Agency Services, Tour Operator Services, Tourist Guide Services (Modes 1–4), Watersports Services (Modes 3 & 4)
Dominica	Travel Agency Services (Modes 3 & 4)
Grenada	Hotel and Motel Lodging Services (Modes 3 & 4)
Jamaica	Lodging Services of Hotel and Motels (Modes 3 & 4), Travel Agency Services and Tour Operator Services (Modes 3 & 4), Tourist Guide Services (Modes 3 & 4)
St Lucia	Hotel and Lodging Services (Mode 3)
St Vincent and Grenadines	Hotel Services (Mode 3), Amusement Park Services (Modes 3 & 4)
Trinidad and Tobago	Accommodation Services under 21 rooms (Modes 3 & 4), Tour Operator Services (Modes 3 & 4), Destination Management Services (Modes 3 & 4)

The barriers to market entry in the EU, US and Canada

This section of the report will discuss the regulatory barriers faced by CARIFORUM tourism services exporters in the EU, US and Canada. The basis for this analysis is the restrictions listed in the GATS schedules of those WTO members, and their initial GATS offers. The most restricted Mode of Supply within these markets is Mode 4, when CARIFORUM nationals seek to enter these markets to sell tourism services. All three WTO members retain significant 'horizontal' restrictions on this mode of supply, which are discussed below. Also discussed below are the sectoral restrictions specifically in place for Tourism and Travel Related Services in these markets across all modes of supply.

However, it should be noted that the commercial barriers to entry in these markets are just as onerous, if not more so, that the regulatory barriers as recorded in GATS schedules of commitments. These include the high cost of marketing in these markets, which is beyond the means of all but the largest CARIFORUM hotel groups, and the difficulties that CARIFORUM tourism suppliers have in gaining access to the distribution channels that place tourism products on the EU, US and Canadian markets (e.g. tour operators, airlines, CRS or GDS systems).

In terms of the export profile of CARIFORUM tourism services suppliers, only a handful of companies sell their services by establishing a 'commercial presence' in overseas markets, Mode 3. During the consultations undertaken for this assignment, there were no suggestions that any regulatory barriers (Mode 3) have been encountered by CARIFORUM tourism companies in the EU, US or Canada. Most sell their services through a combination of Modes 1, cross-border supply (e.g. through internet reservation systems, via a GDS, or through a tour operator), and 4, by visiting these markets to meet clients (e.g. at international tourism trade fairs). Because most CARIFORUM tourism services suppliers 'export' their services only when foreign tourists enter CARIFORUM markets, they rely heavily on Mode 2, 'consumption abroad'. Proposals to remove the remaining Mode 2 restrictions such as travel taxes and duty free limits – which as 'frontier formalities' are not currently within the scope of the GATS – are included in a later section of this report.

(a) Mode 4 restrictions in the EU, US and Canada

Within the sectoral Mode 4 commitments on Tourism and Travel Related Services (W/120, 9 A-

D), these three WTO members have marked their schedules 'unbound, except as indicated in the horizontal section'. In their initial GATS offers – presented in the GATS services negotiations between March 31 and April 31, 2003 – the EU, US and Canada have repeated this. The following is a brief summary of the Mode 4 horizontal commitments contained in their initial offers:

(i) The **EU** has three types of service provider that are able to enter the market on a temporary basis: (i) **Intra-corporate transferees** (ICTs) which can be either (a) managers, (b) specialists or, a new category, (c) graduate trainees. Entry and stay is limited to a maximum of three years in the case of (a) and (b), and to 12 months for (c). The second category (ii) is **Business visitors** (BV) who are permitted to stay for up to 90 days in any 12 months. The EU has expanded the third (iii) category: **Contractual service suppliers** (CSS) in its offer. These can be either (a) employees of juridical persons (EJP) or (b) independent professionals (IP), for which 'numerical ceilings', or in other words quotas, will be established. To enter under category (iii), persons must have a university degree or equivalent. Under the EJP category, the EU presents a list of 'activities' for the performance of 'service contracts' including 'Travel Agencies and Tour Operator Services' although this is left unbound for seven EU member states, including the UK. Entry and stay is a maximum of 12 months under this category. It should also be noted that regulatory authority regarding Mode 4 entry remains with EU member states, and not with the European Commission.

(ii) The **US**'s initial offer on Mode 4 contains four types of persons who are allowed to enter the market on a temporary basis. Firstly, **Services salespersons**, who are allowed to enter the market for 90 days. For **Intra-corporate transferees** such as 'managers', 'executives' and 'specialists', entry is limited to three years that may be extended for a further two. **Personnel engaged in establishment** must present proof of their acquisition of physical premises within one year of their entry to the market, thereby confirming a link between Mode 4 access and Mode 3 (a link that developing countries have sought to break). Finally, a quota of 65,000 Fashion models and Specialty occupations are permitted entry for a maximum of three years.

(iii) **Canada**'s initial GATS offer contains four types of natural persons who are permitted temporary entry to the market. Canada has offered to extend entry for **Business visitors** from 90 days to 6 months. **Intra-corporate transferees** such as 'executives', 'managers' and 'specialists' must have been employed by a juridical person in another WTO member state for at least a year. For the first two subcategories, entry and stay is for 'an initial period equivalent to the period of the transfer', for 'specialists' it may not exceed five years. Canada also includes an amended list of nine **'Professionals'** who require work permits and who are permitted entry for a maximum period of one year. No tourism-related profession is included within this list. Canada has also added a new category, **Spouses and common-law partners of intra-corporate transferees or professionals** in its initial GATS offer.

The first important observation regarding the initial GATS offers of the EU, US and Canada is that they do not improve access for lesser skilled service providers, a key area of export interest for CARIFORUM states. All three offers demonstrate a general bias towards qualified labour. This report proposes that CARIFORUM negotiators seek to submit ambitious Mode 4 requests on tourism services – in the form of Hospitality Service Providers Programmes at both skilled and lesser skilled levels – in regional and hemispheric trade negotiations rather than at the WTO. There would be little value in pursuing this request in multilateral negotiations as the benefits of such programmes would be lost if developed countries introduced them on an MFN basis (i.e. open to all WTO members). However, it would be in CARIFORUM's interest to request at the WTO that qualified tourism professionals from UWI, PUCMM and the national hospitality train-

ing institutes within CARIFORUM are included within the EU's category of Contractual service suppliers (CSS), within Canada's list of 'professionals', and within the US horizontal commitments on Mode 4.

Early clarification should be sought from the EU, US and Canada of the criteria for refusing entry to persons on the basis of security concerns. This threatens to become a non-tariff barrier for the temporary movement of CARIFORUM hospitality service providers to these markets. With the heightened level of security in the US, many CARIFORUM tourism professionals have increased difficulties in entering the US market. Some have commented that this market is essentially 'closed' for the time being. Finally, CARIFORUM professionals have not encountered regulatory difficulties in obtaining visas to enter the EU or Canadian market to attend trade fairs or to meet with clients as 'business visitors'. However, in all three markets, CARIFORUM hospitality trainees or students have been denied visas when seeking to enter these markets to gain work experience within the hotel and accommodation sectors.

(b) Sectoral restrictions on tourism services in the EU, US and Canada

Compared to other economic sectors, there are relatively few limitations on market access or national treatment in GATS schedules of the EU, US and Canada for Tourism and Travel Related Services. In particular, there are no limitations on market access and national treatment under Modes 1[29] and 2. Below, the most important limitations are highlighted.

(i) Hotels and restaurants

The EU's commitments on Tourism and Travel Related Services include limitations on Mode 3 market access in three states for 'A. Hotels, Restaurants and Catering', where 'authorisation can be denied to protect areas of particular historic and artistic interest' in three member states. Canada has offered to remove some limitations on Mode 3 market access in the form of residency requirements for the sale of liquor under 'A. Hotels and Restaurants', but has also retained some (e.g. in Québec). Also, Canada has maintained a Mode 3 national treatment limitation for non-residents who are required to pay a 20% land transfer tax for the 'purchase of recreational property'. The US has no limitations on market access or national treatment in the Hotels and Restaurants sub-sector.

(ii) Travel agencies and tour operator services

Canada has not offered to remove its Mode 1 limitation on market access in Ontario and Québec, where these services must be supplied through commercial presence. Ontario and British Columbia will also retain residency requirements under Mode 1. The US has not offered to remove a Mode 3 market-access limitation that 'official tourism offices with diplomatic status are not permitted to operate on a commercial basis' under Mode 3. The EU has offered to eliminate a Mode 3 market-access limitation on non-EU nationals wishing to establish travel agencies in the territory of the EU. This limitation was present in three countries only.

(iii) Tourist guide services

Canada has not committed this sector. The US's initial offer maintains a Mode 3 market-access limitation that 'the number of concessions available for commercial operations in federal, state and local facilities is limited'. The EU retains Mode 4 limitations on market access in this sector, in the form of nationality requirements in five member states.[30]

The WTO negotiations to agree on disciplines for services subsidies

Negotiations are also ongoing within the WTO Working Party on GATS Rules to agree on new multilateral rules for services subsidies. These negotiations – which are outside of the mandate of the Doha Round – are scheduled to be completed by 'prior to the conclusion of the services market-access negotiations'. For CARIFORUM, it will be important to monitor these negotiations so that any new rules for services subsidies are sufficiently flexible to permit CARIFORUM states to offer their tourism sectors with a wide range of incentives. The worst-case scenario is that the new GATS disciplines on subsidies will make some of the subsidy and incentives currently offered by CARIFORUM governments to the tourism sector 'GATS-incom-

patible'. A list of some of the subsidy measures that WTO members – including CARIFORUM states – have introduced for tourism is attached in an Annex to this report.

WTO negotiations to agree on guidelines for domestic regulations

A further essential issue that requires careful monitoring is the WTO negotiations within the Working Party on Domestic Regulation (WPDR). Article VI:4 of the GATS calls on the WPDR to develop disciplines to ensure that domestic regulations relating to licensing requirements and procedures, technical standards, and qualification requirements and procedures do not constitute unnecessary barriers to the trade in services. Paragraph 7 of the GATS negotiating guidelines states that work under Article VI: 4 should be finished before negotiations on specific commitments are concluded, which is the deadline for the overall round of 1 January, 2005. Of particular relevance for the CARIFORUM tourism sector are the discussions regarding 'measures regulating' the entry of natural persons into, or temporary stay in, a WTO members territory. CARIFORUM negotiators should monitor these negotiations closely to ensure that the final outcome – in the form of multilateral disciplines – does not constrain CARIFORUM states' ability to regulate their tourism sectors.

'Offensive' negotiating requests for CARIFORUM for the EU, FTAA and Canada–CARICOM Services Negotiations

The scope of regional and hemispheric negotiations on tourism

It is assumed that the final agreements on services resulting from the FTAA, CARIFORUM–EU and CARICOM–Canada negotiations will contain two elements: a set of guidelines and priorities between the contracting parties; and a schedule of specific commitments. Of these, the FTAA negotiating process is by far the most advanced and is scheduled to conclude by January 2005. Within the Draft FTAA Chapter on Services (FTAA.TNC/W/133/REV.2 of November 2002), tourism is only mentioned twice, and on both occasions in footnotes.

Within the CARIFORUM–EU negotiations, regional negotiators should seek to establish a Chapter on Tourism that includes both a set of guidelines and some priority areas for development assistance using European Development Fund (EDF) resources. Similarly, regional negotiators should also push for specific language on tourism to be included in the respective services chapters of the FTAA and Canada–CARICOM agreements. This language needs to recognise the importance of the industry to the economic development of smaller economies in particular, and also position tourism as a recipient for technical co-operation activities.

(a) Should air transport passenger rights be included in the EU and Canada negotiations?

One of the major constraints to the sustainable growth of CARIFORUM tourism is the lack of incoming airlift. This problem is particularly acute for the OECS destinations. Low air traffic density, which reduces the profitability on 'thin' routes, and insufficient demand in tourist-generating markets have both been contributory factors. As a result, some CARIFORUM governments are now in the enviable situation of having to offer incentives – often in the form of seat guarantees – to scheduled airlines and air charter companies. As one CARIFORUM transport official stated 'if we want an additional charter service, we have to pay for it'. That CARIFORUM governments are now contributing to the profits of developed-country air transport service providers in the EU and US – and therefore indirectly to developed-country treasuries – is an issue that should be raised in international trade negotiations.[31]

Passenger rights, so-called 'hard rights', are currently excluded from the WTO and FTAA services negotiations on air transport services.[32] Given the relatively advanced status of these negotiations, it may be too late to introduce a discussion on passenger rights. However, CARIFORUM could propose to the EU and Canada that negotiations on air transport services, including route rights for scheduled airlines and charter services, be included

within the EPA and CARICOM–Canada negotiations respectively. The inclusion of route rights – normally negotiated within bilateral 'open skies' agreements – within a multi-sector trade negotiation could be beneficial for the regional tourism sector if it resulted in enhanced airlift into the region, and better route rights to Europe and Canada for regional carriers. Credit could also be sought in the negotiations for the incentives offered by some CARIFORUM governments to European and Canadian carriers to operate services to CARIFORUM countries.

The 'Community of Interest Principle', as established in Article 83bis of the ICAO Chicago Convention, could be used for CARIFORUM/CARICOM to negotiate on behalf of regional carriers. The 1998 CARICOM Multilateral Air Services Agreement (MASA) has also created a regional policy platform for CARICOM to negotiate on air transport services. Given the fundamental importance of airlift to the regional tourism industry, this proposal is worth exploring further. A thorough consideration of the costs and benefits is required, as is consultation with regional airlines.

The negotiating recommendations for CARIFORUM on tourism services

The following are a series of 'offensive' negotiating requests on tourism services that could be submitted by regional negotiators in the FTAA, CARIFORUM–EU or CARICOM–Canada negotiations. These requests deliberately go beyond the scope of negotiating requests being submitted by WTO members in the GATS negotiations, and as far as possible, attempt to resolve the major trading problems of the CARIFORUM tourism sector in international markets. The requests are presented as:

- horizontal requests affecting tourism services;
- sector-specific requests on tourism services;
- negotiating requests to implement Article IV of the GATS on 'Increasing the participation of developing countries';
- development assistance and technical co-operation requests; and
- other requests to address some specific trading problems.

Horizontal requests affecting tourism services

(a) Reduce costs and facilitate access to visas for the temporary entry of CARIFORUM tourism professionals wishing to enter the EU, US and Canadian markets to supply services.

The costs (over US$100) and time associated with obtaining visas for temporary entry into the EU, US and Canada represent a market access barrier to the export of CARIFORUM tourism services. For example, a Caribbean tourism professional from Barbados wishing to travel to Germany for the ITB trade fair may have to send his/her passport to the German Embassy in Trinidad and Tobago. This is a unique constraint for small-island developing states, many of whom are too small to warrant diplomatic representations for the purposes of processing visas.

Although Shengen visas are available to CARIFORUM nationals visiting the EU, they are sometimes not easily accessed for some islands in the Caribbean and the costs are high. This could be presented as a horizontal Mode 4 request for all services sectors. A possible solution to this would be for developed countries to introduce electronic visas, as Australia has done with the 'Electronic Travel Authority System' (ETAs). An 'ETA' is equivalent to a visa, and applications are submitted through travel agents or airlines in the country of departure without requiring a visit to an Australian diplomatic office. Such a system would greatly facilitate the temporary business entry of CARIFORUM tourism professionals to key markets such as the EU, US and Canada.

(b) Include tourism professionals with tertiary-level hospitality qualifications from UWI, PUCMM and national hospitality institutes within criteria established for the temporary entry of 'professionals' or 'business visitors'.

Regional negotiators should aim to ensure that suitably qualified tourism professionals from CARIFORUM are included within the lists of 'professionals'

or 'business visitors' for the purposes of horizontal mode 4 commitments made by the EU, US and Canada in the EPA, FTAA and Canada–CARICOM trade negotiations. Within the NAFTA agreement, 'Hotel Manager' is the only tourism 'professional' permitted to enter the markets of NAFTA signatories without the necessity of the application procedures commonly required for employment authorisations.[33] CARIFORUM negotiators should ensure that regional hotel managers and other tourism professionals (e.g. catering specialists) receive at least equivalent treatment in the FTAA and Canada–CARICOM negotiations.

(c) Establish programmes within the EU, US and Canada to recognise tourism professional qualifications and credentials developed in CARIFORUM states.

The negotiation of such programmes is an essential precursor for increasing the export of CARIFORUM tourism services via Mode 4. Issuing authorities for visas and work permits in the EU, US and Canada are more likely to facilitate the temporary entry of CARIFORUM tourism professionals if a prior agreement exists to recognise the tourism qualifications obtained in CARIFORUM states.

These programmes could be negotiated as a side deal or as an integral part of the overall agreements on services. CARIFORUM could request that the following tourism-specific qualifications are recognised in these markets, and granted equivalence with similar programmes in those markets:

(i) tourism-related Masters and Bachelors degree programmes from the University of the West Indies (UWI) and the Pontificia Universidad Católica Madre y Maestra (PUCMM);

(ii) qualifications from the national Hospitality Training Institutes within CARIFORUM states, including hospitality and tourism Associate Degree programmes and National Vocational Qualifications (NVQ)[34] relating to the tourism sector; and

(iii) industry credentialing programmes such as the 'Caribcert' programme being developed by the Caribbean Hotel Association (CHA).

The Caribbean Tourism Human Resource Council (CTHRC), managed by CTO, should be consulted on this issue. The CTHRC brings together key stakeholders from business, labour, government, industry associations and education and tourism-related organisations and groups to collectively address the tourism human resource needs of the region.

Sector specific requests on tourism services

(a) Review EU,[35] US and Canadian legislation relating to health and safety standards in the hospitality sector that are applied to CARIFORUM hoteliers (Mode 1).

Industry representatives have indicated that they fully support the development of appropriate health and safety regulations to protect international consumers of tourism services visiting the region. But they also point out that some standards are inappropriate for the Caribbean climate, and the location, design and architecture of Caribbean hotels. In particular, the huge costs of compliance with EU standards – in the form of national regulations implementing the EU Package Travel Directive[36] – are a major issue for CARIFORUM hoteliers.

For example, some CARIFORUM properties have to introduce elaborate evacuation systems more suited to high-rise buildings when they have only two or three floors. These standards need to be refined to suit the Caribbean region. A review of all national consumer regulations within Europe affecting Caribbean hoteliers could help to reduce these costs by avoiding any unnecessary alteration to CARIFORUM properties receiving European tourists. This review should take into account tourism health and safety standards developed within CARIFORUM, such as the 'Quality Tourism for the Caribbean' (QTC) programme.[37] Regional negotiators may wish to consult further with the regional tourism sector to assess whether similar issues exist with US and Canadian legislation.

Under the EU Package Travel Directive, the interests of European consumers received special attention. In contrast, the impact of the Directive on the suppliers of tourism products and services – such as CARIFORUM hoteliers – were not consid-

ered within the scope of the Directive. For example, there are no provisions to mitigate the impact on tourism suppliers in the event that a European tour operator or travel agent becomes insolvent. Some destinations within Europe – led by Greece – have sought to address this by proposing that the European Commission issues a similar Directive to protect suppliers of tourism products and services. CARIFORUM negotiators could raise this issue with the EU in the EPA, FTAA and Canada–CARICOM negotiations to ensure that adequate provisions are introduced to protect CARIFORUM suppliers if a tour operator or travel agent from those markets enters bankruptcy proceedings.

(b) Introduce tax incentives for EU and Canadian businesses holding conferences or conventions in CARIFORUM countries (Mode 1).

This proposal would assist in attracting more business visitors to CARIFORUM destinations. Under a provision of the Caribbean Basin Economic Recovery Act (CBERA), US taxpayers are able to deduct legitimate business expenses incurred attending a business meeting or convention in a qualifying CBERA country. A qualifying CBERA country must have a tax information exchange agreement in effect with the US. Within CARIFORUM, the following countries do not benefit from this scheme:[38] Belize, St Christopher and Nevis, St Vincent and the Grenadines, and Suriname. CARIFORUM has several excellent facilities to accommodate business meetings and should push for a similar scheme to be introduced by the EU and Canada in the EPA and Canada–CARICOM negotiations. This will increase the export of business convention services, a priority area of future growth for many CARIFORUM destinations. The per capita spending of business visitors is generally higher than for other tourists (although the length of stay is generally lower than leisure tourists).

(c) Reduce travel taxes imposed on EU, US, and Canadian tourists travelling to CARIFORUM states to consume tourism services (Mode 2).

For the tourism sector, 'consumption abroad' under Mode 2 is arguably the most important mode of supply. GATS commitments under this mode of supply concern the restrictions imposed by WTO members on their own consumers, or in this case tourists, travelling abroad, to consume tourism services. The World Tourism Organisation (WTO–OMT) lists the possible restrictions under Mode 2 for tourism as:

> *'Exit visa (passport formalities, exit taxes and charges, whether independent or attached to specific services (e.g. airport taxes), currency allowances and means of payment, export of personal effects, including personal vehicles (as well as fuel, spare parts, etc), customs formalities relating to non-personal effects (articles whose character and number exceeds the quantity which may be considered as corresponding to personal use), insurance formalities, health formalities etc.*[39]

This wide definition of restrictions under Mode 2 currently goes beyond the scope of WTO members' commitments in the GATS services negotiations. Accordingly, some WTO members have stated 'none' under Mode 2 even though the restrictions listed above are in place. This is because the elimination of 'frontier formalities' of the type listed above is not currently considered within the remit of the GATS negotiations. CARIFORUM could therefore seek to remove the restrictions listed above under Mode 2 in regional or hemispheric trade negotiations.

The Caribbean Tourism Organisation (CTO)[40] has recently estimated that US per capita ticket taxes currently amount to $42.[40] for all persons travelling to and from the US by air (see Box 7 below). Ironically, the US identified 'overly burdensome exit fees or taxes, or similar restrictions on the departure of outbound travellers' as a major obstacle in the tourism sector in its WTO negotiating proposal on 'Tourism and Hotels' (S/CSS/W/31).

According to the president of the World Travel and Tourism Council (WTTC), the combined taxes on outgoing air travel from Europe is as high as 30% of the total value. It should be noted that each EU member state currently levies different types and levels of taxes on air travel such as Security Charges, Embarkation Taxes, Air Service Charges, Passenger Fees and Departure Charges. Some EU member states are considering the introduction of environmental taxes on departing flights from the EU with

Box 7. US fees and taxes on outbound travellers

Code	Name	Amount (US$)
US2	US International Transportation Tax ($13.40 both directions)	26.80
ZP	Segment Tax	3.00
XY	US Federal Inspection Fee	7.00
XA	US (Animal, Plant Inspection Service) User Fee	3.10
AY	US Security Fee	2.50
Total		42.20

differential rates for short-haul and long-haul destinations. CARIFORUM could propose that some of the revenue from long-haul flights to the CARIFORUM states be re-directed to a CARIFORUM Sustainable Tourism Fund.

The proposal will have to be considered carefully, in view of the heightened security measures – and their associated costs – currently in place at international airports in the EU, US and Canada. Furthermore, CARIFORUM states should resist any requirements for reciprocity on the basis of their narrow taxes bases and their states as small vulnerable states and as a special and differential treatment measure. Despite this, any reduction on air travel and airport taxes for outgoing flights to CARIFORUM states would provide a much-needed stimulus to international carriers to operate in the region.

(d) Increase duty-free exemptions for EU, US and Canadian returning residents, and make information available to all tourists, including cruise-ship passengers, making purchases in CARIFORUM states for personal or household use (Mode 2).

The aim of this proposal would be to increase per capita tourist expenditure in CARIFORUM states. This proposal would benefit retailers within airport facilities as well as other regional retailers. Limits on duty-free purchases and purchases made by returning residents are another example of restrictions placed by countries on their nationals consumption abroad under Mode 2. The importance of duty-free exemptions is evident from the experience of the USVI, where the exemption for returning US citizens from the USVI ($1,200 per person) is significantly higher than from other CARIFORUM states ($800 per person). Accordingly, US cruise ships normally direct their passengers to make all their purchases in the USVI, rather than other CARIFORUM states, because of the higher duty-free exemptions. This has led to the growth of retail tourism in the USVI from cruise ships. The current customs/duty-free exemptions are shown in Box 8.

A variation on this proposal could be that higher limits are introduced for goods produced in CARIFORUM states, such as tobacco products and distilled spirits. Ensuring that information regarding these duty-free exemptions is publicised may also stimulate additional expenditure by cruise passengers in CARIFORUM states.

(e) The negotiation of regional Hospitality Service Providers Programmes with the EU, US and Canada (Mode 4).

The aim of the Hospitality Service Providers Programmes would be to ensure that CARIFORUM nationals are guaranteed work permits for the purpose of temporary contract work. There is already a demand for the skills of qualified CARIFORUM tourism professionals in the EU, US and Canadian markets. For examples, a UK recruitment agency has recently visited the region to recruit graduates from national Hospitality Training Institutes within CARIFORUM under the UK's Working Holiday-maker Scheme available to Commonwealth nationals. Similarly, a Canadian hotel chain has been actively seeking to recruit lower skilled hotel work-

Box 8. Customs duty-free exemptions for the EU, US and Canada

	For returning residents coming from visiting CARIFORUM states
EU	**UK – £145** of all other goods (in addition to separate limits for alcohol, tobacco and perfume products)
	EU €175[41] of other goods (in addition to separate limits for alcohol, tobacco and perfume products)
US[42]	**US$600** for all Caribbean Basin countries, including exemptions for alcohol and tobacco products. NB. The US duty-free exemption rates are US$800 for 'anywhere other than a Caribbean Basin country or a US insular possession', and US$1200 for US insular possessions (U.S. Virgin Islands, American Samoa, or Guam).
Canada	**CDN$750** including $200 allowance for tobacco and alcohol products

ers from CARIFORUM states. At the national level, only Jamaica has a formal mechanism for the temporary export of tourism workers. Jamaica has benefited from the United States Overseas Hotel Employment (H2B) Programme since 1968, managed by the Jamaican Ministry of Labour. The programme operates as a seasonal quota for as many as 4,600 persons per year.

The case for such a programme could be built by matching the labour surpluses in the CARIFORUM hospitality sector (between April and November) with the labour deficits in the EU,[43] US and Canadian hospitality sectors. Further research is needed to achieve this. The programme could cover the temporary movement of both lesser skilled and skilled tourism professionals with appropriate credentials or qualifications. It could be designed to suit the seasonality of the CARIFORUM tourism sector, to ensure that there are no labour shortages during the high season (November–April) for CARIFORUM tourism. Gaining direct exposure to the hospitality industries of the EU, US and Canada could raise the service standards and practices of the regional tourism industry, and could enable a transfer of skills and expertise to CARIFORUM hospitality workers. In the case of Canada and the EU,[44] these programmes would also facilitate a transfer of language skills.

The design of such a programme will require careful consideration. The lack of skilled human resources is one of the main overall constraints to CARIFORUM services exports in general. It would be disastrous for the tourism industry if this proposal

Box 9. Should compensation from trading partners be sought for the costs incurred by CARIFORUM hospitality training institutes?

In an interview with Dr George Forde, Principal of the Sir Arthur Lewis Community College in St Lucia in April 2003, the issue of compensation was raised. At that time, a British recruitment agency was conducting a series of on-campus interviews with recent graduates from the College's Hospitality Institute for employment opportunities with the UK leisure sector.

Dr Forde expressed concern about the high cost of training students within the Associate Degree Hospitality Programme, which he estimated to be EC$10,000 per year. While he supported the idea of negotiating Hospitality Service Providers Programmes to increase the Mode 4 trade in tourism services, he also stressed that recipient countries should offer financial compensation to contribute to the training costs of hospitality institutes that are providing skilled tourism workers to fill labour shortages in the tourism sectors of recipient countries.

resulted in the permanent migration of the most highly qualified tourism professionals. It is therefore proposed that these programmes are introduced on a small scale at first.

The design of the programme will also require significant input from the private sector. Some of the larger CARIFORUM hotel groups invest substantial resources in the training of their staff, and may be reluctant to promote the temporary export of tourism services in this way.[45] In the case of the Jamaican programme, there have been complaints that the Jamaican programme actually causes major personnel management problems for local hoteliers. For example, one hotel had to cope with a sudden loss of personnel after fifteen workers decided to leave for the US at short notice during high season. It has been suggested that the programme should begin on the basis of an annual quota, but consultations are needed regarding whether a public or private agency should manage this. Appropriate measures will also have to be factored in to limit the potential for illegal overstayers. This would also ensure that the temporary movement of tourism professionals to overseas markets does not become permanent, thereby causing a reduction in the levels of human capital in the CARIFORUM tourism sector ('brain drain').

When presenting these negotiating requests to the EU, US and Canada, CARIFORUM negotiators should highlight that tourism, specifically the hotels and catering sub-sector, is one of the main sectors for illegal labour in OECD countries.[46] In this way, this negotiating request could result in a net gain for all parties, as it would help developed countries to regulate their labour markets more effectively by reducing the amount of illegal labour activity in the tourism sector.

(f) Facilitate visas for CARIFORUM tourism students entering the EU, US and Canada on hospitality internships or stagier programmes (Mode 4).

Within CARIFORUM states, there are several internship programmes for tourism students from national hospitality institutes and the UWI to travel abroad to gain work experience. However, in some cases, the visa-issuing authorities in developed countries have denied entry to these students. This recently occurred in the Dominican Republic where the Pontificia Universidad Católica Madre y Maestra (PUCMM)[47] in Santo Domingo had negotiated an agreement for an internship programme with the Delta Hotels Group in Canada. Under this programme, between fifteen and thirty students from the PUCCM's tourism school would travel to Canada for summer internships. However, the Canadian government rejected the visa applications for these students, with the result that the agreement has never been implemented. CARIFORUM negotiators should therefore request that OECD governments, particularly the EU, US and Canada, introduce streamlined visa-approval arrangements to facilitate this type of temporary movement for student internships in the hospitality sector.

Negotiating requests to implement Article IV of the GATS

The full implementation of GATS Article IV by the EU, US and Canada would greatly assist the development of the CARIFORUM tourism sector. Eight years after its entry in force, it has not been implemented by developed country WTO members. Under Article IV, WTO members committed themselves to increasing the participation of developing countries in the global services trade by strengthening services capacity and competitiveness, improving access to distribution channels and information networks, and facilitating greater market access in areas of special interest. To date, the only response of developed country WTO members has been to introduce 'contact points'. Although these are intended to facilitate the access of developing country members' service suppliers to information, they contain no information of practical value for CARIFORUM tourism service suppliers. CARIFORUM negotiators could therefore submit the following negotiating proposals *during* the FTAA, ACP–EU and CARICOM–Canada negotiations to implement the Article IV of GATS in the tourism sector.

(a) The introduction of market-access contact points for the Mode 4 export of CARIFORUM tourism services in the European, US and Canadian markets.

CARIFORUM should propose that 'single desk' contact points are established in these markets to provide information on temporary employment opportunities in the hospitality sectors of those markets, monitor labour market developments, and facilitate visa processing. The proposal could be implemented on a stand-alone basis, or in parallel to the Hospitality Service Provider's Programmes.

(b) Provide small airline carriers from tourism-dependent regions with affordable access to European and US Computer Reservations Systems (CRS) and Global Distribution Systems (GDS).

Both Air Jamaica and BWIA use Sabre. The subscription fees for using this service are prohibitively high for small carriers. Negotiators should propose that GDS introduce differential pricing for small carriers from tourist-dependent regions.

(c) Enhance interface possibilities of CARIFORUM reservation systems – such as CHARMS and the Go Caribbean online booking engine – with GDS and online reservation systems, and increase their visibility in the tourism internet marketplace.

The development of 'Caribbean storefronts' for all online reservation systems would enhance the visibility of Caribbean tourism products. The above two negotiations requests – 10 and 11 – touch on major areas of debate in the WTO negotiations, such as how to increase developing country access to technology through the WTO Work Programme on Electronic Commerce, and the implementation of GATS Article IV. Even so, it remains to be seen whether trade negotiating requests in government-to-government services negotiations can change the policies of GDS and online reservation systems. This would require some form of government intervention in the commercial practices of the private companies that control these distribution channels. Despite this, these are critical issues for the CARIFORUM tourism sector and should be raised in external services negotiations, particularly with the EU and US, the origin markets of the main GDS and online booking engines.

(d) The establishment of websites to identify market access opportunities in tourist-generating markets for small hoteliers and tourism services suppliers.

The aim of these would be to identify new market access opportunities for CARIFORUM tourism suppliers within Europe, the US and Canada on a rolling basis, anticipate new trends in tourist-generating markets, and provide information on tourism-industry developments. This would encourage the direct Mode 1 supply of tourism services by CARIFORUM SMEs to those markets. One CARIFORUM state, the Bahamas, is currently working to devise strategies to increase direct cross-border sales of tourism services to consumers in tourist-generating markets before they travel to the region, rather than rely on intermediaries (e.g. cruise ships) who take a commission on any tours or services provided to their passengers in CARIFORUM states during their vacations.

(e) Establish government-to-government consultation mechanisms for the issuance of travel warnings.

This negotiating request would aim to create an obligation on the part of the authorities in the EU, US and Canada to consult CARIFORUM governments prior to the issuance of travel warnings. Since the events of September 11, 2001, government-issued travel advisory warnings have caused major damage to several tourism destinations in both developed and developing countries. This has led one destination, Kenya, to call for a review of the international 'travel advisory machinery'.[48] Since September 11, CARIFORUM states have been largely successful in promoting themselves as safe and secure tourism destinations. Given the potentially catastrophic impact on CARIFORUM economies of travel advisory notices[49] advising against travel to the region, negotiators should urgently seek to negotiate new consultation procedures before any travel advisory is issued by the governments of tourist-supplying countries.

Box 10. Information technology and tourism: CRS, GDS and the internet

The rapid expansion of information technology has had an immense impact on the tourism and travel industry. IT applications are now fundamental to tourism product marketing and distribution. Computer Reservation Systems (CRS) were the pioneers of computer applications in the 1960s. These are distribution platforms – in the form of a mainframe computer with a massive database attached – through which airlines sell tickets to travellers via traditional travel agents.

CRSs have evolved into Global Distribution Systems (GDS). GDS connect many supplier CRS systems with end users, and are the 'macro' version of CRS. Over time, GDS have expanded their operational reach to include airlines, hotels, cruises, car rental companies, tours and other tourism services. Market consolidation has left four main GDS: Sabre, Amadeus, Galileo and Worldspan. *The Financial Times* ('Travel vendors embrace the internet', 13 March, 2002) recently described GDS ownership as a 'cosy oligopoly that has long raised the suspicion of users and anti-trust bodies'. The competition effects of GDS consolidation on supplier destinations such as CARIFORUM have never been explored.

In the past, the four GDS systems were wholly owned by the airlines, but that is now changing. Sabre became the first GDS to become completely independent of airline control in 2000, when American Airlines' holding company, AMR, sold its shares to the public. Galileo is now owned by Cendant, a US lodging and car rental group. Three European airlines still have majority ownership of Amadeus: Air France, Iberia and Lufthansa. Worldspan is the only GDS still completely owned by US airlines: American Airlines, Delta and Northwest.

With the growth of online reservations via the internet, the owners of GDS feared that they would become 'dis-intermediated' by cheaper internet solutions to tourism marketing and product distribution. To avoid this, some have bought into the online distribution sector. For example, Sabre, a US-owned GDS, now owns 70% of Travelocity. A further threat to the GDS's central role of commercial intermediary is direct online selling by independent airlines (e.g. Easyjet).

CARIFORUM tourism companies have long complained about the high costs of GDS subscription fees, but there is no real alternative if their products are to be widely distributed. This is a major commercial issue affecting the Mode 1 supply of CARIFORUM tourism services. Many of the larger CARIFORUM tourism companies and airlines use Sabre. Tourism SMEs are effectively shut out from these distribution channels because of the high fees. Industry experts predict that GDS will be superseded completely by internet reservation systems within ten years. Even so, the bargaining power of CARIFORUM suppliers with the newer online reservation systems is likely to be as weak as with GDS. This is because smaller tourism suppliers in CARIFORUM states will always face prohibitively high fees due to their inability to generate volume sales.

The CHA has established presences with GDS and online reservation systems to provide access to these distribution channels for their memberships. The CHA Charitable Trust's 'Go Caribbean' online reservation system is currently paying a monthly subscription fee to Expedia, owned by USA Interactive Inc., to link into their system. CHA has established a reservation system, CHARMS, to facilitate the access of small hotels to GDS systems at a reduced price. CHARMS uses Utell's GDS identifier to gain access to GDS, thereby allowing small hotels to benefit from Utell's volume discount for listing. Utell is a US reservations service that provides hotel inventory to the GDS systems for their member hotels.

Development assistance and technical co-operation requests

Although the public position of the European Commission (EC) is that the EPA negotiations with ACP states will not have a budget attached to them, it is highly likely that CARIFORUM will have the opportunity to present development assistance requests to the EU for European Development Fund (EDF) resources. The following are some initial proposals, pending further consultations between CTO and CHA on the development needs of the CARIFORUM tourism industry.

(a) A programme of assistance for internet marketing strategies for small hotels (of 75 rooms or less).

The internet is set to dominate tourism marketing, and it has many advantages as a marketing tool for those SMEs that cannot access the main international distribution channels (e.g. tour operators, GDS). As part of this programme, the EU, US and Canada could be requested to encourage partnerships between CARIFORUM tourism SMEs and technology suppliers. It could also promote best practices on new technology applications involving tourism SMEs.

(b) Technical and financial assistance to CARIFORUM states to introduce Tourism Satellite Accounts (TSA).

These aim to measure tourism-related activity by determining what percentage of each industry is accounted for by tourism. The establishment of TSAs[50] in CARIFORUM economies would ensure availability of comprehensive and reliable information on the impact of tourism on CARIFORUM economies. This is currently lacking. TSAs would also facilitate public policy planning for the growth and development of tourism in CARIFORUM states, and would clarify the extent of tourism linkages to ancillary economic sectors. The introduction of TSAs could complement the detailed statistics on the cross-border movement of tourists already being produced by the Caribbean Tourism Organisation (CTO).

(c) Provide technical support to CARIFORUM services providers wishing to establish commercial presence (Mode 3) in the EU, US and Canadian markets.

Although only a handful of CARIFORUM tourism services suppliers have established a commercial presence in these markets, this situation may change in the future. The provision of technical support by the EU, US and Canada to facilitate this may stimulate CARIFORUM service providers to increase their participation in this mode of supply.

(d) Encourage partnership programmes between CARIFORUM hospitality training institutes and their counterparts in the Europe, the US and Canada.

The objective of this proposal is to share hospitality training best practices, as well as encourage the development of student exchanges between hospitality institutes.

Other requests to address some specific trading problems

Listed below are three further trading issues that are constraining the future development of the CARIFORUM tourism sector. These are the lack of incoming airlift to supply CARIFORUM destinations; the insurance problems facing CARIFORUM hoteliers; and the dumping of US food exports on the CARIFORUM tourism sector. These issues could be raised in regional or hemispheric trade negotiations on services in order that solutions can be identified.

(a) Establish a programme with unallocated EDF resources to increase air services to small, tourism-dependent states within CARIFORUM.

This proposal may be particularly relevant for the EPA negotiations with the EU, and CARIFORUM negotiators could propose that unallocated EDF resources be set aside for this purpose. This would ensure that it is European, not CARIFORUM, public funds that support the air services of European carriers to CARIFORUM destinations. Such a programme could be designed in a similar manner to the US Essential Air Services System (see Box 11), with EDF resources providing payments to airlines

willing to provide services on 'thin routes' under special licences. The proposal could also be raised in the Canada–CARICOM negotiations.

(b) Request that the US exercises stronger oversight control over US food exports for the CARIFORUM tourism industry to ensure that old stocks are not being dumped on CARIFORUM tourism markets.

Two CARIFORUM destinations, Jamaica and the Dominican Republic, believe that old stocks of US food items are being dumped on the tourism markets of these two countries. Many hoteliers have found that food imports, particularly perishable items, have a very limited shelf life. CARIFORUM negotiators should therefore request in the FTAA negotiations that US authorities investigate this issue and ensure that there is sufficient oversight authority to prevent such practices by US food exporters.

(c) Introduce specific measures to expand insurance coverage for the CARIFORUM tourism sector and to reduce costs.

The costs of insurance policies for CARIFORUM hoteliers and tourism service suppliers has been increasing in recent years, not least for coverage against natural disasters such as hurricanes. Another recent trend is that international tour operators and cruise lines are now transferring liability and risk to local operators for personal injury claims. This began after US cruise lines were sued in US courts for injuries sustained by passengers while engaging in onshore activities (e.g. riding on jet skis). Rather than taking on the costs of insurance themselves, the cruise lines are passing these on to local operators and, in some cases, refusing to deal with them unless they have specific types of insurance coverage.

Similarly, many of the contracts between CARIFORUM hoteliers and international tour operators contain a clause indemnifying the tour operator from any compensation claims for personal injuries sustained by tourists while on property. Tourists usually chose to pursue those claims in the courts of the country where they reside. This means that CARIFORUM hoteliers have to purchase insurance policies with worldwide – rather than local – jurisdiction. This massively inflates the premiums for these policies. So much so, that the cost of insurance with worldwide jurisdiction for one Barbados hotelier is $250,000 per year whereas insurance with Barbados cover would cost $25,000.[51]

CARIFORUM negotiators could raise these issues in external negotiations on services, and request that trading partners support the settling of such cases in local courts. CARIFORUM negotiators could argue that the necessity to buy insurance policies with global jurisdiction is a trade barrier.

Box 11. A proposal to increase incoming airlift into CARIFORUM states

At the Worldwide Air Transport Conference in Montreal, Canada (24–29, 2003), the World Tourism Organisation tabled a proposal to address 'aviation market failure, and with it tourism market failure', in the world's poorest countries, the least-developed countries (LDCs). The WTO–OMT called for 'any practical measures to increase air transport service levels and decrease price levels in developing state markets'. The proposal referred to existing national and regional programmes in the EU and US to strengthen 'distressed market failure regions,' such as the US Essential Air Services System. These were based on the provision of substantial central funds for 'supplemental payment to airlines willing to operate under special licenses to such regions'. The proposal emphasised that the aim of this was 'to increase services, not to support airlines'. CARIFORUM should propose that a similar system be introduced in the EU negotiations, using unallocated EDF resources.

Source: *Liberalisation with a human face: The Aviation Dimension*, presented by the World Tourism Organisation (WTO-OMT) at the Worldwide Air Transport Conference, 24–29 March, 2003 (ATCONF/5-WP/32).

However, an informal legal opinion sought for this assignment has indicated that it would be difficult to challenge an individual's right to pursue a claim in their own jurisdiction. Also, the issue of cruise ships only dealing with operators who have certain kinds of insurance policies appears to be a commercial issue that once again reflects the weak bargaining power of CARIFORUM services suppliers in the tourism market. Despite this, negotiators should consider raising this issue in the negotiations with the EU, US and Canada.

(d) Request that EU, Canada and the US approve the portability of health insurance policies in order to cover spa, rehabilitation, and chronic care services provided to their nationals in CARIFORUM states.

A recent study[52] commissioned by the CRNM identified as a major trade objective the need to increase the flow of health tourists to the region by extending insurance coverage and by improving standards. The study recommended that international portability of insurance, and recognition of professional and hospital standards should be considered priority areas for discussion and future work. It further proposed that Caribbean countries may wish to examine the possibility of pursuing under GATS Art. VI. 4 the question of standards and portability of insurance as barriers to trade.

Priority actions at the CARIFORUM level to promote the tourism sector in services trade negotiations

The liberalisation of tourism inputs in CARIFORUM states

The CARIFORUM is both a consumer and provider of goods and services. The tourism product consists of many inputs including both publicly traded services – such as transport, electricity and water supply – and privately traded services, such as hotel and accommodation, catering services and visitor attraction services. The ability of a tourism destination to compete[53] internationally will depend on whether the entire range of these goods and services are provided efficiently and at low cost. This means that both the public and private sectors have a role to play in building competitiveness.

Compared with the global competition, CARIFORUM destinations – apart from the Dominican Republic – are now considered high-cost destinations. As the president of the Caribbean Development Bank recently stated, 'CARICOM destinations are pricing themselves out of the market'.[54] The industry would support further liberalisation in local infrastructure services, particularly electricity and telecommunications services, if this leads to these services being provided more efficiently and at lower cost. However, if privatisation leads to the replacement of a public monopoly with a private one, any benefit in terms of lower operating costs will be lost. In this regard, the economies of CARIFORUM may have a natural handicap given that small market size can result in limited competition – as CARIFORUM markets are not large or attractive enough to attract many service providers – and the continual presence of monopolies.

From a trade negotiating perspective, the CARIFORUM tourism sector would support further liberalisation in the following services, all of which are major inputs into the tourism product, if this leads to more efficient services at lower cost:

(i) **Electricity services:** The tourism private sector places particular importance on lowering utility costs, especially for electricity. It therefore supports further energy market liberalisation if it can reduce operating costs and improve the efficiency of supply.

(ii) **Telecommunications services:** The growing importance of internet bookings highlights the importance of low-cost telecommunications and internet services for the future development of the CARIFORUM tourism sector. Telecommunications liberalisation can reduce the costs to SMEs of providing services to foreign markets via online channels. The lack of a cost-competitive information and communication technology infrastructure to support the cross-border supply of services currently limits the Mode 1 supply of tourism services.

(iii) **Environmental services:** CARIFORUM negotiators should consider the full liberalisation of

environmental services market. Gaining access to higher quality and lower cost environmental services would help the industry attain its sustainable development objectives. The June 2002 Caribbean Tourism Strategic Plan spoke to the need to 'minimise the adverse impacts on the socio-cultural and natural environment and other touristic assets'.

(iv) **Insurance services:** There is a shortage of reinsurance capacity in the region, and the costs of property and liability insurance are extremely high for CARIFORUM hoteliers. A recent World Bank study[55] found that 'high insurance penetration and low quantities of risk transfer indicate that the prices of catastrophic insurance in the Caribbean region are high'. The same study also proposed a 'recommendation for public sector intervention' that 'restrictions on foreign insurance companies be eliminated'. CARIFORUM negotiators should consider whether further liberalisation will reduce the costs of insurance for the CARIFORUM tourism sector, and increase capacity.

Concerning goods, tariff reductions on the following tourism inputs have been identified as being of particular benefit in lowering hotel operating costs: furniture and linen, pasta, wines and spirits, bar and kitchen equipment (e.g. chillers and freezers) and specialty meats fish and shellfish.

Policy recommendations to support the growth of tourism

As a result of the consultations with public and private sector officials in CARIFORUM states and desk research conducted for this assignment, the following policy recommendations are proposed to promote the growth of tourism in CARIFORUM states.

(a) The development of a regional policy towards cruise tourism.

The costs and benefits of cruise tourism to CARIFORUM tourism economies is a highly divisive issue between, and among, the public and private sectors engaged in tourism. Many public sector officials – particularly those within the Port Authorities of CARIFORUM states – point to the upgrading of port facilities, paid for by passenger head taxes, as a key benefit of cruise tourism. However, one senior CARIFORUM tourism public sector official has emphasised that external trade negotiations should provide the stimulus for a regional policy on cruise ships. The aim of this policy should be to increase the collective bargaining power of destinations in the negotiations with cruise ships and to maximise on-shore expenditures by cruise ship passengers. It should also establish environmental standards for cruise operations, and mechanisms to increase the economic benefits of cruise activities to national economies. It is important to note that the proposal for a common regional passenger head tax,[56] as advocated by the Caribbean Association of Industry and Commerce (CAIC) and others, may not be feasible given that the costs of operating port facilities differs greatly from island to island. CARIFORUM trade negotiators could seek to raise this issue at COTED.

(b) The development of a regional definition for tourism, to be included within the CSME.

If CARIFORUM states are to be 'demandeurs' on tourism services in services trade negotiations, which they should be as the world's most tourism-dependent region, it is essential that they adopt a regional definition of tourism. This would assist tourism planning at the national and regional levels, but would also inform the positions on regional negotiators in all services trade negotiations. As previously noted in this report, the development of a regional tourism definition is an essential first step to achieving a wider definition of tourism under the GATS and in all other regional and hemispheric services negotiations. It is recommended that a regional tourism is developed rapidly, using the list of 'Tourism Characteristic Products' set out in the Annex to the GATS negotiating proposal entitled 'Draft Annex on Tourism' (S/CSS/W/107 of September 2001) submitted by the Dominican Republic and its co-sponsors. Those services – such as 'ski field operation services' – that are not relevant for CARIFORUM tourism should be omitted, and replaced by emphasis on cultural

events and heritage and other unique selling points for CARIFORUM tourism.

(c) The need to upgrade the statistical capacity of CARIFORUM member states to measure the impact of tourism on national economies.

An essential prerequisite for successful public policy planning on tourism, and participation in external trade negotiations on services, is the availability of accurate data on the impact of tourism on national economies. The statistics produced by the CTO are thorough and extensive, and focus on the movement of tourists and cruise passengers, occupancies and expenditures. The national statistical accounting systems do not accurately measure the impact of tourism on national economies: in many cases, tourism is not even disaggregated from general services statistics. The introduction of Tourism Satellite Accounts (TSA) would improve the understanding of tourism and its value to national economies. Without the upgrading of the regional statistical capacity for tourism, the industry will have to continue to rely on external research organisations, such as the WTTC, to provide this data. The introduction of the TSAs will also facilitate the agreement of a regional definition for tourism for the first time.

(d) The need to facilitate the movement of tourists within CARIFORUM, and of tourism professionals.

CARICOM nationals do not require a visa for travel for tourism purposes within the regional grouping. Even so, the development of the intra-regional tourism sub-sector would be facilitated if regional governments agreed to phase out travel levies and taxes on CARICOM nationals vacationing in other CARICOM states (see Box 12). Most CARICOM states currently have differential levels of departure taxes for CARICOM nationals and nationals from other tourist-generating countries. CARIFORUM/CARICOM governments should also consider the introduction of a single visa for international travellers. This would greatly facilitate multi-destination tourism or 'island-hopping' tourism within the region. In this regard, it should be noted that the regional private sector would support the introduction of streamlined visa and work permit procedures to facilitate the temporary entry of highly qualified tourism personnel into CARIFORUM markets.

(e) Tourism is not viewed as an export industry, and is not treated as such in national taxation policy.

There is still a reluctance to view tourism as an export industry in public policy planning in CARIFORUM states. The industry has emphasised that this is much more than just an esoteric discussion. They point to the fact that the tax burden of the tourism sector is far greater than any other economic sector. For policymakers, taxing travel and tourism is attractive because the bulk of the tax burden is perceived to fall on the shoulders of non-constituents, i.e. foreign tourists. However, the increase of the tax burden on tourism destinations can have a direct impact on competitiveness. UNCTAD (1998) noted that, 'Fiscal policy in many developing countries places a heavy tax burden on tourism service suppliers (particularly small and

Box 12. The 2002 ASEAN Regional Tourism Agreement: A model for CARIFORUM?

In November 2002, ASEAN (Association of South East Asian Nations) governments signed a Regional Tourism Agreement[57] which extended visa-exemption arrangements, harmonised visa procedures for international travellers, and put in place a timetable for the phasing out of travel levies and taxes on ASEAN nationals visiting other ASEAN member states. This comprehensive regional tourism agreement contains a range of policy measures to promote the growth of tourism in ASEAN states. Within the agreement, the ASEAN states – leading competitors of CARIFORUM destinations – emphasised the strategic importance of tourism as a means for accelerating the regional integration process.

medium-sized enterprises). While most governments provide for tax and duty drawback paid by exports of goods, this is usually not applied to exports of tourism services'.[58]

The issue of tourism taxation at the national level is outside the scope of this report unless foreign and domestic services suppliers are not similarly taxed (i.e. foreign suppliers do not receive 'national treatment'). But national taxation is essential in any discussions regarding the competitiveness of the CARIFORUM tourism sector. A recent World Bank study highlighted the price elasticity of tourism in the Caribbean, and emphasised that 'anything that makes an island more expensive relative to competition will lead to a substantial fall in total revenues'.[59] This report recommends that CARIFORUM governments consider making a commitment not to increase tourism taxation beyond current levels. This would greatly increase investor confidence in CARIFORUM tourism.

(f) How the design of the CSME limits the scope of negotiating requests on tourism services.

Finally, the design of the CSME may constrain the scope of CARIFORUM negotiating requests in two areas: proposals for disciplines to prevent anti-competitive disciplines in the tourism sector, and Mode 4 requests on the temporary exports of tourism services supplying nationals. Firstly, as noted previously in this study, CARIFORUM states will only be able to implement, in the regional market, any new multilateral disciplines regarding anti-competitive practices once a regional competition policy has been introduced. Secondly, the potential to increase the temporary export of hospitality labour to developed country markets may be limited due to the CSME provisions on the movement of natural persons. A recent study on the temporary movement of natural persons[60] concluded that Commonwealth countries would derive substantial economic benefits if developed counties liberalised the unskilled rather than the skilled end of their labour markets. The Protocol II provisions of the CSME have a bias towards qualified labour, and they aim to facilitate only the movement of qualified professionals with UWI qualifications. As a result, developed countries may seek to reject any CARIFORUM Mode 4 request to facilitate the temporary export of lesser skilled hospitality labour on the basis that CARIFORUM states do not permit this type of movement within their own regional integration process.

Actions to promote the tourism industry in services trade negotiations

Beyond pursuing the negotiating requests outlined previously, the following actions would serve to promote the interests of the tourism industry in services trade negotiations:

(a) Promote the tourism sector as a recipient of donor funded development assistance.

There has been a marked reluctance on the part of the donor community to embrace tourism as a means of addressing poverty alleviation and promoting sustainable economic development. This is partly due to concerns about the legitimacy of the sector as a recipient of public resources, particularly as the level of foreign ownership in the sector is so high. Given tourism's status as the leading source of income and employment in most CARIFORUM states, CARIFORUM negotiators should seek to negotiate specific provisions in all services trade negotiations that recognise the industry as a recipient of development assistance. The aim should be to negotiate specific funding facilities within EDF envelopes, and USAID and CIDA funding mechanisms. The CARIFORUM tourism sector urgently needs support to be targeted at the following areas: hospitality training and the upgrading of industry human resources; finance for the upgrading of hotels and tourism infrastructure; the enhancement of regional marketing programmes; and the encouragement of tourism's integration with the rest of CARIFORUM economies. In the case of the EPA negotiations with the EU, it is likely that substantial compensatory funds will be negotiated to support a transition away from traditional agriculture (e.g. sugar) to newer services industries. It is essential that regional negotiators position the tourism sector as a recipient of any EDF programmes aimed at restructuring and economic transition.

(b) Encourage a greater level of participation of both public and private sector in external trade negotiations on services.

In order to pursue the strategy outlined in this report, the increased involvement of both public and private sector tourism officials in external trade negotiations is required. A small trade negotiating committee could be established to include representatives from both CTO and CHA under the leadership of a senior CARIFORUM tourism minister to ensure that the interests of the regional tourism sector are adequately defended in all current external trade negotiations. That minister could be called upon to represent industry interests in formal negotiating fora as and when required.

(c) The inclusion of CARIFORUM tourism ministers in COTED discussions relating to services trade negotiations.

From an institutional perspective, it may also be necessary to facilitate the participation of tourism ministers in COTED meetings where discussions on services trade negotiations are scheduled. As tourism is now becoming an important issue on the region's trade negotiating agenda, it could be beneficial if tourism ministers and officials were party to COTED discussions on negotiations affecting the trade in services. Given the unique complexity of tourism as an economic sector, the successful participation in external trade negotiations on services will require inputs from both the trade and tourism ministries of CARIFORUM states. Finally, a further recommendation is that the ten-year Caribbean Tourism Strategic Plan for the tourism sector should be amended to include participation in international trade negotiations as an integral element of the achieving the sustainable growth of tourism in CARIFORUM states.

Areas where further research is required

Further consultation with the regional tourism sector is required to identify the areas where further research may be required. The following could be used as a basis for this consultation:

(i) Research into the costs and benefits of including air transport services in the services negotiations with the EU and Canada.

(ii) Research into whether trade negotiations on insurance services can be used to increase insurance capacity and reduce costs for the tourism industry.

(iii) A study on the competition policy issues affecting CARIFORUM tourism services suppliers within the regional market and in cross-border tourism services transactions.

(iv) The impact of external services negotiations on sustainable tourism development in the CARIFORUM region.

(v) Research into the hospitality labour markets of CARIFORUM states and OECD states for the purposes of negotiating Hospitality Service Providers Programmes.

(vi) An assessment of the impact of market consolidation of the EU, US and Canadian hospitality and airline sectors and its impact on the CARIFORUM tourism sector, including the competitive effects of this consolidation.

(vii) A study on internet marketing strategies to increase direct cross-border trade of CARIFORUM tourism services suppliers, particularly SMEs.

(viii) Research to tailor the GATS Model Request on Tourism and Travel Related Services to suit the specificity of the CARIFORUM tourism sectors.

Annex I

Model Request on Tourism and Travel Related Services

Proposal by [Bolivia, Cuba], Dominican Republic, [Ecuador, El Salvador, Guatemala, Honduras, MERCOSUR, Nicaragua, Panama, Peru, Venezuela] ...

The following request develops the proposals, concepts and ideas presented in the following documents:

(1) S/CSS/W/107, 'Draft Annex on Tourism' – Communication from Bolivia, Dominican Republic, Ecuador, El Salvador, Honduras, Nicaragua, Panama, Peru and Venezuela, dated 26 September 2001;

(2) S/CSS/W/122, 'Tourism and Travel Related Services' – Communication from Colombia, dated 27 November 2001;

(3) S/CSS/W/125, 'Tourism Services' – Communication from MERCOSUR,[61] dated 29 November 2001;

(4) S/CSS/W/128, 'Tourism Services' – Communication from Costa Rica, dated 30 November 2001; and

(5) S/C/W/149, 'Conclusions and Recommendations of the Expert Meeting on Tourism' – Communication from the Paradisus Group,[62] dated 23 May 2000.

The co-sponsors present a request for specific liberalization commitments and for the withdrawal of horizontal measures and MFN exemptions applicable to tourism and travel related services. Adoption by Members of this model request should serve to 'ensure the effective implementation of Articles IV and XIX:2' as provided for in paragraph 15 of the Guidelines and Procedures for the negotiations on Trade in Services, in order to increase the participation of developing countries in services trade.

Model Request on Tourism and Travel Related Services (continued)

As a mechanism for the effective implementation of Articles IV and XIX: 2 of the GATS.

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of naural persons

Sector or Sub sector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments
II. SECTOR-SPECIFIC COMMITMENTS. 9. TOURISM AND TRAVEL RELATED SERVICES.			
A. Hotels and restaurants (CPC 641-643)	(1), (2), (3), (4) None	(1), (2), (3), (4) None	Desiring to implement Articles IV and XIX:2 in order to facilitate the increasing participation of developing countries in trade, [Member] agrees to adopt these principles[1]: Strengthening the competitiveness of developing countries; Liberalization of market access for developing country suppliers; and Cooperation for the sustainable development of tourism.
B. Travel agencies and tour operator services (CPC 7471)	(1), (2), (3), (4) None	(1), (2), (3), (4) None	
C. Tourist guides services (CPC 7472)	(1), (2), (3), (4) None	(1), (2), (3), (4) None	
D. Other Fishing license services (CPC 91131) Hunting license services (CPC 91131) Spa services (CPC 97029)	(1), (2), (3), (4) None	(1), (2), (3), (4) None	

[1]A. Strengthening the competitiveness of developing countries

1. Prevention of anticompetitive practices

Adequate measures shall be adopted to prevent these practices in the tourism industries, to address, *inter alia*, the following:

(i) Discriminatory use of information networks, predatory pricing or the allocation of scarce resources;

(ii) Abuse of dominance through exclusivity clauses, refusal to deal, tied sales, quantity restrictions or vertical integration; and

(iii) Unfair use of information, including through travel warnings.

2. Access to technology

Members shall encourage the transfer of technology on commercial basis to firms in tourist destinations through joint ventures and other forms of partnership with foreign firms.

3. Small and Medium Enterprises

Members shall support positive measures to strengthen Small and Medium Enterprises and to further their participation in tourism originating markets.

B. Liberalization of market access to developing country suppliers

1. Horizontal commitments

Under horizontal commitments, Members:

(i) Withdraw measures affecting commercial presence in the tourism industries or make explicit reference that they *do not apply* to the tourism industries; and

(ii) Ensure that conditions for purchase, lease or use of real estate are not applied in such a manner as to nullify or impair the benefits accruing to any Member under the terms of specific commitments in tourism and travel related services.

2. Exceptions to Articles II.1

Members shall ensure that measures inconsistent with paragraph 1 of Article II of the GATS pertaining to the supply of tourism and travel related services and/or are of horizontal application *do not apply to tourism and travel related services.*

3. Specific Commitments

Members, in their specific commitments in tourism and travel related services:

(i) Shall not require compliance with economic needs tests;

(ii) Shall provide access on a commercial basis to computer reservation systems/global distribution systems according to transparent, reasonable and objective criteria;

(iii) Shall endeavor to ensure that their migration authorities facilitate the movement of tourists;

(iv) Shall not place limitations on the participation of foreign capital nor requirements to establish specific types of legal entities; and

(v) Shall facilitate the temporary entry of natural persons supplying services in this sector with respect to visa and temporary residency provisions. The competent authorities shall take account of professional qualifications related to tourism services acquired in the territory of another Member, on the basis of equivalency of education and using qualification recognition methods.

C. Co-operation for the Sustainable Development of Tourism

1. Financing

Members endorse and encourage the participation of developed and developing countries and their suppliers of network-related, business and environmental services in international, regional, sub-regional, bilateral and private financing programs in support of the sustainable development of tourism.

2. Trading conditions

Members shall ensure equitable and pro-competitive trading conditions for the sustainable development of tourism through the implementation of these commitments.

3. Standards

Members encourage compliance with environmental and quality standards applicable to the tourism industries, as established by relevant international organizations.

Annex II

The objectives of the 2002 Caribbean Tourism Strategic Plan (2002–2012)

i. Increase annual tourist expenditures by at least 5% per annum over the next 10 years.

ii. Increase stay-over arrivals by at least 1% above the world average growth as estimated by the World Tourism Organisation (WTO-OMT).

iii. Achieve the optimal rate of development of cruise tourism and increase the conversion of cruise tourists to stay-over tourists.

iv. Enhance the linkages between tourism and other sectors of the economy, in particular through increasing the purchases of supplies, services, food and beverage, etc by the cruise sector.

v. Increase the level and range of employment opportunities for Caribbean nationals in the industry and provide the requisite levels of tourism education and training.

vi. Improve the range and level of professional skills and so enhance the quality of service throughout all areas of the industry.

vii. Minimise the adverse impacts on the socio-cultural and natural environment and other tourism assets, while maximising the benefits to the wider community.

viii. Achieve the highest levels of technological expertise needed to compete in an information-driven industry in the information age.

ix. Improve return on investment both for private and public sectors.

x. Enhance the supporting infrastructure.

The Plan sets out a vision for Caribbean tourism to the year 2012: '*The further development of a Caribbean tourism industry that is fully understood and embraced by the peoples of the region and which, through co-operative action among Governments and with the private sector, makes a significant and sustainable contribution to development in both mature and emerging destinations*'.

The Plan was approved by the board of the Caribbean Tourism Organisation (CTO) in 2002. It has also been endorsed by the private sector Caribbean Hotel Association (CHA). CTO and CHA are currently in discussions to resolve outstanding questions regarding the Plan's marketing and funding elements.

Endnotes

1. Source: World Tourism Organisation, http://www.world-tourism.org/market_research
2. Source: *Caribbean Tourism Strategic Plan*, Revised Draft Report, June 10, 2002.
3. CTO Latest Statistics 2002. April 11, 2003.
4. CTO statistics for 2001.
5. Source: Belize Tourist Board. This figure compared to a 1.8% increase in tourist arrivals.
6. In late March 2003, the Government of Antigua and Barbuda requested WTO consultations with the US on proposed measures, contained in the 'Leach Bill', affecting the cross-border supply of gambling and betting services. The Bill would criminalise the use of financial instruments, such as credit and debit cards, for debts incurred in internet gambling. It would enable state and federal attorneys to request that injunctions be issued to any party, such as a financial institution or internet service provider, to prevent this type of crime. Officials in Antigua and Barbuda maintain that the Leach Bill, if adopted, could result in the closure of 40 internet casinos and some 800 job losses, as well as a loss of $2.2million in annual licensing fees. The dispute could escalate into the first ever WTO challenge under the GATS agreement. (*US threatened with WTO Dispute case over online gambling restrictions*, International Trade Daily, March 24, 2003L; *United States: Measures affecting the cross-border supply of gambling and betting services (Brought by Antigua and Barbuda)*: 27 March 2003, World Trade Organisation (WTO), WT/DS285/1 S/L/110).
7. Report on the ACS Consultative Committee on Multi-destination tourism in the Greater Caribbean, Port of Spain, Trinidad and Tobago, 27 February, 2003.
8. The hoteliers of one resort in the Dominican Republic, *Bayahibe*, have devised a collective negotiating strategy in response to pressure from tour operators to lower prices. They have agreed not to lower prices below specific rates. This collective approach to pricing is probably unique within CARIFORUM.
9. For a discussion of tour-operator-led tourism development, see *Competitividad del Turismo en Republica Dominicana*, Vial, Brown and Seward, August 2002.
10. *The changing structure of international trade in tourism services, the tour operator perspective*. Alain Flook, Secretary General of the International Federation of Tour Operators (IFTO). Presentation delivered to the WTO Symposium on Tourism Services, Geneva 22–23 February, 2001.
11. Ibid.
12. According to UNCTAD (1998) 'Leakages are a major obstacle to the positive contribution of tourism to development. Leakage is a process whereby part of the foreign exchange earnings generated by tourism, rather than being retained by tourist-receiving countries, is either retained by tourist-generating countries or remitted back to them. Leakages can take the form of profit, income, and royalty remittances; payments for the import of equipment, materials, and capital and consumer goods to cater for the needs of international tourists; the payment of foreign loans; various mechanisms for tax evasion; and overseas promotional expenditures'.
13. *Using Cluster-based Economic Strategy to minimise tourism leakages*, Golub, Hoiser and Woo, 2002. Paragraph 25. Paper prepared for World Tourism Organisation (WTO–OMT) Working Group on Liberalisation.
14. This has led to calls for the development of a regionally owned tour operator or wholesaler. However, serious doubts have been expressed about the viabiliry of this proposal.
15. According to ICAO, 'There were more than a dozen major CRS vendors in 1993, now there are only four mega-CRSs' (Source: ICAO presentation at WTO Symposium on Tourism Services, 22–23 February, 2001.)
16. The Tourism Satellite Account (TSA) attempts to measure tourism-related activity by determining what percentage of each industry is accounted for by tourism. Under the TSA, 'tourism characteristic products' are defined as those for which the level of consumption would be significantly reduced in the absence of tourists. Four intergovernmental organisations developed the standards contained in the Tourism Satellite Account or TSA: the United Nations; the World Tourism Organization; the Organisation for Economic Cooperation and Development (OECD) and the European Commission. The United Nations Statistical Commission approved the TSA on 1 March, 2000.
17. Article XIX of the GATS is titled 'Negotiation of Specific Commitments'. Paragraph 2 states that 'The process of liberalisation shall take place with due respect for national policy objectives and the level of development of individual Members, both overall and in individual sectors. There shall be appropriate flexibility for individual developing country Members for opening fewer sectors, liberalising fewer types of transactions, progressively extending market access in line with their development situation ...'
18. The 'positive list' approach to services liberalisation under the GATS is viewed by most developing countries as offering more flexibility in making commitments. Countries are free to make commitments in any services areas of interest to them, rather than having to make commitments in all services areas except those specifically excluded, as in the 'negative list' approach.
19. S/CSS/W/107 of September 26, 2001. Point 2.35.
20. There are already provisions on anti-competitive practices in two WTO Agreements: the 'Reference Paper on Telecommunications' and the TRIPS Agreement.
21. The 141 members of the World Tourism Organisation includes only three CARIFORUM states: Dominican Republic, Haiti and Jamaica. (Source: www.world-tourism.org/frameset/frame_members.html)
22. Source: IATA's (Richard Smithies) presentation on *Airline views on the proposed Tourism Annex to the GATS*, WTO Symposium on Tourism Services, 22-23 February, 2001.
23. *Passport to Progress: Competition Challenges for World Tourism and Global Anti-competitive Practices in Box 2 the Tourism Industry*, Francois Souty, 2002.
24. The text of the Convention establishing the Sustainable Tourism Zone of the Caribbean (STZC) can be located at www.acs-aec.org
25. *Latest Statistics 2002*, Caribbean Tourism Organisation, April 11, 2003.
26. See Ocean Conservancy report, Cruise Control, page 8. This issue is complicated by the fact that five CARIFORUM states currently offer flags of convenience: Antigua and Barbuda, Bahamas, Barbados, Belize and St Vincent and the Grenadines.
27. The consultant for this assignment did not have sight of all the confidential GATS negotiating requests presented to CARIFORUM WTO members. Hence, only the EC and US requests are discussed.
28. Source: *Programmes for Removal of Restrictions-Protocol II*, CARICOM Secretariat, 2002. It should be noted that this document does not contain all the restrictions currently applied within CARICOM. For example, Belize currently restricts tourist guide services for Belizean nationals, yet this is not included here.
29. The EU has left Mode 1 'unbound' for Hotels and Restaurants

because, according to the EU, 'a commitment on this mode of supply is not feasible'.

30. France places restrictions on European tour guides who are trained in other member states. The European Commission recently publicly stated that it believes the French restrictions contravene the rules for the freedom of movement in Europe
31. Further consideration is needed to assess whether this issue should be raised within the WTO discussions relating to 'credit' for autonomous services liberalisation.
32. The GATS Annex on Air Transport Services covers only aircraft repair and maintenance, computer reservations systems, and selling and marketing by airlines. The current GATS negotiations on Air Transport Services are taking place on these three issues. Some WTO members, such as the EU, have also been seeking to negotiate on two additional areas: ground-handling services and airport-management services.
33. *NAFTA Professional Job Series List*. USA Immigration Services website (www.uais.org)
34. A reciprocal recognition agreement already exists for all National Vocational Qualifications within the Commonwealth.
35. In May 2003, the European Commission extended its eco-labelling scheme to services, with tourist accommodation the first service sector for which ecological criteria has been developed.
36. EU Council Directive 90/314/EEC on Package Travel, Package Holidays and Package Tours.
37. *The Caribbean Tourism Health, Safety and Resource Conservation Project* established the QTC programme. It was a joint venture between the Caribbean Alliance for Sustainable Tourism (CAST), the Caribbean Epidemiological Centre (CAREC), and was funded by the Multilateral Investment Fund of the Inter American Development Bank (IDB/MIF), the Caribbean Development Bank (CDB), CAREC and CAST/CHA. The final report was presented in January 2003.
38. On April 8, 2003 Antigua and Barbuda signed a Tax Information Exchange Agreement with the US and became the latest CBERA country to be considered as part of the 'North American area' for the purposes of determining whether US taxpayers may deduct expenses incurred in attending conventions, business meetings and seminars. (http://www.ustreas.gov/press/releases/js165.htm).
39. *Understanding of Consumption abroad under GATS with respect to tourism*, Revised draft note prepared by the WTO/OMT Secretariat, Working Group on Liberalisation, January 2003.
40. *Concept Paper, Proposal for Revenue Sharing of Per Capita Ticket Tax on USA originating visitors to the Caribbean*, L. Miller, presented to the CARICOM Joint Meeting of Ministers of Finance and Tourism, 12 February, 2003, Port of Spain, Trinidad and Tobago. The CTO has proposed that revenue from US taxes should be re-directed to the region to fund the Caribbean Tourism Strategic Plan. The rationale for this proposal was that the total revenue to the US could actually increase if the reductions resulted in an increase in the number of persons travelling to the 31 CTO member states. No agreement has been reached between CHA and CTO on this issue.
41. *Travelling in Europe 2003*, European Commission.
42. US customs service website (http://www.customs.ustreas.gov/). Section on Duty Free Exemptions in *Know before you go! – online brochure*.
43. The 'Hotel and Catering Sector Panel' of the UK's Home Office concluded in their February 2002 meeting that there was a shortage of kitchen porters, waitresses and waiters, cleaners and chefs of all skill levels in the UK's hospitality sector.
44. According to the EU's list of MFN exemptions under the GATS, a similar programme exists for the EU hotel and catering sectors for seasonal workers from Russia, Ukraine, Belarus, Georgia and Mediterranean countries.
45. It has been suggested that the major hotel groups in the region should view training as a business offshoot. For example, if the agency placing the workers within such a programme was a subsidiary of a CARIFORUM hotel chain (e.g. Sandals), they could benefit as for each trainee accepted the placement agency would receive a commission.
46. *Where do illegal migrants work?* OECD Observer, 24 February, 2000.
47. Interview with Dr Guillermo Graglia, PUCMM, Santo Domingo, 2 May, 2003.
48. 'Travel warnings are bad for business', by Stephen Kalonzo Musyoka, Foreign and International Affairs Minister of Kenya, *The Spectator*, 7 June 2003.
49. In December 2002, the British government warned that Trinidad and Tobago was at increased risk of terrorist attack, prompting one cruise company to cancel visits.
50. In April 2003, the CHA signed a three-year co-operation agreement with the WTTC. As part of this agreement, the WTTC will produce a regional Tourism Satellite Account (TSA) for the Caribbean. EU member states are now implementing Tourism Satellite Accounts, with the Commission offering financial support to introduce TSAs (see Commission Communication to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, *Working Together for the Future of European Tourism*, and Brussels 13.11.2001 COM (2001) 665 Final.)
51. Telephone interview with William Tomlin, General Manager of CGM Insurance Brokers Ltd, 7 May, 2003.
52. *Health Tourism and Related Services: Caribbean development and international trade*, Gonzales, Brenzel and Sancho, 2001.
53. Two CARIFORUM states, Antigua and Barbuda and Grenada, currently rank among the bottom five tourism destinations in the Price Competitiveness Index of the World Tourism and Travel Council's (WTTC). This Index uses data and indices that include hotel price index, power parity index, adjusted consumer price index and taxes on goods and services.
54. *Some thoughts on tourism*, address by Dr Compton Bourne, president of the Caribbean Development Bank (CDB), 21 October, 2002.
55. 'Catastrophe Insurance Market in the Caribbean Region: Market Failures and Recommendations for Public Sector Interventions', P. Auffret, *World Bank Policy Research Working Paper 2963*, January 2003.
56. Earlier this year, Bermuda insisted that cruise operators hire more Caribbean nationals, contribute $1.5million to an education fund, introduce $50 vouchers to be distributed to every cruise passenger to be spent onshore on local businesses, and raise the passenger head tax to $60.
57. Source: ASEAN Tourism Agreement signed at Phnom Penh, Kingdom of Cambodia, 4 November, 2002.
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VII
Investment

27

A Southern Agenda on Investment? Promoting Development with Balanced Rights and Obligations for Investors, Host States and Home States

Howard Mann and Konrad von Moltke

Investment and development

The linkages between investment and development – and sustainable development – are so strong as to be self-evident. In a market economy, investment determines the pace, direction and strength of development. Countries with insufficient investment have little prospect of development; countries that are developing strongly are characterised by vigorous investment.

Foreign investment is a necessary part of the investment universe in most countries. Even in developing countries that are not as constrained by lack of capital as others (South Africa, for example) the entry of foreign investment is important because it brings in foreign investors and creates economic links with the global economy and with the economies of these investors' home countries. The resulting benefits have been documented extensively.[1]

Public authorities in most jurisdictions seek to attract investors, including foreign investors. Attracting investment has, however, proven to be an uncertain art. Based on extensive analysis, there is consensus concerning numerous necessary conditions to attract investors.[2]

Yet linkages between foreign direct investment (FDI) and development are less straightforward than might be supposed. More is not necessarily better, yet there are hardly any attempts to establish qualitative distinctions between investments, including FDI, which can be driven by various factors and can take many forms. The relative weight of these factors will vary according to the aims of the investor, and the financial aspects and circumstances of the host country, always seen in comparison to competing opportunities for investment. Investment can be market-seeking, designed to supply a market that cannot be as effectively supplied in any other manner; it can be resource-seeking, designed to capture certain natural resources that are not as available elsewhere; or it can be efficiency-seeking, utilising dimensions of a location's competitive advantage – wages, skilled labour, natural resources or access to transportation, for example.

Certain investments, in particular those that are resource-seeking or that have exceptionally elevated rates of return, may be made almost irrespective of issues of governance, while other investments, where returns are robust but comparatively uncertain, will not be made under any circumstances. There are jurisdictions that exhibit all the characteristics of good governance and attract no foreign investment, just as some jurisdictions with a reputation for poor governance still attract investment.

The number and variety of factors that influence FDI decisions are confusing and render any simple approach to foreign investment problematic. IIAs that promote investment that supports the development objectives of the host country must reflect the full range of factors in an appropriate manner.

Certain foreign investments may crowd out domestic investment, leaving the host country with additional external obligations but no measurable domestic benefits. Other investments, particularly in services, are likely to create balance-of-payments pressures, as foreign investors have a higher propensity to work with familiar (foreign) suppliers, thereby increasing imports without a corresponding increase in exports; and profits from service invest-

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ments additionally burden the balance of payments when they are repatriated, since there are no balancing exports to generate foreign currency.[3]

It is clear that development benefits associated with FDI do not accrue automatically. Not all FDI contributes to economic growth, and even FDI that contributes to growth may not support the development priorities of host countries. For this to change, developing countries believe that the linkage between FDI and development must be explicit and supported by policies that promote desired outcomes, even while they recognise the fundamental economic requirements associated with any investment. Such policies are not easy to craft and not easy to implement. IIAs should be specifically designed to support them.

The need for domestic policies to ensure that development benefits flow from FDI is further accentuated when seeking to promote sustainable development, which brings an additional set of policy priorities into play. It is nonetheless essential if there is to be any prospect of moving towards a more sustainable society.

Many of the required policies are within the scope of normal governmental activity in host countries; they do not depend on international agreements. There is, however, a continuing risk that international investment agreements can get in the way of necessary measures, in particular when they fail to explicitly recognise the need for such measures. Beyond this defensive concern there is the obvious desire to see international investment agreements make a positive contribution to development and sustainable development. This applies particularly in countries that lack some of the vital capabilities to determine the viability of FDI, for example institutional resources, sufficient information to make necessary decisions, the financial means to support such decisions when appropriate, or the legal and administrative tools to ensure that investments are sustainable in the local environment. Consequently, the challenge is to craft international investment agreements that promote a proper balance between investor rights and the sustainable development goals of host and home countries.

International investment agreements

More than 2,000 international investment agreements (IIAs) exist, yet their purpose remains singularly limited to protecting foreign investors while ignoring many other critical aspects of the relationships surrounding FDI.[4] Most of these agreements pursue this goal using absolute standards of treatment ('fair and equitable treatment' or 'expropriation') or relative standards ('national treatment' or 'most-favoured-nation treatment') to achieve this objective. They provide protection to investors after an investment has been made, particularly from expropriation and access to international investor–state dispute settlement. Promoters of these agreements have argued that the effect of such protection will be the promotion of additional investment between the parties but there is scant evidence to show that they have had a measurable effect.[5]

Some international investment agreements also include rules governing the pre-establishment phase of investments, imposing limits on the use of so-called performance requirements (specified actions required of foreign investors as a condition of authorising the establishment of an investment), and may even initiate a process of 'liberalisation' regarding the right to establishment, for example by identifying certain sectors in which foreigners may invest as of right. There is often an assumption that the list of covered sectors can be expanded through subsequent negotiation between the parties. In a few instances, the agreement will articulate the principle of free access (notably within the European Union), subject to a list of excluded sectors. It is worth noting that 'liberalisation' applies only to pre-establishment rules; post-establishment rules cover all investments that have been made between the parties while the agreement is in force, unless they are specifically limited or balanced by other public interests in an agreement.

Almost all IIAs include one or more parties that are developing countries. Yet few explicitly address the development aspirations of these countries in their statement of purpose.[6] No specific provisions designed to promote development have found widespread use. Freestanding IIAs do not mention sustainable development, a topic broached only

occasionally by trade agreements that include investment provisions.

IIAs that make no difference in terms of development or increased investment may be viewed as a harmless exercise in declaratory international relations. Indeed, there is evidence that at least some IIAs were concluded as an adjunct to some diplomatic event that required a formal outcome and the signing of an IIA appeared harmless when no other option was available. Investment is, however, too important to be the object of such practices. Even seemingly harmless agreements can produce undesirable results. Indeed, it is clear today that IIAs do have an impact, albeit not the one their authors may have intended.

Existing IIAs fail badly from the perspective of governance for globalisation. They inadequately frame the roles of the key actors in international investment – investors, host states and home states – as well as those of other stakeholders. They hinder the ability of developing countries to exercise some of their most fundamental rights, namely to identify development goals and to pursue public welfare by regulating economic activities. And they impact the capacity of all countries to promote and enact sustainable development policies and measures.

The stated purposes of IIAs are important. They help determine the standards by which an agreement and its impacts will be judged. In dispute settlement they provide arbitrators with guidelines for interpretation. More often than not today, the only stated purpose is investment protection and promotion, but substantive treaty provisions only deal with investor protection, leading arbitrators to give priority to this one goal. Frequently, however, a statement of purpose can be used to articulate longer term goals, some of which may currently be unattainable. This creates a framework for arbitrators and an incentive for negotiators to exercise caution and to create opportunities for (rather than obstacles to) subsequent adjustment of agreements to reflect an evolving understanding of what works and what does not.

Little empirical evidence has emerged to support the contention that the treaties that provide investor protection stimulate new and additional flows of foreign direct investment. There is no recognisable relationship between IIAs and investment flows. Some countries that are party to no IIAs receive significant international investment and many countries that are party to numerous IIAs receive almost none. Some countries are not party to investment agreements yet receive investment. Some countries that receive international investment are indeed party to IIAs, but the investment does not follow the pattern of agreements in any discernible manner.[7] This is hardly surprising, actually, given the number of factors that condition investment decisions but are not affected by existing IIAs. In practice these factors outweigh the impact of existing IIAs.

Development is undoubtedly the overriding purpose of developing countries in international economic policy. From a Southern perspective, investment agreements are undesirable if they do not support development. It is hard to argue that existing IIAs serve this priority.[8] The substantive provisions of the existing agreements give no visible consideration to the processes and dilemmas of development—or sustainable development for that matter. This is due in part to the uncertainties that surround efforts to ensure that investment promotes development. Yet traditional investment agreements continue to be pursued, and investment provisions are inserted in trade agreements.

No IIA by itself can ensure that host countries attain their development goals. That is hardly surprising once it is recognised that IIAs are primarily about international governance of investment in a globalised economy. Institutions of governance are designed to promote desirable outcomes, to avoid undesirable ones, and to ensure due process. They can rarely guarantee specific outcomes by themselves. There is a need for a regime for international investment that is characterised by equitable governance at all levels and that meets the most fundamental criteria of legitimacy, transparency and accountability.

Necessary conditions for investment for development

It is appropriate to focus first on what we do know, and that concerns conditions necessary to promote investment.[9]

Markets. Investments can only be made where there is a market for the products or services produced by the investment at prices that cover its costs and promise a reasonable profit. Without markets there should be no investment – and when investment occurs where there are no markets, it often signals the existence of some form of market distortion. These markets can be local, national or international. One of the major limitations of investment in certain public services, such as water supply and sanitation, is the inability of local markets to support the costs associated with making and upgrading those investments. Understanding markets and ensuring that they function in a satisfactory manner is important to promoting investment flows.

Labour. The availability of (skilled) labour is frequently critical for investment. The appropriate framing of this issue is one of the more challenging tasks of the sustainable development debate. On the one hand, low labour costs are a critical source of comparative advantage for producers in developing countries; on the other hand, it is important that fundamental labour rights are respected. Where skilled labour is not available locally, the ability to move qualified persons in and out of the host country becomes important, in addition to the need to control certain key appointments in relation to investments that are integrated into an international product chain.

Natural resources. Numerous foreign investments are made to ensure access to important natural resources. Indeed, certain resources are so critical that investments are made almost irrespective of conditions in the host country. Some investors have struggled with issues relating to sustainable development of natural resources and other issues such as respect for the rights of indigenous populations.[10]

Infrastructure. The existence of key infrastructure – transportation, communications, energy and environmental services, in particular – is critical to many investments, whether to produce goods or services. In some instances, such as the exploitation of natural resources, investors are willing to create necessary infrastructure as part of their overall investment.

Public institutions. Foreign investors are dependent on the institutions of governance of the host country. They need timely, impartial and effective administration of the rules and regulations governing their activities, including reviews and appeals. While the existence of good governance alone does not guarantee the flow of investments, all other things being equal, the quality of governance can have a decisive impact on investment decisions.

Private institutions. Investments do not exist in an institutional vacuum: they require a range of private institutions to provide necessary support, mostly in the form of services: banking, legal advice and insurance at a minimum and, often, technical support and other forms of consulting services. Investment risk rises rapidly in the absence of such institutions.

Not all of these conditions are controlled by public authorities in the host country. For this reason, as for many others, successful investment policies require an unprecedented level of public–private co-operation as well as the active engagement of public authorities in different countries and the existence of appropriate international organisations. Promoting national and international mechanisms to foster these conditions must be the ultimate objective of international investment agreements.

Investment can occur in the absence of one, and sometimes even of all, of the above conditions, but it is unlikely to do much to promote sustainable development. Investment in the extraction of natural resources may be determined by a single consideration, namely where the needed resources are located. All other considerations recede next to this self-evident requirement. Yet, in the absence of some of the above conditions, international investment in natural resource extraction is unlikely to contribute to the sustainable development of the host country, let alone the host jurisdiction within that country. Numerous examples of oil extraction in particular can be cited to illustrate this point.

This list also illustrates that investment is a complex phenomenon with significant implications for sustainable development. An adequate understanding of the full agenda on investment is a condition for fashioning successful international investment regimes.[11]

The pre-establishment phase

From the perspective of development, and of sustainable development in particular, the pre-establishment phase of productive long-term investment is critical. During this planning and preparation phase, key decisions are taken that determine the impact of an investment on a national economy, the environment and the community. Prospective investors articulate their goals and their activities. Depending on the size and nature of the investment, they require permissions and authorisations that can include the registration of a company (with the attendant rights and obligations, in particular in terms of hiring and taxes); permission to use certain public infrastructure such as roads and ports; and land use permits and environmental permits to use and discharge water, to emit wastes to the atmosphere or to otherwise manage the waste stream. In the case of large productive investments, each of these activities can have long-term implications for the local community and the environment. Entire ecosystems may be transformed, particularly by investments based on natural resources, and the prospects of a community to grow and prosper may be determined.

During the pre-establishment phase, the relationships between a prospective investor, the host country and the home country are likely to be more intense and entail more important decisions than at any other time in the life-cycle of an investment. In practice, a foreign investor is about to become an economic citizen of the host country. Just as countries have the right to accept or reject natural persons for citizenship, they need to be able to take considered decisions on the admission of economic citizens – because, once admitted, such citizens have rights that must be respected, not only because of international rules, but also on account of domestic legislation. In practice, this phase may entail a negotiation process and IIAs that create a right to invest – as some do – effectively shifting the balance between the investor and the host state in favour of the former, often eliminating controls a host state might use. In particular, applying the right to national treatment in a pre-establishment phase accords rights to foreign investors even though they have not yet become economic citizens of the host state.

Some IIAs that include national treatment in the pre-establishment phase use lists to limit its applications. These can be positive lists that identify covered sectors, or negative lists with sectors that are excluded. The effectiveness of such lists in protecting the right of host states to pursue their development priorities depends on the quality of information concerning possible future implications of a listing, and on the ability to change sectors once they have been listed in or out. The availability of such information may vary widely, with governments of many developing countries at a pronounced disadvantage for lack of adequate information. These are matters that require negotiation in an environment where information is equally distributed. None of these issues can be determined on the basis of economic principles, so that adequate solutions require a careful balancing of sometimes conflicting priorities. In this respect, investment negotiations bear little resemblance to trade negotiations where an optimum economic outcome can be calculated, even if it cannot be attained in practice.

The admission of productive foreign investment to a country, like the approval of any productive investment, involves a complex process that is designed to ensure that all relevant interests are taken into account. These procedures range from the registration and governance of an enterprise to numerous licences that authorise the use of resources or public facilities, from environmental impact assessment to provisions for health and safety. They are accompanied by appropriate procedural requirements concerning the provision of information, transparency and public participation. And they are subject to administrative appeal and judicial review. An IIA that risks short-circuiting these requirements in any way would be harmful, undermining the essential development of the institutions required to support these procedures in an open society.

Once an investment has been made, relationships between the principal stakeholders shift notably. The investor has acquired important rights, not only in terms of permissions and authorisations but also broader rights based on the investment and the commitments it entails.

It is consequently important to distinguish clearly between the pre-establishment phase and the remaining lifetime of an investment, a lifetime that can run to many decades. It can even last more than a century, as is the case when virgin forest is converted to agricultural uses. The pre-establishment phase should be designed to ensure that a proper balance is struck between the legitimate interests of (private) investors and the public goods their investment is likely to affect. This is a demanding task that requires extensive administrative resources. In many countries, it includes obligations to inform the public and opportunities for public participation when the impacts of a proposed investment are expected to be extensive.

Following this initial determination of rights and obligations of key stakeholders in an investment, the focus shifts to ensuring that all parties live up to their commitments and that the balance that has been established is maintained in an appropriate manner. It is also critical that this balance be adjusted to new economic developments and to new knowledge or changes in policy priorities in a manner that reflects standards of good governance.

From the perspective of IIAs and development, one of the most important decisions concerns whether the agreement is to cover the pre-establishment phase, and if so, what kinds of disciplines are envisaged. A range of models exists in this regard, including agreements that establish binding limits on the host country's government action in the pre-establishment phase; agreements that enunciate general principles governing the pre-establishment phase; and agreements that do not address the pre-establishment phase at all.[12] None of the agreements to date addresses issues of investor responsibility or the role of home-country governments in the pre-establishment phase, a significant gap from a Southern perspective.

The implications of these arguments for a Southern agenda on investment are clear. The starting position for Southern negotiators is likely to be a rejection of pre-establishment commitments. Should there nevertheless be negotiations on such commitments, they need to be articulated in a manner that is notably different from the approach to be found in most existing IIAs, recognising that decisions on the admission of investments can involve complex procedures in the host country, to which due deference must be given.

Re-thinking performance requirements

'Performance requirements' are obligations imposed upon an investor by host state public authorities. They are typically part of the pre-establishment negotiations conducted between a prospective investor and the relevant home-state authorities, but they can also arise in connection with re-authorisation or the granting of some advantage to an existing investment. A wide range of performance requirements have been identified but they fall into six broad categories: export performance; joint venture and equity ownership; research and development; technology transfer; employment and training; and other requirements such as local content requirements or the provision of surety in the form of bonds or otherwise.[13]

Performance requirements make an investor give undertakings to meet certain criteria that would presumably not be met based on market criteria alone – otherwise there would be no substantive reason to impose them. Consequently performance requirements are widely seen as imposing an economic burden or otherwise decreasing the economic efficiency of an investment. Yet the literature on the appropriateness of performance requirements is ambiguous. Empirical economic analysis has shown that performance requirements can work, presumably because the loss of economic efficiency is more than outweighed by gains in development and public welfare.

Performance requirements are subject to a range of disciplines in some IIAs, while others do not address them. Most importantly, the WTO Agreement on Trade Related Investment Measures (TRIMs) effectively prohibits local content requirements; trade-balancing requirements; foreign exchange restrictions related to the foreign-exchange inflows attributable to an enterprise; and export controls. As with all WTO agreements, implementation of the TRIMs Agreement is multi-unilateral: each member state interprets it individually, subject to the possibility of a dispute being initiated to contest

its interpretation. The TRIMs Agreement, however, provides only state–state dispute settlement through the WTO Dispute Settlement Understanding. Such disputes are relatively unlikely, in particular with respect to individual investments, since states will need to weigh their interests in such a dispute against a general prudence in taking recourse to dispute settlement in the WTO. No investor–state recourse is available within the WTO.

A much longer list of performance requirements is prohibited, conditioned or discouraged by some bilateral investment treaties (BITs) or regional agreements such as the North American Free Trade Agreement (NAFTA). These include requirements concerning the establishment of joint ventures or domestic equity; the location of facilities; employment requirements; export requirements; restrictions on the sale of goods in the jurisdiction where production is located; supply of goods or services; sole-source supply agreements; technology transfer; and research and development. Other performance requirements, such as the obligation to provide surety, are not restricted.

It has been argued that developed countries used many of the policy tools in their development process that IIAs now seek to prohibit for developing countries.[14] Even if this was the case, it does not follow that developing countries will benefit from using the same tools under the dramatically changed circumstances of the early twenty-first century with decolonisation complete and the emergence of a global economy. Nevertheless, the obverse does not hold either – there are no adequate grounds to decide that performance requirements in general are unacceptable.

Just as pertinent is the fact that developed countries use complex rules of origin to establish trade preferences, many of which are by now sanctioned by bilateral or regional trade agreements. These have the same economic effect as performance requirements. Rules of origin require that products must contain a specified percentage of locally produced content to receive the preferred tariff treatments set out in bilateral or regional free trade agreements. Rather than specify export performance, rules of origin limit imports. They act as local content requirements. They also create powerful incentives to invest in the local jurisdiction in question or to establish backwards linkages to other local economic actors. Seeking to achieve these effects through direct policy measures is, however, just what performance requirement prohibitions seek to proscribe.

Performance requirements impact on many of the development priorities a government may be pursuing when negotiating with an investor. They can help to stabilise a relationship that is, by its nature, subject to a wide range of disturbances that can emanate from any of the parties to the process. Consequently, many developing countries consider the right to use performance requirements to be of vital importance in ensuring that foreign investment contributes to their development priorities. At the very least, it appears questionable whether IIAs should prohibit such requirements since the determination of their appropriateness often depends on the specific circumstances of an investment rather than on general economic principles, and is consequently best left to the participants in that decision. Moreover, powerful market disciplines exist to establish boundary conditions for performance requirements: when host states overreach they lose investment.

This suggests that developing countries should not accept provisions in IIAs that limit their use of performance requirements, or should at least be exercising great caution in doing so.

Host-state rights and obligations

Most IIAs focus on investor rights and host-state obligations. The lack of consideration given to investor obligations has often been remarked upon. Yet there is also no visible effort to balance rights and obligations of host states, even though IIAs impact on both.

The most important of host-state rights – the right to regulate – is not in the gift of any investment agreement. It is an inherent element of the sovereignty of states. Indeed, regulation is a core function of a sovereign state, one that is untouched by debates concerning the appropriate form and degree of regulation that have raged in many developed countries for several decades. The right to reg-

ulate is so fundamental that it would be inappropriate for IIAs to address it as an exception to their own requirements.

It may be argued that the right to regulate does not need to be mentioned in IIAs. Yet IIAs impact on a host state's right to regulate, and it is imperative that these impacts be explicitly recognised and weighed and that drafters ensure that any limits imposed on this right are justified by commensurate benefits. That has not happened, leaving a situation where creeping limits are imposed on host states, often through dispute settlement procedures that themselves do not meet even the most elementary criteria of good governance.[15]

This stark statement of the current situation leaves an urgent need to ensure that limits placed directly or indirectly on the ability of host states to exercise their right to regulate are explicitly identified, precisely defined so as to limit the discretion of dispute panels, and fully justified.

Host-state's rights and obligations towards an investor, domestic or foreign, are in practice very extensive. The host state must adopt the full range of regulations that are designed to ensure that investors are accountable, that the impact of an investment on communities and the environment is acceptable, and that an investment contributes to public welfare through employment, taxes and in other ways. In practice, this involves the entire range of laws and regulations governing the conduct of business in the host country. At the same time, the host state must act in a manner that is legitimate, transparent and accountable and must protect the rights that investors and investments have acquired by virtue of investing in and conducting a business.

Most countries have elaborate legal and institutional arrangements to ensure a balance between investor rights and public welfare. All of these are potentially affected by IIAs as long as no provision is made to ensure that they are given due deference. These arrangements are robust, they continue to evolve, and they have withstood the test of time in developed countries. The situation in developing countries is different. Many developing countries have an incomplete institutional infrastructure to achieve the desirable balance. They seek to augment that infrastructure even as they seek to attract investors, both domestic and foreign, and many of the existing institutions have a limited history of dealing with major challenges. Developing countries that were previously colonised emerged from the colonial era almost devoid of indigenous institutions and of the human resources required to run, let alone to develop them. Lack of human and financial capacity continues to limit necessary institutional development in many cases.

It would seem almost self-evident that IIAs should contribute to the process of institutional development in developing countries. At the very least, they should not undermine it. Yet there is little in most existing IIAs that contributes to this goal. The approach of pre-emption that characterises many IIAs, that is the tendency to move disputes directly to the international level without providing for settlement in the host country, and without an expression of deference to the laws or institutions of the host country, may undermine efforts to achieve good governance domestically.

The unmet challenge is to devise international agreements that actually promote host-country institutional development. Presumably, this will require the elaboration of benchmarks that identify the degree to which host country institutional development meets international standards, and to link these to the specific provisions of the agreement itself. Countries that have adequate domestic institutions should largely be shielded from international interference. The goal here is not to create perfect institutions, but institutions that meet essential standards of good governance and that lead to results that appropriately reflect the interests of those who are affected by an investment. Countries that do not meet such standards should receive institutional assistance from the international level in a form that meets the same standards of process and outcome.

There is an astonishing degree of variation in the formulations that are to be found in existing IIAs, even among agreements signed by a single nation and even when expressing widely recognised principles such as national treatment, most-favoured-nation treatment, expropriation and minimum standards of treatment. This transfers the task

of determining whether such differences are meaningful to dispute settlement, and creates indeterminate scope for interpretation. It is likely that these variations do not reflect considered decisions, but are the result of indifferent negotiation of IIAs and a lack of public discussion of their purposes and how best to achieve them.

In addition, most IIAs fail to provide those responsible for dispute settlement with a reliable guide to negotiators' intent or with a framework for interpretation. By enunciating principles for non-discrimination and fair treatment of investors, but none for many other relevant dimensions of the investment process mentioned above, IIAs indicate that investor rights should be interpreted without reference to other priorities of development, let alone sustainable development.

It is important to ensure that the texts of investment agreements draw on a carefully developed vocabulary that can only be the result of extensive public analysis and debate. In practice, it is likely to require much more elaborate detailing of the intent and reach of rights and obligations that are created.

Investor rights and obligations

The focus of many IIAs is on investor rights; mention of investor obligations is rare. Yet an investment agreement that does not address investor obligations is manifestly incomplete.

Investor obligations are qualitatively different than host-state rights or obligations or investor rights. An international agreement between sovereign states that seeks to create specific investor obligations is in many ways problematic. International agreements are concluded between – and impose obligations on – states. Normally, they impose obligations on individuals only by obligating states to take all necessary measures to ensure that their citizens act in accordance with international agreements. Some international agreements, in particular those dealing with human rights, create rights for individuals and are moving to create direct obligations as well. Yet in the absence of enforcement by states, the enforcement of these rights through international institutions is exceedingly difficult.

By contrast, IIAs that create rights for investors move in an environment with few precedents. They have succeeded by subjecting the conduct of states to investor–state arbitration. They do not, however, take the next step and seek to create obligations for foreign investors.

A canon of investor rights has emerged from existing IIAs. They include a parallel to the non-discrimination approach that has served the trade regime well, that is 'national treatment', 'most-favoured-nation treatment', and dispute settlement. This approach, however, fails to adequately recognise the differences between the relatively straightforward trade context and the web of relationships created by an investment to the host community and to multiple levels of government. As a result, the emerging experience with the North American Free Trade Agreement (NAFTA) and with several bilateral treaty arbitrations where this approach has been put into practice has indicated that, seen through the prism of investor–state dispute settlement, none of these provisions is without problems.[16]

Other key investor rights have also not been without problems. The most critical of these have been the right to a minimum standard of treatment by host states and protection against expropriation without compensation. The former is emerging, at least under some arbitrations, as an international law standard of transparency and good governance that is being imposed on host states without any sense that this was the original intention based on the history of the provisions in this area. The latter has now been expanded to include claims to compensation for regulatory measures that impact the economic performance of an investment. This issue is returned to more specifically below.

To a significant degree these problems are attributable to lax drafting practices that many assumed were appropriate for agreements between states, with the implicit safeguard of sovereignty in the implementation process. No such safeguards exist, however, in the investor–state dispute settlement process and lack of precision in drafting can lead directly to undesirable outcomes.

From a developing country perspective, what seems more critical than the idea of investor rights is

the ability to generate sufficient clarity in the scope of these rights so as to ensure both the investor and the host state have the capacity to function properly and without undue fear or burdens. That said, there is a significant question as to the ability of any national treatment obligation to operate without unduly restricting developing-country policy space to promote development linkages from foreign investments.

Efforts to generate obligations, or at least responsibilities, for foreign investors have been made in the past, but have never succeeded in the way the creation of investor rights have. One reason is that the affected individuals have made their views known unambiguously and have acted forcefully to avoid the drafting of open-ended rules.

Negotiations on binding investor obligations have been extremely contentious. More than 20 years ago, the United Nations Conference on Trade and Development (UNCTAD) attempted to undertake this task through its United Nations Centre for Transnational Corporations (UNCTNC). The attempt attracted the overwhelming resistance of major transnational corporations and of the governments of countries where they were domiciled, and it failed amid recriminations.[17] The UNCTNC was shut down, a rare occurrence in international organisations, and UNCTAD's work on international investment was stunted for many years.

The definition of less-than-binding investor obligations has had a less contentious history. The Organisation for Economic Cooperation and Development (OECD) elaborated *Guidelines for Multinational Corporations* that have been successfully amended.[18] A growing number of other voluntary guidelines have been developed and, recently, the International Organisation for Standardisation (ISO) has begun to work towards the development of a standard in this area. None of these statements of investor obligations have been linked successfully to any international investment agreements.

Since the demise of UNCTNC, there have not been any attempts to develop an approach to investor obligations that takes the needs and priorities of host countries as their explicit point of departure. In practice, the challenge involves striking a proper balance between binding and voluntary elements in such provisions. Binding obligations can provide minimum-level protections for host states for such things as environmental assessments, human rights practices of foreign investors, anti-corruption requirements, and perhaps other minimal standards increasingly seen as critical from a sustainable development perspective. Voluntary elements can ensure that standards reflect actual business conditions and can evolve as what is generally accepted as good practice evolves.

None of the existing IIAs goes the obvious next step, namely to subject the conduct of investors to the rules and disciplines of dispute settlement. This goal can be achieved by making the obligations included in an IIA subject to domestic law and hence enforceable in domestic courts; by permitting state–investor arbitration; or by conditioning the access of investors to investor–state arbitration on a review of investor performance in relation to investor obligations, which can indeed be voluntary so as to ensure that they are appropriate to the size and nature of an investment. These obligations should also be sufficiently flexible to adjust to the changing understanding of appropriate investor practices. Additional depth for investor responsibilities can also come from the use of voluntary systems of standard-setting that involve the interested parties.

A further approach may be to ensure that investor performance with regard to a voluntary standard can become part of any investor–state (or state–investor) dispute settlement process. Investors may be given a choice of voluntary codes to adhere to and may be required to identify a code that they accept and the process by which their practices are being monitored, including the option of audits that report to corporate boards.

This is a debate that has not been pursued, leaving significant ambiguity concerning the expectations of host developing countries with respect to investor behaviour. Addressing this side of the investor–host state relationship for inclusion in IIAs has been raised expressly by developing countries such as China, India and Brazil, and is an increasingly prominent issue for civil society.

Home-state rights and obligations

Existing IIAs do not address home-state rights and obligations. Yet home states are indubitably stakeholders when it comes to foreign direct investment. The interests of home states are largely determined by their desire to ensure the security of their investors, who will in many instances be exporting capital from the home state and repatriating profits.

The rights of home states revolve around measures they may adopt to promote foreign investment and to help their investors manage the attendant risks, which are typically related to the movement of capital and the security of investments in the host state. This can involve investment promotion and various forms of insurance. While these can serve the interests of all parties – home state, host state and investor – it is essential that they be handled in a manner that is rules-based and transparent, a task that IIAs can help to accomplish.

The obligations of home states are more difficult to define. Home states may be expected to provide certain information, assist in combating corruption, and ensure that investor liability extends to the home state in an appropriate manner. An emerging problem is the use of 'home states of convenience' by investors who have no substantial activity in those states, with the potential to undermine the effectiveness of IIAs in much the way that flags of convenience render the control of shipping practices particularly difficult. Each of these areas presents challenges in terms of drafting and implementing IIAs that promote development in host states.

The problem of 'home states of convenience' can be resolved by making the designation of a home state a matter of mutual agreement between investor and host state, subject to certain principles that establish that an investor must have a material relationship to a designated home state. Such an approach can be decoupled from the legal, financial and tax considerations that frequently determine the place of incorporation for certain investments. This approach permits the development of more substantive provisions concerning home-state obligations.

Once it has been established that the investor has a material relationship with the home state it also becomes possible to draw on relevant information that may be available to home-state authorities concerning the investor and his or her operations. This is not a simple matter, since much relevant information is dispersed among home-state agencies and it is imperative to ensure that confidentiality is maintained throughout. Nevertheless, the home state may be able to provide important assistance to host states confronted with complex, technically demanding investments and lacking many resources that may be required to deal with them appropriately.

The problems of corruption are widely recognised. Yet combating corruption that involves international investment is particularly challenging since it requires commitment and effort on the part of all actors, investors, home states and host states. Home states may be needed to ensure, in particular, that investors publish information on payments they make to public authorities or their agents in host countries, and to make corruption by investors a criminal activity at home, even for acts taking place abroad.

Finally, home states have a role to play when their investors incur liability in the host states through actions that originated in the home state, or when those who are liable are out of reach of host-state authorities without assistance from home states.

It is striking to note that from the perspective of sustainable development, home states have a much more active and important role than is generally recognised by IIAs, or even discussed in the literature. The simple conclusion from the perspective of a Southern agenda is that many host states cannot respond appropriately to investment opportunities without the help of home states.

Dispute settlement

Dispute settlement is a key institution for the implementation of trade agreements, ensuring that the unilateral interpretation of the multilateral rules by each party is subject to review – and possible dispute – by all others. Dispute settlement in trade law is an exclusively state–state process.

Investment agreements are implemented in an entirely different manner. The primary, though not

the only, relationship for implementation is between the host state and the investor; hence state–state dispute settlement is unlikely to play a major role in the implementation of IIAs. This has led to the introduction of the investor–state dispute settlement process in IIAs.

International dispute settlement was originally designed to resolve specific instances of conflict between states and between private parties. It was not designed for disputes between private parties and states that require much more elaborate procedural safeguards to protect the rights of both parties. It was not designed to create a body of interpretation that could shift the balance of rights and obligations of parties to an agreement or of those affected by it. The absence of *stare decisis*, that is the assumption that no dispute would prejudice the handling of other disputes, was an essential tool in limiting the functions of dispute settlement. Absent *stare decisis*, there was also no need to establish an independent international judiciary, to ensure that decisions were publicly available, or to foster a culture of analysis and discussion to ensure that mistakes could be identified and ultimately corrected. Yet investment dispute settlement has now embarked on a course that effectively assigns dispute panels an active role in implementation and interpretation without any of the institutions of good governance that are essential to such an undertaking in other jurisdictions.

For many years, there were not many investor–state disputes (or at least few became known, since there was, and is, no publicly available source to monitor all such disputes). Investor–state dispute settlement did not attract much attention, but then neither did IIAs. Problems with investor–state dispute settlement have only emerged since investment agreements became a contentious issue about 10 years ago. These problems concern less the principle of investor–state disputes – which reflects the problem structure of IIAs in a compelling manner – than the appropriateness of the institutions involved and whether the text of IIAs provide sufficient guidance to the dispute settlement process to ensure that it does not lead to unacceptable results. By now the number and seriousness of the concerns about investor–state dispute settlement are so significant that they fester like an open wound. Fortunately, there are solutions to most of these concerns. Central to any Southern agenda on investment is a requirement to ensure that the approach to dispute settlement is fully revisited.

There is no compelling reason why review of an investor's claims against a state cannot be undertaken by the institutions of the state in question – provided these are independent of the public authority that is in dispute and discharge their duties in accordance with basic principles of good governance, including an independent judiciary. This is the approach outlined in GATS Article VI on domestic regulation of services. International investor–state dispute settlement is only needed when this process fails and an investor suffers serious damage without adequate recourse.

Unfortunately, there is little indication in the texts of IIAs that negotiators have acted with prudence to promote better domestic dispute settlement in the host state or to ensure that international processes respect basic principles of good governance. The result has been that the vagaries of investor–state dispute settlement have become such that prudent administrators may now avoid the most legitimate of actions to minimise the chances of being caught up in such a dispute, a phenomenon known as regulatory chill. This highly undesirable outcome is the result of IIAs that have only addressed a limited part of the agenda associated with international investment and that are inadequately drafted; and of shortcomings of dispute settlement institutions. No agreement that fails to confront these problems comprehensively can be expected to address the needs of developing countries.

The shortcomings in drafting described earlier in relation to the articulation of investor rights are compounded by the inadequacies of the arrangements for dispute settlement. Existing dispute settlement institutions were not designed to address the complex issues of public policy that now routinely come into play in investor–state disputes. They were created at a time when there was little international investment, few international investment agreements and scant discussion of what the appropriate rules for a globalised economy might look

like. Indeed, the concept of globalisation itself had not yet been articulated. It is, consequently, hardly surprising that the investor–state dispute settlement process is characterised by a lack of transparency and suffers from structural conflicts of interest. In response to criticism, some modest changes have occurred in some of the available dispute-settlement institutions. Disputes filed with the International Centre for the Settlement of Investment Disputes (ICSID), which is closely linked to the World Bank, are now listed on a publicly available register. An arbitral panel (operating under rules of the United Nations Commission on International Trade Law, UNCITRAL) has accepted *amicus curiae* briefs. And arguments in some cases have been made in public. This is at best a beginning.

Solutions to the issues of dispute settlement are available. They include more transparency; selection of arbitrators in a neutral manner rather than by the parties; proper deference to domestic dispute-settlement procedures; clear separation of the functions of arbitrator and advocate; and the introduction of an appellate process. Most of these changes by now appear inescapable. The precise manner in which these steps are taken must be the outcome of analysis, debate and proper negotiations, in which developing countries participate.

These issues far transcend the needs of a Southern agenda on investment, reflecting matters that should be of concern to all governments. Yet developing country host states are more affected by them than any other actors in the investment process by the simple fact of the number of arbitration claims they face, and will continue to face into the future. While these problems need to be addressed in the interests of everybody concerned with governance of the global economy, they are of overriding concern for developing countries.

Monitoring results

It is important to identify the anticipated results of any international agreement that deals with investment. Otherwise there is no standard against which to assess its effectiveness. And it is necessary to monitor actual outcomes in light of projected results.

Economic theory indicates that liberalisation of trade will generate benefits almost automatically, although it says nothing about the distribution of these benefits. No similar conclusions apply to either the liberalisation of investment or the introduction of new rules to promote investment or to ensure adequate international governance of investment. Indeed, most existing investment agreements are characterised by a substantial degree of uncertainty concerning their practical consequences. It is, consequently, essential to monitor international investments and the impact of IIAs to ensure that lessons can be learned from experience in a timely manner and to identify further steps that can be taken to improve effectiveness. It is striking that the single most important factor among the many economic drivers of globalisation – investment – has no single international institutional focal point.

Most current information on international investment is quantitative. International investment flows and stocks have been assessed regularly for many years.[19] Yet qualitative information is exceedingly hard to come by, in particular qualitative information that is systematic and covers most countries. Indeed, there is not even much agreement on the criteria to apply in gathering such information. The place to start is the articulation of widely accepted, carefully negotiated purposes for international investment agreements.

Monitoring the results of investment agreements requires an institutional and organisational framework that is capable of undertaking such a task – and that is subject to the same principles of governance as investment, that is it is legitimate, transparent and accountable. In practice this implies robust institutional means and an organisational structure that reflects the needs of all actors in international investment. While it is possible to identify some of the necessary elements of such an institutional framework for international investment – and existing international organisations such as the United Nations Conference on Trade and Development and the World Bank provide some elements – its final shape must be the product of careful negotiation.

Institutions and funding for investment agreements

It is difficult to overstate the uncertainties associated with governance for international investment, in particular when the primary focus is the development of a Southern agenda. All governance concerning investment must originate at the national level. Hence the first priority is to find ways to strengthen national investment governance.

The relationships among investment actors at the international level are poorly developed. These relationships need to be explored over time and the appropriate institutional responses must be identified. The ultimate goal is a robust, legitimate, transparent and accountable system of international governance for investment that takes full account of the development priorities of developing countries. This can only be the result of a process that extends over a period of years and is constructed to permit learning and adjustment as greater understanding of the specific requirements is developed. The principal task of an international agreement on investment that reflects the needs of sustainable development is consequently to articulate the general principles that are to apply, to put in place an initial set of measures, and to establish procedures that permit the dynamic adjustment of the regime over time.

IIAs are constructed like trade agreements on the assumption that they are largely self-executing and that their benefits are automatic. Yet investment promotion, a frequently articulated goal of IIAs, let alone the promotion of sustainable investments, requires a greater degree of institutional capacity, and must be supported by funding.

Investment involves case-by-case decisions for investors as well as public authorities. While some investments occur in accordance with well-established practices and consequently require little or no discretionary action, other investments engender long and complex decision-making processes for investor and host state. The institutional capabilities of both parties – and the ability to take into consideration additional concerns of other stakeholders – are of critical importance. While most of these institutions will be domestically based, some may involve other countries in regional co-operation, and some may engage international organisations in a variety of ways, including the World Bank and the International Finance Corporation (IFC). IIAs must contribute to institutional development and the proper functioning of these processes, and not only by means of dispute settlement when one party believes they have gone wrong.

The institutional needs for this purpose at the international level are not all currently known. Some have been developed by the World Bank Group but now need to better reflect the interests of all countries concerned than the governance structure of the World Bank will ever permit. Some can be derived from existing models, in particular in the areas of trade policy and international environmental management. Some will need to be developed step by step as needs are recognised and institutions are fitted to these needs. The implications for IIAs are relatively clear: they must have the flexibility to respond to new institutional needs as they arise.

The broader question of funding in support of investment (in particular foreign investment) to countries that currently receive less than might be expected in light of their needs and the prevailing conditions, poses numerous dilemmas. Again, the World Bank Group has long played a role in this area, but the need to repay World Bank loans renders them less suited to institutional development and capacity building, since neither activity is liable to generate a revenue stream capable of amortising a loan. The ability of the International Finance Corporation (IFC) to participate in investments – and to hold equity stakes – represents one important avenue for improving the ability of least-developed countries to attract investment. Yet the crucial issues of institutional development and capacity building remain unresolved, in addition to the issues surrounding World Bank governance.

A robust international regime for investment needs to be able to generate funds to support institutional development, to undertake capacity building and to improve key factors that may influence investment decisions. These funds must be governed in an equitable manner by all the countries that participate in a particular regime, reflecting both the ability to provide capital and some criteria of need.[20]

Conclusions

Existing IIAs have not been designed to meet the development needs of developing countries, let alone to promote sustainable development globally. To pursue these goals, future investment agreements will need to exhibit a number of critical characteristics:

- Recognise that an investment agreement is fundamentally about good governance to ensure that investor rights and public goods are protected in a manner that is legitimate, transparent and accountable.
- Apply basic standards of good governance to the international agreement itself.
- Establish a clear purpose or objective for the international agreement: to create an approach to international investment that respects the aspirations of developing countries and promotes global sustainable development.
- Contain clear provisions that balance investor rights with investor obligations, and with host and home-state rights and obligations.
- Set out specific proposals to fix what is currently a broken investor–state dispute settlement system.
- Include an approach to investor obligations that strikes a balance between voluntary and binding elements.
- Provide an institutional framework that ensures monitoring of its progress as an instrument of development, promoting learning from its errors and creating a foundation for future improvements.

Investment is central to any attempt to promote sustainable development. It is hard to conceive of a global economy without a robust, creative and transparent set of rules for investment. A bold new approach will set an agenda to improve the international investment climate and to advance sustainable development, giving greater certainty to investors faced with demands from many stakeholders and rewarding companies that already follow good practice.

Endnotes

1. See United Nations Conference on Trade and Development (UNCTAD), World Investment Report (annual), UNCTAD, Geneva.
2. UNCTAD (2004) *Incentives*. UNCTAD Series on Issues in International Investment Agreements, UNCTAD, Geneva.
3. For details, see the SAI case studies on Argentina (www.iisd.org/pdf/2004/investment_country_report_argentina.pdf) and Brazil (www.iisd.org/pdf/2004/investment_country_report_brazil.pdf).
4. This generally includes bilateral investment treaties (BITs), bilateral, regional and inter-regional trade agreements that include investment provisions, and multilateral investment agreements. Agreements on trade in services include investment provisions as well.
5. Mary Hallward-Driemer, (2003) *Do Bilateral Investment Treaties Attract FDI? Only a bit ... and they could bite*, World Bank, June, http://econ.worldbank.org/files/29143_wps3121.pdf. For an alternative view, see Jeswald Salacuse and Nicholas P. Sullivan (2005) 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain', *Harvard International Law Journal*, Vol. 46, No. 1 (Winter 2005), pp. 67–130. The focus of this paper is, however, on US BITs, including NAFTA and a US–China BIT so they are highly particular.
6. Luke Eric Peterson (2004) *Bilateral Investment Treaties and Development Policy-Making*, International Institute for Sustainable Development (IISD), Winnipeg, MB, p. 4: '– the author's experience of examining more than 150 [bilateral investment] treaties ... suggests that references to development are exceedingly rare in treaties pushed by a number of Western governments with developing countries'.
7. Salacuse, Hallward-Dreimer (see note 5).
8. See Luke Eric Peterson, Bilateral Investment Treaties (see note 6).
9. V.N. Balasubramanyam, 'Foreign Direct Investment in Developing Countries: Determinants and Impacts', paper prepared for OECD Global Forum on International Investment, Mexico City, Nov. 26–27, 2001, p.13.
10. See Mining, Minerals and Sustainable Development at www.iied.org/mmsd/finalreport.
11. United Nations Economic Commission for Latin America and the Caribbean (ECLAC), Preliminary Version of the Foreign Investment in Latin America and the Caribbean 2005, ECLAC, Santiago., Maurice W. Schiff and L. Alan Winters (2003), *Regional Integration and Development*, Oxford University Press, New York. See also the *World Bank Investment Climate Surveys* at http://rru.worldbank.org/InvestmentClimate/
12. The WTO General Agreement on Trade in Services (GATS) establishes most-favoured-nation treatment in Article 2 as a general obligation, subject to possible negative listing. It also includes a range of pre-establishment provisions that apply when a country has made commitments on specific sectors and specific modes of supply of services. As a rule, the country will have opened its market to service suppliers in the committed areas on a national treatment basis.
13. UNCTAD (2003) Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries, UNCTAD, Geneva.
14. Ha-Joon Chang, Kicking Away the Ladder. Development Strategy in Historical Perspective, Anthem Press, London.
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www.iisd.org/publications/publication.asp?pno=627.
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17. UNCTNC, 'Draft United Nations Code of Conduct on Transnational Corporations,' in UNCTAD, *International Investment Agreements. A Compendium*, Vol. 1: Multilateral Instruments, United Nations, New York.
18. OECD (2000) *OECD Guidelines for Multinational Enterprises: Text, Commentaries and Clarifications*, OECD, Paris. www.olis.oecd.org/olis/2000doc.nsf/LinkTo/daffe-ime(2000)20
19. Annual reports on investment are published by UNCTAD and by some of the UN regional commissions.
20. The governance structure of the Global Environment Facility, which requires double majorities for formal decisions, may offer useful lessons.

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The European Investment Bank and the ACP Countries: An Effective Partnership?

Sacha Silva

Introduction

The EU–ACP partnership is one of the most crucial in North–South relations, in both country coverage and the aggregate amounts of bilateral aid changing hands. The European Commission has become the world's fifth largest donor of development aid. EC resources for development come from three sources: the EU budget for non-ACP countries, the European Development Fund (EDF) for the 77 African, Caribbean and Pacific (ACP) states, and the European Investment Bank (EIB).

In 2002, the EU budget and the EDF contributed €6.5 billion to their various development partnerships, of which a large share (€2.4 billion) went to the ACP states. Together with aid from its member states the EU provides more than 50% of all aid going to ACP countries. Although the demands of EU accession in Central and Eastern Europe meant that ACP countries are no longer the primary beneficiaries of EU aid, the absolute amount of EU–ACP aid has increased substantially since the Yaoundé and Lomé conventions. The first Financial Protocol of their successor, the Cotonou Agreement, is for €15.2 billion over the five-year period.

The EIB is becoming an increasingly important actor in the provision of EU aid to ACP countries. The EDF remains the primary vehicle for EU aid to ACP countries, but its funding is largely grant-based, requiring constant donor replenishment,[1] and often focused on grants to the public sector. The EIB's co-financing requirements and syndication instruments means that its financial impact can spread beyond its relatively smaller allocation. The Cotonou Agreement contains substantial language oriented towards private-sector development, intended in part to recognise the important role of markets and the private sector as a primary engine of economic growth – a major break with the 25 years of Lomé co-operation that were marked by exclusive government-to-government relations (ECDPM, 2001). The EIB's comparative advantage in financing private-sector investment implies that it is uniquely poised within the subset of European institutions to play a larger role in EU–ACP relations.

The EIB lends more than any other multilateral institution yet has so far operated under relatively little external scrutiny. Due to its expanding mandate under Cotonou, however, a systematic study of the EIB's mandates and instruments is in the interest of ACP countries. This chapter is a contribution to this study. Its scope is necessarily limited by the lack of publicly available information on the EIB's activities and the noted reluctance of many EIB officials to disclose such data (see later section 'Reforming the EIB–ACP investment nexus'). The study is intended to be a starting point for future work on the EIB and to provide some initial analysis of its roles, functions and utility for ACP investment.

The next section outlines the EIB's role in the provision of EU aid to ACP countries, followed by a brief historical overview of the EIB's performance under the Lomé conventions. The EIB's mandate under Cotonou and the instruments available for ACP investment is outlined, while the final sections proposes enhancements to the EIB's role as a catalyst for ACP investment.

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The EIB and EU development aid

A 'policy-driven public bank'?

Founded in 1958 by the Treaty of Rome, the EIB is the official financing institution of the EU, owned by its member states. The institution views itself as a 'policy-driven public bank' (EIB, 2003), and its lending guidelines are set accordingly. Its mandate states that it should serve to function as a European financial institution towards the promotion of a 'balanced and steady development of the Common market in the interest of the Community'. The EIB's principal task is to fund investment within the European Union, but it also operates in more than 120 countries in the framework of external cooperation and development policies of the EU. As such the EIB can be considered as the EU's 'development bank', performing similar functions to other IFIs such as the World Bank Group. It is the largest institution of its kind in the world (measured by volume of annual financing activity), with lending activities in developing countries stretching back nearly 40 years. By end-2001, the EIB has provided over €7 billion to the ACP and Overseas Countries and Territories (OCT) regions (EIB, 2002).

Despite its size and central role in EU external financing, the EIB's mandate in developing countries is unclear. This is due in part to its autonomous legal status, accorded by article 266 of the EC Treaty. The EIB has often argued that it serves a dual purpose (EIB, 2003); that of a bank and an EU institution. Yet within EU documentation, it is not named as an institution with a legislative or enforcement task. However, it is legally bound to act within the limits of the EC Treaty. Recently, NGOs have seized upon this ambiguity to address perceived shortfalls in corporate governance and social/economic standards in the EIB's operations. This chapter will address these issues briefly in later sections.[2]

From a development perspective, what is most relevant is that while the Bank's legal personality and financial autonomy are specified in the EC Treaty, policymaking autonomy is not. While the EIB is endowed with its own decision-making bodies, its freedom to manoeuvre is limited by EC decision-making. These policies often take the form of external mandates to lend from the EIB's own resources with a Community or member states guarantee, or from grant resources provided by the EC or member states (known as risk capital operations). Thus the EIB is called upon by the EC to further its development policy objectives in partner countries. However, this somewhat derivative approach to the EIB's development financing has raised concerns with several observers. A recent DFID report (DFID, 2000) noted that:

> *'The Bank manages its external lending operations according to certain broad principles. Foremost among these is the principle that external lending conforms to the EU's overall development strategy. However, there is no agreed statement setting out how the Bank's proposed activities will contribute to the EU's international development aims and external regulations. There is a need for a clear set of objectives together with associated performance indicators. Without these it is difficult to judge the effectiveness of the Bank's operations and whether it makes good use of the grant resources it receives from the EU... The Bank defines the concept of value-added in very broad terms, without differentiating effectively between internal and external lending. Lending under the mandates is intended to support the EU's development objectives, and associated budget resources (including backing for member state guarantees) are classed as development assistance. So the objectives and impact of external lending need to be defined in developmental terms. This requires assessment of the economic, financial, environmental and social impact of projects.'*

The DFID report noted that that the EIB's lack of specific mandates for development, low staff-to-disbursements ratio compared to other IFIs, heavily centralised structure and little presence on the ground in developing countries meant that 'insufficient consideration is given to whether the intervention is developmentally sound'. The DFID report goes on to say that the EIB is 'fundamentally a project-based institution': it does not prepare its own country or sector strategies, instead often relying on those prepared by the EC and its country delegations.

This situation may arise for several reasons. The first is that the EIB operates within an often convoluted and overlapping institutional architecture for

EU aid delivery. The EIB intervenes in tandem with a number of EU bodies, such as DG Development, DG Trade, PROINVEST, and CDE whose mandates also extend to developing countries and especially the ACP region. This renders any direct comparison between the EIB and other multilateral lenders difficult, since institutional instruments, capacity and mandates vary considerably across the board. Given recent developments such as the creation of a single implementing office for aid, EuropeAid, and the deconcentration of authority to developing-country delegations, any evaluation of the aggregate impact of EIB interventions – especially individual project loans – is increasingly complex. Moreover, within this institutional framework, the EIB's lending is a relatively small share – as seen in Table 1, EDF allocations dwarf those of the EIB.

The second possible reason is that the EIB's lending to ACP countries is in turn a small share of its own portfolio. As mentioned earlier, EIB priorities reflect those of the EU, of which relations with developing countries (especially far-off ACP regions) rank, by revealed preference, a distant fourth on the list. The EIB's lending to the ACP region is a small fraction of its total portfolio. Of the €42.3 billion in loans signed in 2003:

- €34.2 billion went to the EU-15;
- €4.6 billion went to the CEE accession states;
- €2.1 billion went to the Mediterranean Partner Countries;
- €372 million went to Balkan states;
- €348 million went to Asia and Latin America; and
- €723 million (1.7% of total lending) went to the ACP and OCT states, of which €260 million went to South Africa (EIB, 2003).

The third and more likely reason lies in the commercial nature of the EIB's operations. The EIB's operations within the EU, as seen above, are the lion's share of total lending. The higher grade client base and the EIB's relationship with EU banks implies that its operations within the EU are akin to that of an investment bank. This more commercial portfolio (compared to other IFIs) exerts a powerful influence on the EIB's internal guidelines shaping transparency, lending criteria, portfolio balance, and institutional structure. The EIB guidelines and institutional structure have created a unique 'lean and mean' business model that allows for relatively decentralised and streamlined operations with a minimal amount of staff.

However, the EIB's remit includes the financial co-operation protocols of the ACP–EU mandate. This gives it an external role more in common with the multilateral development banks, who have a very different structure. Reviews of the EIB's lending operations in ACP countries have raised legitimate and pressing concerns regarding the suitability of the EIB's lending toolkit for the economic prospects of its clients in the ACP region.

Table 1. EU aid to ACP countries (ECU/€ million)

	Lomé I	Lomé II	Lomé III	Lomé IV		Cotonou
	1975–80	1980–85	1985–90	1990–95	1995–2000	2000–07
EDF	3,072	4,724	7,400	10,800	12,967	13,500
Grants	2,150	2,999	4,860	7,995	9,592	–
Special loans	446	525	600	–	–	
Risk capital	99	284	600	825	1,000	
Stabex	377	634	925	1,500	1,800	–
Sysmin	–	282	415	480	575	–
EIB	390	685	1,100	1,200	1,658	1,700
Total[a]	**3,462**	**5,409**	**8,500**	**12,000**	**14,625**	**15,200**

Source: Wolf and Spoden (2000)

[a]Excluding OCT (200 ECU million, of which 165 million is through EDF and 35 million through EIB).

Despite the EIB's low institutional weight in EU–ACP financing and the small ACP share of its total lending, there are several pressing reasons to reform the EIB–ACP investment nexus. First, investments that are 'small' from the EIB's perspective can certainly have large impacts in small economies that dominate the ACP membership. Second, one of the EIB's strengths is its ability to use its lending to lever in additional finance, and facilitate access to the international market for countries and enterprises that would not otherwise be able to gain access to loans. This implies that in ACP countries the actual development impact of the EIB's interventions may be several orders of magnitude larger than the nominal disbursement of individual loans.

Third, as noted in the introduction to this paper, the EIB through the language of the Cotonou Agreement is poised to play a larger role in ACP–EU negotiations. Although EIB allocations will most likely remain subordinate to those of the EDF, the larger development role accorded to the private sector in Cotonou instruments implies a greater EIB role and by extension greater consideration for its potential impact. Lastly, the recent emphasis on enhancing aid effectiveness at other IFIs includes greater co-ordination and coherence among donors to reduce the burden on aid recipients and allow for clearer evaluation of development targets. The fact that the EIB operates within overlapping institutional frameworks implies that greater formal co-ordination and accountability for outcomes is required, not less. While EIB lending based on an external mandate may not be a problem *per se*, a lack of clear, publicly available documents linking specific EIB activities and broader EU development targets is a cause for concern.

Evaluating EIB operations under Lomé

Under the successive Lomé Conventions, projects or programmes were financed by grant or risk capital from the EDF or by loans from the EIB.[3] Risk capital for investment financing was used to assist the implementation of directly productive investment, both public and private, in order to contribute to the economic and industrial development of the ACP states (Article 263 of the Lomé IV Convention). The main guideline for the EIB's interventions in the area of risk capital operations is to be found in Article 236 of the Lomé IV Convention, stipulating that the EIB should finance in the first instance productive projects and programmes in industry, agro-industry, tourism, mining, energy and in transport and telecommunications linked to these sectors.

Article 233.2 of the Lomé IV Convention (Article 197.2 and 3 of the Lomé III Convention) gives criteria to be considered in deciding upon the method of financing for aid projects or programmes:

1. the level of development, the geographical situation, and the economic and financial circumstances of the ACP states;
2. the nature of the project or programme, its economic and financial return, as well as its social and cultural impact; and
3. in the case of loans, the factors guaranteeing their servicing.

A series of special reports by the Court of Auditors (1998), conducted on the basis of a tripartite agreement between the EIB, the EC and the Court of Auditors, reviewed the EIB's role under Lomé. These reports were among the first to publicly criticise the EIB's lending in ACP countries and highlight the consequences of the disconnect between the EIB's 'commercial' operations and its development role. These studies' findings were partially echoed in a review by the EIB's own Operations Evaluation Department of risk capital operations undertaken between 1989 and1998.[4]

Lack of consideration of development context

Both reviews found that while EIB documentation contained a high level of technical assessment at the *project* level, assessment at the *country* level regarding the development context for the intervention was absent. Both reports emphasised the need for stricter criteria and guidelines for the use of risk capital funds to be developed, in order to obtain an additional value for development purposes.

When some projects were selected, in some countries, especially those which have modernised their economic policies less than others, insufficient attention was paid to the country's development priorities and therefore the potential development impact of the EIB's risk capital resources. In particular, the proportions of total lending allocated to infrastructure projects (usually as a co-financier), private-sector enterprises and global loans through financial intermediaries were not always consistent with development priorities (EIB OED, 2000).

Both the lack of consideration of economic risks and of development considerations were tied to criticism in both reports of the lack of capacity within the EIB itself. The OED report noted that this lack of capacity caused unnecessary delays and that bottlenecks have occurred in project selection, particularly when the bank's technical, economic or legal staff – all of whom have much wider responsibilities than the ACP countries – have failed to respond promptly to requests from loan officers for advice on the suitability of projects for selection (EIB OED, 2000). The OED report ended with a blunt assessment of the EIB's capacity constraints:

The EIB has an inadequate institutional memory and also makes insufficient use of knowledge management to ensure that the staff working on the ACP countries learn from each other's experience. Project documentation is erratic and incomplete, duplication of material is commonplace, and the introduction of electronic communication has not been matched by appropriate filing or recording systems. Partly due to work overload, there are few formal or informal opportunities for loan officers in particular to learn from the successes and failures of other loan officers in different divisions.

Crowding out of local sources of finance

On a related point the reports criticised the EIB's lack of consideration as to whether the proposed intervention could potentially crowd out local sources of financing, and whether a bilateral intervention needed to be made from risk capital resources. The ECA report noted that this was partially due to the criteria defined in the Lomé IV Convention and by the bank being broad so that any judgement as to whether the financing of a project is appropriate is subjective. However, it provided a few examples of operations financed from risk capital resources where the rationale for an EIB intervention was debatable and/or unclear. The following examples are from ECA (1998):

- The modernisation of joint-venture fishing fleets in Mozambique and in Madagascar, which in fact were profitable and generating hard currency for repayment of the loans so that other sources of financing could have been found.
- The proceeds of the two global loans given to financial intermediaries in the Dominican Republic on-lent entirely to established SMEs which had already proven to be successful in their operations, thus the loan would have been given to the final beneficiary even without the EIB global loan being available.
- The use of risk capital funds in the form of global loans and a loan with participating rights in New Caledonia, where other sources of funding could easily have been mobilised.

Unclear pass-through of interest rate subsidies

A major criticism of EIB interventions has been the lack of clarity surrounding its interest rate policies, notably the Bank's high reliance on on-lent funds (via local intermediaries, such as so-called 'global loans'). It is clear that the Bank's strong balance sheet and favourable credit rating allows financial intermediaries to access funds on borrowing conditions that are highly favourable *vis-à-vis* their own domestic market. What is less clear is how much of that borrowing premium ends up with the final investors as interest rates are usually set at market level.

It should be noted that this practice yields several benefits, noted in the ECA report: it avoids distortion of competition; it mitigates the risk of irregularities occurring in the selection of beneficiaries (risk of corruption); and encourages loan beneficiaries to be self supporting in the longer

term. For the final beneficiary, however, the only advantage of this risk capital financing is that it provides easier access to medium- or long-term financing rather than mitigating the prohibitively high interest rates that are endemic in many ACP states. While longer maturity loans are of clear benefit to investors, it is not apparent whether the EIB is best positioned to provide such domestic-rate financing as it is often available on the local market and there is a risk, alluded to above, of a crowding-out effect.

For Lomé III, the Convention provides that the interest rate shall be determined by reference to the characteristics of each project and shall not be higher than 8%. Under Lomé IV's mandate for EIB risk capital operations, Article 234(1)(c) states that, in the case of loans to ACP states or intermediaries, 'the interest rate shall, in any case, be less than 3%' (though the actual loan price can be higher if the loan remuneration includes a variable interest rate component linked to a performance indicator). Despite these provisions, both the ECA and OED reports found several cases where the interest rates established by the EIB were higher than the rate mandated under the various Conventions.

Furthermore, the EIB's high reliance on on-lent funds – as opposed to more directed interventions to potentially profitable projects – introduced the possibility of market distortion by providing concessional financing to intermediaries only. The ECA report rather bluntly stated that 'from a development policy point of view, the Bank's policy to set interest rates for SMEs at market level and to use more concessional interest rates for larger sized enterprises in the private and public sector is against the spirit of the Lomé Convention and can lead to an unbalanced situation in the allocation of the advantages of risk capital financing to the beneficiaries' (ECA, 1998).

The ECA report went further with two examples worth reiterating:

- An electricity producing and distributing company in the Dominican Republic which received a 6% loan under an on-lending agreement with the Government of the Dominican Republic and with the exchange rate risk to be borne by the beneficiary. In the same country SMEs have to pay interest rates of between 22% and 32% for loans on-lent to them by an intermediary, however, with the exchange rate risks to be borne by the intermediary.
- In Mozambique a local subsidiary of a European enterprise active in fisheries borrowed at an interest rate of 4% from the government through an on-lending agreement. The exchange rate risk was limited as its operations generated hard currency. Newly established SMEs paid interest rates varying between 40 and 46% on on-lending agreements with intermediaries, as the latter had to cover the exchange rate and the inflation risks.

In sum, the use of different types of financing (direct loans, loans via an ACP state, global loans) potentially led to the unequal treatment of final beneficiaries: while some benefit from the 3% maximum interest rate mentioned in the Lomé Convention, the others have to pay market rates. Though not the only determining factor, the effects of exchange rate fluctuations play an important role in setting interest rates above the 3% level. These effects and thus the justification for higher interest rates can be calculated only after loans have been fully repaid. In addition, in the case of loans with participating rights, the total remuneration to the EIB – being at least partly dependent on the result of the beneficiary enterprises – could well exceed the 3% limit (ECA, 1998).

Both reports noted a lack of explicit consideration (i.e. through available documentation) within the EIB of the development value-added of EIB interest rate policies. The OED report criticised the EIB for its '*inadequate justification for, as well as severe inconsistency in, the use of the interest rate differential in those projects where the EIB's loans were on-lent to the ultimate beneficiaries... there has been very little supervision of, or even information about, how this differential was actually used in each case*' (EIB OED, 2000).

Other shortfalls

Both the ECA and OED reports included several other EIB shortfalls in their review of the Lomé III-IV risk capital operations experience:

- **Flawed tendering:** In many cases, the EIB did not comply with EU rules that tenders should be only open to firms having their main seat in ACP or EU member states.
- **Loan undertakings:** Several cases occurred where undertakings were not met by beneficiaries – progress reports / financial statements not provided, foreign currency not provided by state, etc. – and the EIB's reaction was either inconsistent or one of resignation to the problem.
- **Delayed implementation:** Several projects suffered from delayed implementation for a variety of reasons, leading to risk funds being committed without being effectively used (so-called 'sleeping balances').

Cotonou mandate and instruments

The Cotonou approach to the ACP private sector

In 1996 the European Commission issued a Green Paper[5] outlining the EC's approach to the post-Lomé ACP–EU relationship. The Green Paper's main policy message was that the ACP–EU relationship should reflect 'the growth of trade, the unification of capital markets and the globalisation of production and distribution markets'. Any new ACP–EU agreement would have to formulate:

> *'new approaches concerning the role of aid and a redefinition of the parties' respective roles: emphasis is placed on the policy environment, local capacity building, the role of civil society, and on new ways of including other agents of development, especially in the private sector'.*

The Cotonou language promises a new attitude towards the private sector and its primary role in development – as noted in the introduction, a major change from the 25 years of Lomé co-operation marked exclusively by government-to-government relations.

A recent ECDPM report outlined the major Cotonou provisions reflecting this change:

- systematic involvement of the private sector in political dialogue and in defining co-operation policies, strategies and priorities;
- larger responsibilities for the private sector in the implementation of projects and programmes;
- more diversified packages of financial support and private sector support instruments;
- provisions for capacity-building support to strengthen the organisation and representation of intermediate private sector bodies (ECDPM, 2001).

This new approach, deepening the provisions of Lomé IV bis (1995–2000) and complementing the 1998 integrated EC strategy for private-sector development, promises an integrated and dialogue-oriented approach to developing the private sector in ACP states.

Through Cotonou the EU has agreed to provide support at three levels:

- the *macro* sector (policies for macro stability, investment climate reform);
- the *meso* level (sound intermediate business structures and associations); and
- the *micro* level (fostering competitiveness and productivity through access to credit and technical assistance).

The EIB's mandate under Cotonou

The Agreement establishes the EIB's mandate under the new Cotonou approach. According to Article 71.6(c), *'Co-operation shall provide long-term financial resources, including risk capital, to assist in promoting growth in the private sector and help to mobilise domestic and foreign capital for this purpose. To this end, co-operation shall provide, in particular, risk capital for equity or quasi-equity investments, guarantees in support of domestic and foreign private investment and loans or lines of credit.'* Particular emphasis is placed on efforts to improve access of SMEs to risk-sharing instruments and to term finance.

In addition, Article 3.1(b) of Annex II of the Cotonou Agreement emphasises the development of the local financial sector to make it an effective channel for the financing and development of small business, and on domestic ACP capital markets to foster their capacity to mobilise domestic savings. The IF will also fund viable public or private infra-

structure projects as a prerequisite to encouraging investment and sustained growth (Article 3.1 of Annex II). The IF is required under Article 3.1(a) of Annex II to be a revolving fund operating on market terms, ultimately generating adequate economic rates of return in the long run.

EIB instruments under Cotonou

The Cotonou Agreement provides for EU financial assistance to be provided to the ACP states by the EC (for the grant aid programme) and by the EIB (for loans and equity financing for the business sector). The first financial protocol of Cotonou – covering the 9th EDF – is for €15.2 billion over the first five-year period. While Cotonou mandates a wide range of instruments for financial co-operation to be made available by the EIB for private-sector project financing, in practice the number of instruments has been rationalised under a single €3.9 billion tranche. Part of this will be made available though a new Investment Facility (IF) provided for under the Cotonou Agreement. The IF replaces the former risk-capital funds of the member states under the stewardship of the EIB.

Under the IF, the EIB will manage €2.2 billion in EDF grant funds to disburse non-grant aid to investment projects as well as providing €1.7 billion in loans from its own resources. Separately from the EIB, the EDF will disburse €11.3 billion in grant aid for long-term development through national and regional EC programmes (see Table 2).[6] The EIB's mandate under Cotonou includes a separate bilateral agreement with South Africa, where the EIB will provide €825 million in loans from its own resources. The EIB instruments available under Cotonou are described below and summarised in Table 3.[7]

Eligibility: EIB funds under Cotonou are available to investors in the private sector or the 'commercially run public sector', comprising state-owned enterprises involved in market-oriented production. Generally, all sectors are eligible with the exception of a small negative list of excluded sectors (non-ethical drugs, gambling, etc.). Sectoral priorities will be adjusted for portfolio diversification and EC strategies (most notably financial sector development). Beneficiaries include, among others, local and foreign enterprises, financial intermediaries, and state-owned enterprises. The IF's contribution to a given operation will normally not represent more than 50% of the total funding required and the EIB encourages co-financing with other IFIs such as the World Bank. However, circumstances – such as small project size, a small country, or the absence of alternative resources – may justify a larger share.

Operations: Article I of Annex II to the Cotonou Agreement specifies that operations can be financed directly or through intermediaries. On-lent funds are subject to a number of prudential requirements and the right of the EIB to veto any project approved through an intermediary. The dividing line between direct and indirect financing varies according to the size of the economy. In medium/large ACP states, EIB directly finances projects requiring €5 million; in smaller ACP states, particularly island economies, the threshold is €2–3 million.

Instruments and terms: The IF uses a number of instruments on a case-by-case basis to fund ACP investments:

- ***Loans:*** Senior or junior/subordinated debt where maturity, assessed on a case-by-case basis and interest rates or on a 'market-related' basis. For

Table 2: First financial protocol (€15.2 billion) of Cotonou Agreement

European Development Fund (EDF)		
European Commission (EC)	**European Investment Bank (EIB)**	
Grant aid for long-term development (national and regional programmes)	Investment Facility – Loans/equity/guarantees for investment projects	EIB's own resources – loans for investment projects
€11.3 billion	€2.2 billion	€1.7 billion

Source: EIB (2000)

Table 3: EIB financial instruments available under Cotonou

	EIB's own resources	Investment facility
	Loans for investment projects	**Loans/equity/guarantees for investment projects**
Senior debt:	*Pricing:* EIB reference rate *Security:* 1st class guarantee or prime-quality security (with possibility of political risk carve-out) *Currency:* EUR, USD, GBP and ZAR *Amount limit:* max. 50% of project cost	*Pricing:* EIB reference rate + mark-up *Security:* guarantee (international or local) or project security *Currency:* EUR (possibility of other currencies, including local currency, in certain cases)
Junior/subordinated debt:	Not applicable.	*Pricing:* EIB reference rate + mark-up *Security:* project guarantee or other covenants *Currency:* EUR (possibility of other local currencies)
Quasi equity: participating or conditional loans	Not applicable.	*Pricing:* variable remuneration as a function of performance *Security:* usually unsecured or junior status with covenants *Currency:* EUR (possibility of other local currencies)
Equity participation	Not applicable.	*Pricing:* dividends/capital gains *Security:* none *Currency:* local currency
Guarantees	Not applicable.	*Pricing:* reflection of the risk borne
Loans with subsidy in special cases	*Pricing:* EIB reference rate less 3% *Security:* 1st class guarantee or prime-quality security	*Pricing:* EIB reference rate less 3% *Security:* guarantee (international or local) or project security

Source: EIB (2000)

each loan, the rates will be the EIB's reference rate (in turn a function of borrowing costs), plus an administrative margin, plus a mark-up to cover the perceived market or credit risk. In the case of indirect lending, intermediaries determine their own on-lending terms, which are in turn monitored by the IF.

- ***Quasi-equity:*** Mainly in the form of conditional or participating loans in operations requiring risk-sharing. This may include variable remuneration loans where the variable element is set to a relevant parameter such as the price of output.
- ***Equity:*** Taken principally through investment funds, other intermediaries or special-purpose vehicles (although direct equity investments will be considered). The EIB, however, will not normally take a controlling interest nor seek to influence management decisions (though it reserves the right to do so on a case-by-case basis).
- ***Guarantees:*** Pricing of risk of expropriation, war/civil disturbance, non-transfer of currency, breach of contract, etc.

Loans from the EIB's own resources are only available in widely traded international currencies (and for projects in South Africa, in ZAR). Loans from the IF are normally disbursed and paid in EUR but can be made, on a case-by-case basis, effectively in local currency through a currency swap though at a higher interest rate reflecting domestic conditions.

Subsidies: The Cotonou Agreement provides that €195 million of EDF resources will be available to subsidise the interest rate of loans for projects financing by the IF and from the EIB's own resources. The interest subsidies may be capitalised and used in the form of grants paid up front.

Cotonou provides that the subsidised rate may not be lower than 50% of the unsubsidised (reference) rate. In principle it shall not be higher than 3%. Interest rate subsidies are permitted in the case of:

- public sector infrastructure projects in LDC or post-conflict countries;[8]
- restructuring operations in the context of privatisation;
- for exceptional projects with a strong social or environmental impact; or
- for project-related technical assistance.

EFP: In January 2003, the EIB signed a Framework Agreement on Financial Cooperation with the European Development Financing Institutions (EDFIs), Agence Française de Développement (AFD) and Germany's KFW Development Bank to launch the European Financing Partners (EFP), a special-purpose vehicle jointly owned by the EDFIs and the EIB on behalf of the Investment Facility. EFP is a co-finance investment matching facility to support private-sector investments in the ACP region. Its funding will be provided by the Investment Facility (€90 million) and by following EDFI members (€50 million): BIO (Belgium), CDC (United Kingdom), DEG (Germany), FINNFUND (Finland), FMO (the Netherlands) and PROPARCO (France).

Recent EIB investments

The Investment Facility came into force on 1 April, 2003. To carry out its Cotonou Mandate, the EIB established a special business unit within the EIB's ACP department with additional staff, as well as opening regional representative offices in Dakar, Nairobi and Pretoria. Despite the increase in capacity, EIB activity in the ACP states under the Cotonou mandate has been muted so far, with nine projects signed in 2003. As shown in Table 4, EIB lending to the ACP has totalled €2 billion from 1999–2003 (€2.75 including South Africa) evenly distributed across sectors with nearly a third of total lending concentrated in global loans.

According to the 2003 *IF Annual Report*, this is due to '[the IF's] *nature as a revolving fund, its more ambitious objectives in support of the private sector and the wider range of financial instruments to be deployed, all imply that a great deal of organisational preparatory work was required within the EIB... In these circumstances, it was inevitable that operational activities themselves would only make a modest start in the nine months from 1 April 2003 to the end of the year*' (EIB, 2003).

Annex I summarises recent EIB lending, both under the Cotonou/IF mandate and previous mandates. Out of 45 loans for which publicly available information is available, 22 are above €10 million, largely concentrated in heavy infrastructure and utilities (10 loans) and global loans for SME financing (six loans). The largest EIB loan in 2003/04 was a €90 million disbursement under the EIB's co-financing arrangement with EFP. IF financing was also used for equity investments in a series of regional African funds. The most striking aspect of the investments listed in Annex I is that only four loans of the 45 total are explicitly earmarked for a non-African country: global loans for Tuvalu (€1 million), the Caribbean (€8 million) and the Dominican Republic (€40 million) as well as a €11 million hotel investment in Fiji.

Reforming the EIB–ACP investment nexus

Any review of the EIB–ACP investment nexus – a relationship that has now stretched back over sev-

Table 4. EIB lending to ACP and Republic of South Africa (RSA), by sector (€ million)

	ACP (1999–2003)	ACP (2003)	RSA (1999–2003)	RSA (2003)
Energy	478	60	107	50
Transport/telecoms	295	56	145	–
Environment	213 88	–	–	
Industry/services	308	47	25	–
SMEs (global loans)	713	212	475	210
Total	2,009	463	752	260

eral decades – must address the fundamental disconnect between its structure and its ACP mandate.[9] The EIB enjoys the efficiency gains of a more hands-off, streamlined 'commercial' bank operating as an independent body; whose mandates are formulated externally but whose operating guidelines are formulated internally; whose funds are provided at premium rates but is not required to monitor individual loans on a less-than-large scale. This structure avoids much of the hassle experienced at many other IFIs where individual loan officers must often navigate a bureaucratic maze of safeguards, external consultations and formal cross-checks. This more commercial, decentralised and streamlined structure has provided a value-added in its operations within the EU.

However, the previous sections have outlined several criticisms which arise from the EIB implementing an extra-EU development mandate which, this chapter – and others cited within – has argued, it does not have the capacity to implement. The crucial (and potentially problematic) assumption here is that implementing such a development role requires the same structure and capacity of other IFIs. Reshaping the EIB's guidelines in this manner, given the small share of ACP lending in its total portfolio, is arguably both unfeasible and unadvisable. The fundamental issue here is how to balance the EIB's dual role as a commercial financing arm of the EU, but operating under a development mandate without compromising its effectiveness in either role.

The previous two sections of this paper noted that the EIB, under Lomé and Cotonou, operates under a relatively broad mandate, again in comparison to other IFIs where lending activities are formulated on more detailed country strategies, which in turn draw from policy decisions and institutional research. It is not surprising, given this leeway and the EIB's commercial and balance sheet constraints, that it has chosen to take a relatively narrow and conservative view of its development mandate.

This chapter is not arguing that the EIB has fundamentally misinterpreted its Cotonou mandate. This paper has argued that its interpretation, while legally valid, has rendered the EIB highly risk-averse in its delivery of development aid, which often requires higher risk lending, a substantial technical assistance component, and a trial-and-error approach to assessing investment conditions in a given country or sector. There is a clear case for reform if indeed the EIB is to fulfil its complete Cotonou mandate, which includes (in Article 1) the goal of 'reducing and eventually eradicating poverty, consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy'.

Strengthening development-oriented capacity

Although the internal OED report was highly critical of the EIB's lack of a 'development context' for its lending, it unsurprisingly did not call for any major structural changes to the EIB's procedures:

> *Some Member States ... have argued that the EIB should begin to operate like other large multilateral financial development institutions, getting involved in a wide range of macroeconomic, sector, governance, social, environmental and other issues, participating in more co-financed projects while producing much more documentation and justification for the development impact of its lending and the consistency of this impact with EU development policy. The evaluation team believes, on the contrary, that for the allocation of risk capital resources in the ACP countries, the EU's development policies would be best served if the Bank enhances its development impact by concentrating on those strategies, areas and projects in which it has proved to have a comparative advantage over other donors and investors. It should continue to operate on a 'lean and mean' basis, with the maximum flexibility in the way it does business and the greatest speed it can achieve in processing and disbursing high quality loans (EIB OED, 2000).*

However, the OED report quoted above also refers on two separate occasions to the need to enhance the EIB's 'development impact' and states that 'The EIB should co-finance with the World Bank Group (or other multilateral donors or investors) only when its contribution is expected to have a distinct development impact or it can make a strategic

input, by transferring European technology and project experience, or it can exert leverage to ensure the sustainability of its component of the project' (EIB OED, 2000). Assuming that (a) a 'development impact' is assessed on a case-by-case basis and (b) such an assessment goes above and beyond whether a project is sustainable at prevailing domestic interest rates, it is not clear how the EIB is in a position to assess its development impact without moving *to some degree* towards a development financing institution. In response to criticisms from environmental groups, the EIB has added several environmental specialists to its staff to produce impact assessments for individual loans. Adding similar staff for its development lending (i.e. a dedicated development research and evaluations team), and making such documents publicly available, may be seen as a positive first step.

Difficulties may stem from the EIB's highly decentralised structure, where, unlike most other multilateral or bilateral financial institutions, major decisions on project selection are taken at the loan officer level, in consultation with the relevant technical, economic and legal staff. While such consultations are no doubt undertaken by competent and experienced loan officers, there is (at present) little possibility for external observers to ensure that adequate consultations – both within and outside the Bank – have taken place before loans are approved. A similar point can be made for monitoring, again quoting the OED report regarding the development implications of the on-lent interest rate differential:

> *In all cases, the EIB has not seriously monitored or obtained reports on the actual use of the differential, mainly because the staff believed it was the responsibility of the recipient to spend the differential in the way it felt most suitable and that the impact of some of these programmes would have been difficult to monitor (EIB OED, 2000).*

Again, the question lies in the 'comparative advantage' of the EIB which is referred to in the OED report. If the EIB's 'comparative advantage' is based on market considerations at the level of an individual loan, coupled with a relatively hands-off approach from the lender and focused on a narrow range of potentially profitable sectors, there is legitimate scope for the EIB's clients in the ACP region to ask whether this comparative advantage is wide enough to justify a large (€2 billion) and growing share of lending mandates. The implicit OED endorsement of the *status quo* rests on the assumption that a 'high-quality loan' is assessed using equal criteria by the client (ACP countries) and lender (EIB) perspectives. This chapter is suggesting otherwise.

Increasing transparency and accountability

A related point concerns the EIB's transparency. This has been the focus of many NGOs – especially those concerned with environmental issues and to a lesser extent developing countries – and was a major focus of the DFID report. The availability of documentation regarding specific loans and lending strategies is often limited to publicly available information on the EIB website, such as Annual Reports and general material reiterating the EIB mandates. However, on loan-specific material, despite recent improvements there is a paucity of descriptive material.

A useful counterexample is the World Bank, which provides in the public domain a summary of the main project document, materials regarding evaluations and safeguards, information on the implementing agency, and a description of how each loan fits into the World Bank's overall development strategy in the country. The immediate concern would be one of capacity – if, as the OED report mentions often, the loan officers are currently overworked as is, such transparency may put undue strain on the EIB's capacity and decrease its effectiveness. However, two points must be made. First, such documents are undoubtedly drafted for projects; thus making them publicly available should not require significant resources. Secondly, the EIB has not made a clear case why the publication of such documents would imperil the efficiency of its lending. Third, as the EIB currently has the lowest staff per euro disbursed among the IFIs and it oversees a much larger asset portfolio (due to its relatively larger lending in high-investment grade countries), it is not clear why the EIB cannot increase its capacity without adversely affecting the strength of its balance sheet.

Perhaps a more useful example is the International Finance Corporation (IFC), which undertakes many private-sector projects that are closer in nature and scope to the EIB's interventions. The difference in disclosure is striking. For a large number of projects, the IFC's website lists the following information:

- Description of company and purpose of project
- Project sponsor and major shareholders of project company, with contact details
- Total project cost and proposed IFC investment
- Location of project and description of site
- Project development impact and IFC's Role
- An analysis of environmental and social issues, with proposed mitigation mechanisms and monitoring/compliance

While the EIB provides some of the information headings listed above in its project pipeline, the information is often quite minimal (total of less than half a page for most ACP projects currently available on the EIB website) and unavailable once the project has been approved. The EIB state that its transparency policies had to 'protect the interests of its customers, having a duty to respect the confidentiality of business-sensitive information and the privacy interests of individuals... Its information policy must also support the effectiveness of the Bank's decision-making processes and operations'.[10] However, it is not clear how the EIB's lack of transparency *vis-à-vis* the IFC enhances its effectiveness given that both organisations service similar sectors and initiatives.

The accountability of the EIB – i.e. its adherence to basic corporate governance rules – has also been questioned by several external observers. The degree of supervision over and input into the EIB's external lending policy by stakeholders is unclear. For example, while ACP countries were party to the negotiations creating the Cotonou mandate, the operational guidelines of the Investment Facility itself – which arguably matter as much, if not more than the mandate – were drafted within the EIB and presented to the ACP states as a 'fait accompli'.[11] The formal structures through which stakeholders can present their concerns and ideas to the EIB should be made explicit and accessible.

Linking development with the market

A lending institution whose commercial nature renders it highly risk-averse may not fulfil its development objectives, which often require higher risk lending, a substantial technical assistance component and a trial-and-error approach to assessing investment conditions in a given country or sector. Grynberg and Forsyth (1998), in their review of Lomé aid, make this point in the Pacific context:

> *Virtually every donor has failures. The EU is no exception but some project failure is true of any entity that does anything in a commercial context. As we shall see, many of the less than satisfactory projects in the Pacific are small and highly commercial in nature. Moreover, they are frequently 'green fields' projects that attempt to develop new industries or lines of production and are often in the most difficult areas. That such projects should not meet with complete success should come as no surprise to those working in development.*

Grynberg and Forsyth further note that many EIB loans to the Pacific under Lomé have been channelled through the government, notably state development banks. Thus the EIB loans have been used not only as an indirect source of government revenue, but also a means by which the government increases its control of the commercial sector. The end result is that the EIB, by pursuing existing channels of short- and medium-term profitability, has 'not become an instrument for private-sector development but has become an institution that has facilitated the expansion of the state sector, *often at the expense of private sector investment*' (emphasis mine) (Grynberg and Forsyth,1998). There is a potential danger then of the EIB, by concentrating on a narrow range of market instruments and initiatives, will simply crowd out local sources of finance and further dampen the prospects of financial sector development in ACP countries.

The IF, for example, is meant to be a market-related revolving facility which, based on the first

few years of its lending history, is focusing on large, profitable projects (with concessionality on a case-by-case basis) and relying on a high share of global loans (where rates are set by intermediaries at the domestic market level). If this trend continues, there is a concern that IF funds will be primarily focused on developing niche markets which, given the history of many ACP states, notably post-preferences, may be the only sectors that yield rates of returns in endemically high-cost economies. The net result can be a situation where investment is flowing towards individually profitable projects, but the net investment portfolio of a given country is not tailored towards long-term sustainability, capacity-building and flexibility in the wider economy.

If the ACP–EIB relationship is a commercial rather than a development partnership, then the EIB runs the risk of exacerbating the sharp differences in economic growth and investment quality between ACP states rather than reducing them. This was echoed in one of the main recommendations of the DFID report which 'encouraged the EIB to finance projects which develop the private sector in recipient countries and focus less on financing repeat business with the same clients'. This was indirectly acknowledged in the internal OED report, which noted that:

> *The Investment Facility is clearly better designed for those ACP countries which have progressed further down the road of economic development, where market mechanisms have displaced state controls, where private investment in productive enterprises is strongly encouraged and supported and where a coterie of competent project promoters and managers has emerged... In other, less progressive ACP countries, the EIB will necessarily play a less important role, at least until conditions become more amenable (EIB OED, 2000).*

All these factors point to a potential re-assessment by ACP countries, most notably those with less attractive investment climates, as to whether the EIB and the IF in particular are well-suited to their development objectives. No doubt there is a strong role for state activism in reducing the cost premium due to market-distorting economic policies, however many recent papers have suggested that the scope for such a reduction is limited in many ACP countries (see Winters and Martin, 2004). In sum, ACP states must ask whether a facility that lends to high-cost economies yet is meant to be self-sustaining (i.e. deliver market-level returns without future donor flows) can deliver the development impact that they require.

The interest rate issue is a useful case in point. Both reports noted the capacity constraints at the EIB and the result that the value-added of its investment-grade on-lent funds often remain with intermediaries rather than the final investor. While the need to develop capacity at the intermediary level is beyond dispute, such capacity-building may not result in concomitant increases in investment – which is ultimately the goal of an instrument of financial co-operation – if the investor does not receive some pass-through of the implicit subsidy. As noted earlier, EIB credit lines allow for intermediary banks to extend credit to final investors which they may not provide otherwise – an important first step. However, due to concerns over market distortions, the EIB – in line with other multilaterals – has generally avoided passing on the subsidy to the final investor (except for exceptional cases). This approach, while market-friendly, has the potential to exclude projects whose rates of return are marginally lower than the prohibitively high interest rates prevailing in most ACP countries (for further discussion see Havelock and Brewster, 2003).

A potential avenue for the EIB–ACP relationship lies in the IFC's pilot SME lending initiatives in Mozambique (summarised in Annex II). The facility is designed to provide a high technical assistance component which includes a matching grant element, in some cases including working capital and outside services, for so-called 'transformative' expenditures designed to increase the capacity and/or profitability of beneficiary firms. In order to reduce distortions in the domestic money market, the matching grant and technical assistance elements are disbursed directly to the final investors rather than on-lent through an intermediary. This approach, while requiring substantial presence on the ground, a concomitant increase in resources, and substantial donor participation, has been

shaped by the IFC's experience of SME lending in developing countries:

> *There have been various attempts in recent years by bilateral and multilateral lenders to address the need for credit in the SME sector. Results to date have not been encouraging. IFC through its SEF program extended loans to six companies in Mozambique, of which five are currently considered problem loans. The EIB had a similar experience with a recent US$10 million line of credit/partial guarantee program extended through the banking system. While this program achieved utilisation of around 60%, most of the loans were not repaid. The World Bank's US$10 million PoDE line of credit has remained largely unutilised since it was approved in 2000. The two existing private equity funds, GCI and Aureos, operate conventionally and are virtually inactive (IFC, 2004).*

The initiative is a joint IDA–IFC programme and provides some fresh thinking into how to tackle chronically prohibitive lending rates while still encouraging private-sector development.

It is worth reiterating that the EIB as an institution walks a fine line between its higher grade lending within the EU – its core business – and its relatively riskier ACP lending. As such it may be necessary for the EIB to 'ring fence' its ACP lending operations in some manner – for example, by operating the IF funds off its balance sheet – in order to allow it adequate breathing room to expand its scope, scale and initiative of its development lending while still maintaining its comparative advantage as a high-grade, efficient lender.

A fine balance

In conclusion, this chapter argues that, like any institution lending to developing economies, the EIB must place its policy choices within several spectrums:

- between a 'lean and mean' business structure which focuses on a few key outputs, and a more bureaucratic structure that attempts to cover as many bases as possible;
- between providing the concessionary finance needed to kick-start investment in high-cost economies, and avoiding introducing further distortions into the domestic investment climate; and
- between protecting the confidentiality of clients and providing the information external observers require to monitor its operations.

The EIB's location within these spectrums is informed by both policy choices and constraints. This paper has argued that the EIB's 'position' in these policy arenas is often to the detriment of its effectiveness as a lender to the private sector in developing countries. This chapter has further argued that in some cases, there is a Cotonou constraint – i.e. the EIB is restricted by the letter of the Cotonou Agreement.

This chapter, however, finds that in many cases there is an EIB constraint – i.e. there is no apparent *external* reason for the perceived shortfalls in the EIB's performance in the ACP region. The paper has argued that there is scope for the EIB to increase its development effectiveness – and perhaps more importantly its legitimacy in the eyes of the development community – without compromising many of the aforementioned institutional characteristics which make it an important partner in the ACP–EU development relationship. By increasing its forward and backward linkages within the group of EU and ACP stakeholders, by incorporating new thinking in private-sector development, and by increasing its capacity to lend evenly across the entire ACP region (especially outside Africa), the EIB can more effectively execute its increasing role in the ACP countries.

Annex 1. EIB lending in ACP regions 2003/2004

Country	Sector	Signature	Name	Amount (M €)	Description
Mozambique	Energy	22/10/2004	MOZ/RSA Natural Gas-Upstream Component	10.00	Development of two gas fields in Mozambique and construction of gas pipeline from field area to Secunda in South Africa
Gabon	Global loans	18/10/2004	Global Loan II (GABON)	10.00	Financing for SME ventures
ACP states	Services	12/10/2004	African Lion Mining Fund II	6.45	Credit line for the financing of leasing operations in local currency of a minimum duration of 36 months
Botswana	Farming	04/10/2004	Fabulous Flowers	2.00	Creation of the first 5ha phase of a 20ha greenhouse project for the production and export of roses
Uganda	Global loans	09/08/2004	DFCU Leasing	5.00	Financing for SME ventures
Mauritania	Industry	30/06/2004	MAPESCA	5.00	Construction of fish-processing plant in Nouadhibou
ACP states	Services	29/06/2004	Shorecap International Ltd (SCI)	2.50	Microfinance
Mozambique	Industry	18/06/2004	Moma Titanium	55.00	Mining, concentration and separation of heavy mineral sands
ACP states	Services	13/05/2004	EDFI European Financing Partners (EFP)	90.01	Co-financing with European Development Finance Institutions of operations in ACP countries under joint agency agreement
Kenya	Industry	07/04/2004	Magadi Soda Pure Ash Project	21.92	Expansion of soda ash production capacity and product quality enhancement
Fiji	Services	27/01/2004	Novotel Denarau Project	11.00	Construction of hotel on Denarau Island
Tuvalu	Global loans	26/01/2004	DBT GL II	1.00	Financing for SME ventures
Ethiopia	Global loans	29/12/2003	Ethiopia – Global Loan DBE II	25.00	Financing for SME ventures
Cameroon	Global loans	16/12/2003	Private Sector Development – GL	28.00	Financing for SME ventures
Zambia	Industry	11/12/2003	Kansanshi Copper Mine	34.00	Development of open-pit copper mine in Kansanshi, north-west Zambia
Burkina Faso	Global loans	08/12/2003	Global Loan Burkina Faso II	12.00	Financing for SME ventures
Guinea	Transports	28/11/2003	Port De Conakry	12.00	Rehabilitation and extension of port of Conakry
Kenya	Services	25/11/2003	Co-Op Bank Microfinance Loan	2.00	Loan to Co-operative Bank of Kenya for refinancing selected savings and credit co-operatives
Uganda	Global loans	23/10/2003	EIB Microfinance Scheme	2.00	Financing for SME ventures
Cameroon	Global loans	20/10/2003	Africa Leasing Company S.A. PG	0.35	Financing for SME ventures

Country	Sector	Signature	Name	Amount (M €)	Description
Tanzania	Water	16/10/2003	Dar Es Salaam Water Supply & Sanitation	35.00	Repair and extension of water and sanitation facilities in Dar es Salaam
Indian Ocean	Services	26/09/2003	I&P Capital Investment Fund	2.00	Financing for SME ventures
Africa	Services	09/09/2003	African Banks Holdings, LLC	30.00	Equity investment in regional fund for acquiring control of commercial banks in course of privatisation
Mauritius	Services	12/08/2003	Bel Ombre Hotel	12.20	Construction and operation of hotel complex in Bel Ombre in south of island
Madagascar	Transports	17/07/2003	Reseau Nord Des Chem Fer (Madarail)	11.00	Rehabilitation and operation of Madagascar's northern railway network
Zambia	Global loans	14/07/2003	Capital Investment Line GL II – ZAMBIA	20.00	Financing for SME ventures
Mozambique	Energy	02/07/2003	MOTRACO II	1.75	Reinforcement and upgrading of power transmission facilities linking South Africa, Swaziland and Mozambique
Chad	Global loans	30/06/2003	Tchad – Private sector Global Loan	2.00	Financing for SME ventures
West Africa	Services	30/06/2003 Fund	Aureos West Africa	8.75	Participation in fund providing equity to private-sector SMEs in West Africa
Southern Africa	Services	30/06/2003	Aureos Southern Africa Venture Capital	10.50	Participation in fund providing equity to private-sector SMEs in Southern Africa
East Africa	Services	30/06/2003	Aureos East Africa Fund	6.80	Participation in fund providing equity to private-sector SMEs in Eastern Africa
Swaziland	Energy	18/06/2003	MOTRACO II	1.75	Reinforcement and upgrading of power transmission facilities linking the Republic of South Africa, Swaziland and Mozambique
Swaziland	Energy	18/06/2003	SEB III Maguga Hydropower irrigation dam	7.00	Construction of a 19MW hydropower station to be added to an existing large
Mauritania	Urban infra.	02/06/2003	EBTR Mauritanie	4.00	Purchase of equipment for construction of and roads and other infrastructure in Mauritania sub-region
Caribbean	Global loans	13/05/2003	CFSC GL III	8.00	Financing for SME ventures
Niger	Global loans	08/05/2003	NIGER – Financial Sector Global loan	5.00	Financing for SME ventures
Cape Verde	Global loans	06/05/2003	CAP-VERT Financial Sector Global loan	5.00	Financing for SME ventures
Dominican Republic	Global loans	31/03/2003	Financial Sector GL II	40.00	Financing for SME ventures
Mozambique	Energy	28/03/2003	Mozambique–South Africa Natural Gas	50.00	Gas field development and construction of gas pipeline from Mozambique (Secunda) to South Africa

Country	Sector	Signature	Name	Amount (M €)	Description
Africa	Transports	28/03/2003	ASECNA IV	33.00	Renewal and upgrading of airport and aeronautical equipment to improve air traffic safety
Swaziland	Water	28/03/2003	Lower Usuthu Smallholder Irrigation	36.00	Construction of irrigation systems from Usuthu river for smallholdings
Malawi	Industry	13/03/2003	Kangankunde Feasibility Study	0.30	Feasibility study for development and mining of strontium deposit in Kangankunde, north of Blantyre
Botswana	Water,	14/02/2003	Francistown Water Supply	12.50	Extension of water supply network for greater Francistown area
Central Africa	Services	24/01/2003	CAGF-Central Africa Growth Fund	5.30	Regional fund for financing equity participations in private companies

Source: EIB Website (www.eib.org)

Annex 2. IFC Mozambique SME lending facility

The IFC has launched a new, frontier-market approach to small business investing through the creation of the Mozambique SME Initiative, which would be established on a pilot basis as an IFC-administered programme to provide an integrated package of risk capital and technical assistance (TA) to selected SMEs. The total cost of the Initiative is $12 million including investment capital, TA and overhead, with an initial term of five years. The Initiative would be grant-funded with support from donors, and it is proposed that the IFC's contribution take the form of a grant of $3 million in the first year. The project has been developed in consultation with IDA, who may contribute financial and human resources from their existing Enterprise Development Project (PoDE) programme. Mozambique is one of the pilot countries for the new joint IFC–IDA initiative for MSME development.

The project involves creating a $12 million Mozambique SME Initiative to finance small and medium enterprises (SMEs) in Mozambique on a commercial basis. The Initiative would have two components:

1. An Investment Programme (the Investment Programme) of $8 million, including $3 million for management and overhead costs for five years, for financing SMEs by making loan, quasi-equity or equity investments on commercial terms; and
2. A Technical Assistance Programme (the TA Programme) of $4 million to support the Investment Programme by providing direct assistance to investee companies as well as funding costs associated with outside service providers.

Both the Investment and TA Programmes would be funded from donor contributions and by an IFC grant of $3 million in the first year.

The underlying premise of the Initiative is that the investment climate in Mozambique, while improving, remains extremely difficult for private investors. It is not at this time feasible to attract significant private capital to invest in the SME sector in the country given the relatively undeveloped state of this sector. Even the most promising SMEs require significant technical assistance as well as financing in order to develop further. At the same time, there is a strong need to create some success stories if the sector is to develop.

The Initiative has been designed to take into account the lessons of experience from IFC's previous work in Mozambique and experience with SME lending elsewhere in Africa. Its main features are as follows:

- **Integrated investment/technical assistance** – Experience indicates that this is the key success factor for SME financing. Given the challenges of this market, the TA component is relatively high, representing 50% of the Investment Programme. The TA will be dedicated exclusively to supporting the activities of the Investment Programme in developing 'bankable' clients. The Initiative will also draw on the considerable in-country resources of the World Bank Group (in particular the Enterprise Development Project (PoDE) and Africa Project Development Facility (APDF).
- **IFC managed** – While the IFC's preference is always to work with local partners, the integrated investment and TA nature of this Initiative requires that the IFC maintain close control over its management and operations. The proposed Initiative would be led by two experienced IFC officers and it would benefit from existing IFC infrastructure, operating out of the IFC office in Maputo. The Initiative would also be able to draw on the resources of the Regional and the relevant industry departments, in particular Agribusiness.
- **Small initiative** – The World Bank's African Enterprise Fund (AEF) and Small Enterprise Fund (SEF) experience indicates that volume orientation is directly related to high failure rate. The IFC's value added will come from the IFC's ability to select and nurture a limited number of the most promising clients. If use warrants, the Investment Programme can be increased at a later date.

- **Off-balance sheet** – Establishing a financial company in Mozambique would be an expensive and time-consuming exercise. Such a company would not benefit from IFC's immunities, and would face issues of taxation, banking license, employment of expatriates, etc. From an internal IFC standpoint, creating a subsidiary also raises major consolidation issues. Commencing with a donor-funded Initiative structure would allow us to avoid these issues during the initial phase, permitting the officers to focus their efforts exclusively on developing the business model.
- Conversion option – The Initiative will have an initial term of five years, during which the priority will be to develop a successful client base. If it succeeds in this goal, the Initiative can at any time be expanded, and/or converted into a stand-alone SME investment company. The Initiative Agreement will contain language providing donors with an option to convert their share of the Initiative into equity in a new venture to be created. This allows flexibility for duplication, and expansion if it works well. Given the nature of IFC's funding by grant in a Trust Fund structure, proceeds would not revert to IFC's general revenues.

Source: World Bank/IFC

Endnotes

1. EDFs 1–3 related to the Yaoundé Conventions, EDF 4 to Lomé I, EDF 5 to Lomé II, EDF 6 to Lomé III, and EDFs 7 and 8 to Lomé IV. The 9th EDF relates to the first five years of the Cotonou Agreement.
2. See AILC (2002) for a detailed exploration of the EIB's legal status as a Community instrument.
3. This section will primarily focus on EIB activities during the last decade of Lomé co-operation, covering the fourth Lomé Convention. The information has been summarised from Court of Auditors (1998).
4. EIB OED (2000). 31 projects, considered to be representative of the types of risk capital operations by the EIB in the ACP countries, were included in the evaluation. Nine of the operations (29%) were global loans, 11 (35.5%) were individual loans to private sector industrial firms, and 11 (35.5%) were loans to revenue-earning infrastructure projects. In all, the 31 projects represented 17% of the EIB's risk capital operations in the ACP countries during the period.
5. 'Green Paper on Relations Between the European Union and the ACP Countries on the Eve of the 21st Century: Challenges and Options for a New Partnership', EC Directorate-General VIII (Development), Brussels, November 1996.
6. This amount does not include the €195 million available to OCT countries: €155 million in grant financing from the EDF and €40 million through the EIB split 50%–50% between loans from the IF and the EIB's own resources.
7. This section is summarised from a more detailed outline in EIB (2000)
8. In HIPC countries, as IMF and World Bank conditionality mandates public sector borrowing at very concessional terms only, IF financing will apply the maximum authorised subsidy to the loan.
9. This section benefited greatly by comments from Prof Andreas Antoniou of the Commonwealth Secretariat.
10. See 'EIB's Transparent Information Policy' on the EIB Website (www.eib.org).
11. See 'Notes on the Operational Guidelines for the Investment Facility', ACP Secretariat.

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VIII
Regional Perspectives

29

Negotiating an Economic Partnership Agreement for Eastern and Southern Africa

Mark Pearson

Introduction

The main objectives of the Cotonou Agreement are, by building on existing regional integration arrangements, to assist with the smooth and gradual integration of the ACP states into the world economy through enhancing their production, supply and trading capacity as well as their ability to attract investment. These objectives are to be realised in conformity with the provisions of the WTO and, taking account of the respective levels of development of ACP countries, are to be achieved through the negotiation of Economic Partnership Agreements (EPAs).The negotiations on EPAs were launched in Brussels on 27 September, 2002. At the opening session an agreement was reached to sequence the negotiations in two phases. The first phase was at an all-ACP–EC level and during this phase it was intended to address horizontal issues of interest to all parties. The first phase lasted for one year and culminated with the preparation of a joint ACP–EC report (ACP/00/118/03/Rev.1 and ACP–EC'/NG/NP/43) which, among other things, agreed on the principles and objectives of EPAs.

The Joint Report also agreed on a common approach to guide the second phase negotiations (which were to be at the level of ACP countries and regions) in market access, agricultural and fisheries, services, trade-related issues and development support.

The meetings held during the first phase of EPA negotiations allowed the parties to converge on a number of issues but, at the end of the phase, divergent views remained. Therefore, both parties decided to continue discussions at the all-ACP–EC level, in parallel with the regional negotiations, and agreed:

- to establish an all-ACP–EC Technical Monitoring Committee (comprising representatives of the different regional groupings, the ACP Secretariat, the Troika of the ACP Committee of ambassadors, and the EC), in order to maintain transparency with regard to the regional negotiating processes;
- to request the Joint ACP–EC Ministerial Trade Committee to ensure mutual understanding on horizontal issues of interest to all parties; and
- that ACP–EC Ministers would meet as appropriate to take stock of the discussions.

These agreed actions took place, at best sporadically, if at all, and the second phase of EPA negotiations, which was launched in October 2003, have been conducted without the level of monitoring at the all-ACP level that was envisaged at the end of the first phase.

Configuration of the Eastern and Southern Africa Region

The regional negotiations in Eastern and Southern Africa were launched in Mauritius on 7 February, 2004. Prior to this launch, COMESA, represented by its Secretariat, had held negotiations with other regional organisations in the Eastern and Southern Africa region, these being the Secretariats of the East African Community (EAC), the Inter-Governmental Authority on Development (IGAD), the Indian Ocean Commission (IOC) and the Southern African Development Community (SADC) on the configuration to be used in the second phase of the negotiations.

The ACP, and the EU, have traditionally divided the ACP into six regions, these being the Caribbean, West Africa, Central Africa, Eastern Africa, Southern Africa and the Pacific Region. The Pacific Region and the Caribbean are, essentially, physi-

cally defined whereas the African regions are not. West Africa is usually defined as the region covered by the Economic Community of West African States (ECOWAS) and incorporating the member states of the West African Economic and Monetary Union (UEMOA). The Central African region is largely defined by the membership of the Central African Economic and Monetary Union (CEMAC).

In Eastern and Southern Africa, the ACP/EC boundaries of geographical regions do not conform to any of the memberships of the Regional Integration Organisations (RIOs). Both COMESA and SADC, the two largest RIOs in the Eastern and Southern African region, have ACP members that are in at least two ACP/EC geographical regions. The smaller RIOs, these being EAC, IOC and IGAD, are subsets of the two larger RIOs (except for Somalia, which is a member only of IGAD). Under the Lomé Conventions this overlap did not matter too much as there was a working arrangement that SADC had its own Regional Indicative Programme, which accounted for all of the European Development Fund (EDF) allocation to Southern Africa (as defined by the EC), while selected activities of COMESA, IOC, IGAD and EAC were financed from the EDF allocations to Eastern Africa.

In addition to this, the Lomé Convention provided non-reciprocal, duty-free market access to all ACP countries (except South Africa and with a number of tariff rate quotas and seasonal restrictions) into the EU, which is now dependent on a WTO waiver for its continued implementation, and up to 31 December, 2007.[1]

From the start of the EPA negotiations, in 2003, COMESA was in favour of being part of a large negotiating region. After it became obvious that EPAs were not going to be negotiated on an all-ACP basis, COMESA began examining the possibility of an all-Africa ACP. However, this also proved to be impractical so the COMESA Secretariat started a consultative process to gauge support for an EPA that would cover the memberships of SADC (excluding South Africa) and COMESA (excluding Egypt).

The rationale for this approach was the need to preserve and promote African unity, the need to comply with the provisions of Article 37.5 of the Cotonou Agreement and the need to pool scarce resources so that the region had the best chance of negotiating a favourable outcome.

This approach also recognised that EPA negotiations should not, in any way, weaken the process of regional integration already embarked on in Africa and should:

- ensure that the objectives of the African Union were promoted, which could only be done if Africa worked together in sub-regions as large as possible so that the continent remained united;
- ensure the solidarity and cohesion of the ACP group and preservation of the Lomé *acquis*;
- not force countries into making unnecessary choices about membership of Regional Integration Organisations: decisions that were taken for valid and sovereign reasons and which should not be questioned simply because of the EPA negotiating process;
- allow the optimal use of scarce resources (technical and financial) available to the region in the RIOs, and in member states;
- remove duplication of effort;
- recognise that ACP countries eligible to negotiate EPAs have similar market access constraints and common development needs;
- use negotiating structures already agreed on at the all-ACP level and maximise, not duplicate, the use of available expertise;
- send a strong political message to the rest of the world about the readiness of African countries to enter into multilateral and bilateral trade and development negotiations as a united force;
- allow the initiative of the negotiating process to be taken by the ESA ACP group so that it became a demandeur and was not continually responding to proposals from the EU; and
- maximised political leverage by working with as many African ACP countries as possible.

The rationale for negotiating an all-Eastern and Southern Africa EPA can also be seen in the fact

that the development needs of ESA ACP countries eligible to negotiate EPAs are remarkably similar. Exports from those countries into the EU are almost the same and include tourism; fish and fish products; horticultural crops and fresh vegetables; tea and coffee; cotton; textiles and apparel; and commodities covered by the protocols (mainly sugar but also including beef).

The structure of the Eastern and Southern Africa ACP economies is also very similar and, as a consequence, there are very few exports to the EU of manufactured items, except textiles and apparel, or of services, apart from tourism. For those ESA ACP countries eligible to negotiate an EPA and that actually export to the EU, the EU market access constraints they face are almost identical and can be placed into two main categories, these being rules of origin and regulations concerning sanitary and phyto-sanitary and environmental issues. Tariff issues have been of lesser importance in terms of market access.

The proposed joint COMESA-SADC configuration also recognised and respected the sovereignty of all member states. Although it was recommended that negotiations of EPAs would be done in the context of Eastern and Southern Africa, it was recognised that the actual signing of EPAs would be done only after 1 January, 2008 and would reflect the level of integration attained by the region and its member states at this time. Configuration of EPAs would be clear by 2008. If an ESA country was part of a customs union it would sign an EPA as a customs union. Otherwise it would sign an EPA as a country.

In the Eastern and Southern African region especially, there was a lot of debate amongst the Members of COMESA and SADC over configuration as a whole and the position of Egypt (as a COMESA member) and South Africa (as a SADC member). The position of Egypt was quite clear – it is not an ACP country, and already had a bilateral agreement with the EU, so was not eligible to take part in EPA negotiations.

The position of South Africa was not as clear. South Africa is an ACP member as it has signed the Cotonou Agreement. South Africa also has a bilateral agreement, the Trade and Development Co-operation Agreement (TDCA) with the EU, which it spent four years negotiating and which it signed in 1999. Partly because of the TDCA, a special protocol (Protocol 3) is included in the Cotonou Agreement to deal specifically with the ACP membership of South Africa. Article 8 of Protocol 3 sets out the Articles of the Cotonou Agreement and its Annexes that will apply to South Africa and those that will not apply. The entire Part 3, Title II, on Economic and Trade Co-operation of the Cotonou Agreement is designated as not applicable to South Africa. As EPA negotiations are dealt with under Part 3, Title II (in Chapter 2) of the Cotonou Agreement, according to the Cotonou Agreement South Africa cannot be a part of the EPA negotiations. In addition, Article 2 of Protocol 3 states that the TDCA takes precedence over the provisions of the Cotonou Agreement.

The TDCA covers, among other things, the Free Trade Area in terms of products and rules of origin. Under the TDCA South Africa has undertaken to achieve full liberalisation of 86% of imports from the EU by the end of a transitional period of 12 years.

As the TDCA takes precedence over the Cotonou Agreement it is not clear how other SACU member states (these being Botswana, Lesotho, Namibia and Swaziland) that are part of one customs territory will be able to negotiate an EPA outside the TDCA. Presumably, to be in conformity with the provisions governing the operations of a customs union, the other ACP members of SACU will need to accept an EPA that is within the provisions of the TDCA, which implies that an EPA covering SACU will include full liberalisation of 86% of imports from the EU and the TDCA rules of origin.

This is not to deny that the Cotonou Agreement provides for ACP member states to not only decide for themselves whether or not to enter into an EPA with the EU but also to decide on the configuration of the EPA they want. However, it should also be borne in mind that the framework within which EPAs are being negotiated is the Cotonou Agreement and, as such, decisions on EPAs and their geographical configurations need to be in conformity with the provisions of the Cotonou Agreement and its three pillars of: the political dimension, econ-

omic and trade co-operation; and development finance co-operation.

The position held by COMESA was that, in the Eastern and Southern Africa (COMESA–SADC) region at least, if EPA negotiations started on the basis of the membership of RIOs, rather than on the basis of the process of regional integration, this would weaken the creation of the African Union. In this case, overlapping membership could be beneficial to continental integration as it would encourage members of COMESA and SADC to take similar positions in both the organisations they were members of, for the sake of consistency and against a 'common enemy', and so bring the two organisations closer through the use of internal forces of the membership, within COMESA and SADC, rather than trying to externally force a merger or a split.

The COMESA and SADC Secretariats held a number of meetings throughout 2001 and 2002 on the possibility of negotiating an EPA that encompassed the joint memberships of COMESA and SADC (excluding Egypt and South Africa for the reasons given above).

In January 2001, at a meeting at the SADC Secretariat Headquarters in Gaborone in Botswana, the two Secretariats agreed that it was essential for the two organisations to co-operate on developing an EPA and to have a joint approach to the EPA negotiations. It was further agreed that, to take account of the different levels of development, there needed to be acceptance of differential liberalisation of tariffs within an EPA against the EU.

In May 2001, the Chairman of COMESA and Chairman of SADC, meeting in the margins of the COMESA Summit meeting in Cairo, Egypt, established the COMESA-SADC Task Force, which was tasked with co-ordinating the process of rationalising and harmonising the programmes of both institutions and reporting to their respective policy organs on progress made. This Task Force was immediately endorsed by the COMESA heads of state.

At the same COMESA Policy Organs meeting, the COMESA Council of Ministers directed the Secretariat 'to prepare an orientation paper on the nature of the ACP–EU Partnership Agreement'.

In October 2001, at the Second COMESA–SADC Task Force meeting in Botswana, it was agreed that SADC and COMESA would work together to prepare a joint position on the EU Economic Partnership Agreements. Informal discussions between the COMESA and SADC Secretariats on taking a common approach to the EPA negotiations continued throughout 2002 and a number of meetings with the member states were held at which the issue of configuration was discussed.

In May 2002, at their meeting held in Addis Ababa, Ethiopia the COMESA Council of Ministers decided that EPAs should have a development dimension and be coherent with the overall objectives of the Cotonou Agreement and the development needs and choices of the ACP states and regions. Council further re-affirmed its decision regarding the two-tier approach to EPA negotiations. The Council of Ministers called on member states to determine what elements should be negotiated at the all-ACP and regional levels. It reiterated its concern for specificities of LDCs, small landlocked and vulnerable countries to be taken into account during the negotiations. Council also noted that COMESA needed to make a decision on regional configuration as a matter of urgency if it wanted to be able to negotiate an EPA rather than have one prescribed by the EU.

In January 2003 the COMESA and SADC Secretariats were invited to a meeting in London, England, organised by the Commonwealth Secretariat, to work together to prepare an annotated agenda for a meeting of COMESA and SADC member states from which a negotiating mandate could emerge. The outcome of the meeting was an agreement to prepare a series of studies on:

- negotiating structure and negotiating strategy;
- generic issues in market access;
- case studies in market access;
- market access in trade in services; and
- a regional investment agreement.

In March 2003, at its meeting in Khartoum, Sudan, (to which SADC was invited as an observer) the COMESA Council of Ministers decided that Eastern and Southern African countries that are also

ACP countries should negotiate an EPA as a group, and this was endorsed at the heads of state level.

The reaction by some SADC member states following the decision of the COMESA Council of Ministers that Eastern and Southern African countries should negotiate EPAs as a group, was strongly negative and critical. These SADC member states objected to the fact that COMESA seemed to have taken a decision on their behalf, although this was not the intention of COMESA. As can be seen from the above, COMESA and SADC had been holding discussions on the possibility of negotiating a single ESA EPA with the EC since 2001 and were under the impression that this was supported by the SADC Secretariat and the SADC member states. The understanding of COMESA at the time was that SADC would take a similar decision at its Summit, which was scheduled a few months later than that of COMESA.

Some SADC member states then started a campaign to create an EPA negotiating configuration comprising just SADC member states, with South Africa as an observer to the process. After a number of what were often heated and acrimonious exchanges between countries, the configurations stabilised into the Eastern and Southern Africa (ESA) configuration, which was the full membership of COMESA minus two countries[2] (Swaziland, which was a member of SACU so *de facto* part of the TDCA, and Egypt which is not an ACP country) and the SADC Minus configuration comprising seven of the fourteen SADC members at that time, these being the SACU membership (Botswana, Lesotho, Namibia and Swaziland minus South Africa, which is not part of the negotiations) and Angola, Mozambique and Tanzania.

Options on whether or not to negotiate an EPA

The options open to all ACP countries are to either negotiate EPAs or to not be a part of an EPA. The current options are dependent on whether the ACP country in question is a least-developed country (LDC) or not. If a country is not an LDC, its current option is to be a part of the EU's General System of Preferences (GSP) scheme. If the ACP country is an LDC it has the option of being a part of the Everything But Arms (EBA) arrangement.

In terms of the EPA negotiations, the options for ACP countries are, therefore, as follows:

1. **Not negotiate an EPA – option available is GSP for non-LDCs:** Market access under the EC's General System of Preferences (GSP) scheme is not as favourable as market access conditions under Cotonou. Therefore, if a developing (non-LDC) ACP country decides not to negotiate an EPA it will, in the short term, have its tariff preferences reduced compared to what was offered under the Lomé Convention. In addition, it would lose the opportunity to enter into a true negotiation process with the EC on such issues as market access and rules of origin and it would need to agree to accept whatever the EC chooses to give as a GSP.

2. **Not negotiate and EPA – option available is EBA for LDCs:** The EBA initiative came into effect in March 2001. It grants duty-free access to imports of all products from LDCs, with the exception of arms and munitions, and without quota restrictions. Liberalisation has been immediate except for three products, these being fresh bananas (to be liberalised in 2006), and rice and sugar (both to be liberalised in 2009). EBA is embedded in the EU's GSP scheme and access to the EU market is governed by the rules of the GSP. However, in contrast to the GSP, which will be reviewed at the end of 2004, EBA is for an unlimited period and not subject to periodic review. ACP LDC countries, because of the EBA arrangement, will face the same market access levels (these being zero tariffs into the EU) whether or not they are a part of an EPA. Therefore, as far as LDCs are concerned, being part of an EPA will not benefit them in terms of lower tariffs into the EU. However, EBA provides duty-free access to the EU market for all LDCs so the margins of preference that ACP LDCs had over non-ACP LDCs (such as Bangladesh) are eliminated.

3. **Negotiate an EPA:** The main advantages for LDCs and non-LDCs alike in negotiating an

EPA, as opposed to the GSP and EBA schemes, are as follows:

- EPAs give ACP countries the chance to actually negotiate better market access provisions with the EU, whereas EBA and GSP conditions are not negotiable – they are set by the EU.
- EPA negotiations give ACP countries a chance to negotiate more favourable rules of origin so that they improve market access for ACP producers. The rules of origin that apply to EBA are the same as for the EU–GSP and are even more restrictive than those of Cotonou.
- As EPA negotiations will cover both trade and development issues, there could be major gains for countries entering into these negotiations from the dynamic effects of EPAs. Although these dynamic effects are difficult to quantify, it may be these effects that make EPAs more interesting to ACP countries. The dynamic effects include using EPAs as a stepping stone to multilateral liberalisation by making it easier to 'sell' unilateral free trade to domestic producers as removal of protection is compensated by improved access to EU markets and possibly higher levels of investment; possibly enhancing the credibility of African trade reforms and 'locking in' these reforms; improving the regulatory environment in ACP countries; and protecting access into EU markets from further deterioration.

Since the start of the EPA negotiations, and immediately prior to this, there has been a healthy debate taking place on the costs and benefits of EPAs to ACP states. On the one hand there are those who hold the opinion that EPAs will, in principle, be detrimental to the economies of ACP states while, on the other hand, there are those who hold the opinion that EPAs could be a useful mechanism for accelerating the economic development and regional integration of the ACP regions.

The eventual outcome of EPA negotiations, and how close EPAs will be to either of the above mentioned scenarios, will depend to a large extent on how well prepared the ACP side is for the EPA negotiations and how well they conduct these negotiations with the EC. If ACP regions are internally well organised and use the resources they have in an efficient and cost-effective manner, they will be better able to take advantage of the opportunities provided to them by EPAs and will be in a better position than they would have been if they simply used the provisions of Everything But Arms (for LDCs) or the Generalised System of Preferences (for non-LDCs). If, on the other hand, ACP countries are not able to get themselves well organised they will surely lose opportunities they may have had under the EPA process to improve their economic position.

This is not to deny that there will be costs to ACP countries in negotiating EPAs, in terms of the institutional costs of taking part in the negotiations and in terms of the possible revenue losses, higher competition and costs of fiscal adjustments that may be needed. However, unless an ACP country has opted not to implement economic liberalisation measures, these costs are inevitable. The challenge faced by ACP countries in the EPA process is how to make these adjustments under EPAs, and use the provisions of the Cotonou Agreement and the European Development Fund to help pay for these adjustments, rather than to attempt these adjustments outside of the framework of EPAs and at a later date. A further challenge for the ACP is how to obtain additional funds over and above EDF resources to help finance the process of adjustment necessary if ACP states are to play a more meaningful role in the global economy.

ESA negotiating structure

The countries that are part of the ESA EPA negotiating Group are: Burundi, Comoros, Djibouti, DR Congo, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia and Zimbabwe.

The ESA Group launched negotiations with the EC on 7 February, 2004 in Mauritius, with the official launch followed by the first meeting between the ESA Ministers and the EC Commissioner of Trade. This meeting agreed on a joint ESA–EC Roadmap which, among other things, sets out the phases to be followed in the negotiations as being:

1. Setting of Priorities and Negotiating Procedures (March–August 2004)
2. Substantive Negotiations (September 2004 to December 2005)
3. Continuation and Finalisation (January 2006 to December 2007)

The negotiations are being carried out at two levels, the ministerial level and the ambassadorial/senior official level, and in six clusters. The ESA Group has selected six ambassadors (based in Brussels) and six ministers to lead the negotiations as follows:

Cluster	Ministerial lead spokespersons	Ministerial alternate spokespersons
Development issues	Sudan	DR Congo
Market access	Mauritius/ Rwanda	Burundi and Zambia
Agriculture	Malawi	Uganda and Ethiopia
Fisheries	Madagascar	Seychelles and Djibouti
Trade in services	Zimbabwe	Rwanda and Djibouti
Trade-related areas	Kenya	Djibouti

Cluster	Ambassadorial lead spokespersons	Ambassadorial alternate spokespersons
Development issues	Ethiopia	Zambia and Burundi
Market access	Kenya	Zimbabwe and Uganda
Agriculture	Mauritius	Zimbabwe and Madagascar
Fisheries	Eritrea	Seychelles and Madagascar
Trade in services	Malawi	Rwanda and Uganda
Trade-related areas	Sudan	DR Congo and Burundi

Each ESA country has established a National Development and Trade Policy Forum (NDTPF) which is both multi-sectoral (agriculture, trade, investment, services, etc.) and representative of the public and private sectors and non-state actors (NSAs) involved in trade and development work. The function of the NDTPF is to determine what the optimal development and trade negotiating position for the country is and to prepare briefs outlining these positions, which can then be used by the representatives of the country in the Regional Negotiating Forum (RNF) in preparation of the ESA position for the negotiations with the EC.

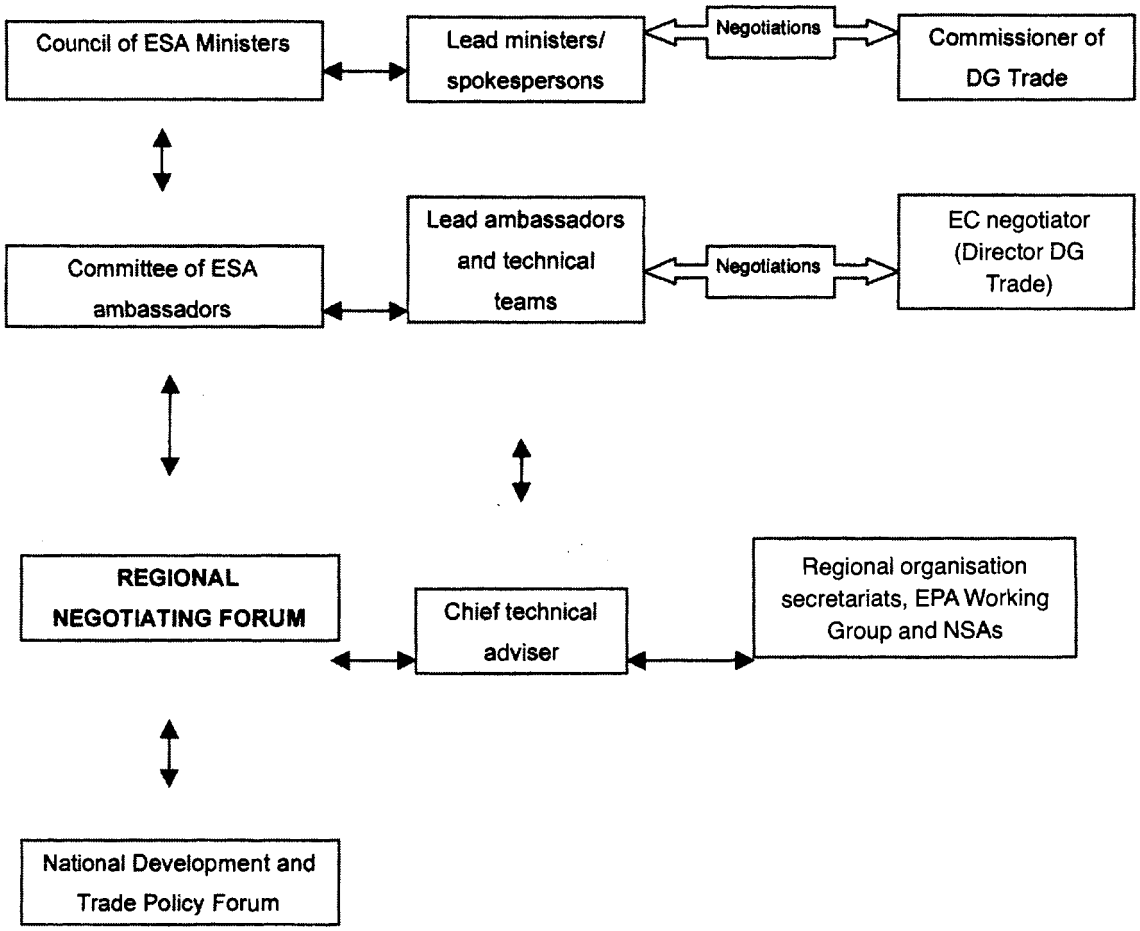
Each NDTPF sends at least three representatives to the RNF, which is scheduled to meet on average once every three months, and more frequently if necessary, during the EPA negotiating period. Each NDTPF has nominated a team leader and an alternate to the team leader, and the team leader or his/her alternate is to be present at all RNF meetings to ensure coherence, continuity and consistency. The members of the rest of the team from each NDTPF are experts in the various sectors to be negotiated under the EPA and vary according to the agenda of the RNF. Depending on issues being negotiated, an ESA member may co-opt experts with relevant expertise to act as advisers.

The membership of the RNF are the countries of the ESA EPA Negotiating Group, currently the sixteen members (public and private sectors and non-state actors) listed earlier. Other participants in the RNF are the ambassadorial lead spokespersons from Brussels and invited guests.

The Secretariats of the regional organisations involved in the ESA EPA negotiations (which are currently COMESA, EAC, IOC and IGAD) are mandated to act as the Secretariat for the RNF, with COMESA taking the lead and co-ordinating role. The Secretariat assists the RNF in the preparation of a series of written negotiating briefs to be used by the negotiating teams who will negotiate an EPA with the EC. Members of the RNF are part of the team to support the ESA ambassadorial lead spokesperson in the EPA negotiations.

The ESA EPA Group has also recruited a chief technical adviser (CTA) who, under the direction of the ESA ministers, Brussels ambassadors and the Regional Negotiating Forum will, amongst other things, help to develop and execute negotiating strategies for the EPA negotiations. The CTA is not the ESA region's chief negotiator but is in place to assist the lead ambassadors in the negotiations and in preparing for the negotiations.

The agreed negotiating structure is as follows:



Content of the ESA EPA

The ESA region has placed great emphasis on the fact that, as well as promoting regional integration; preserving the Lomé *acquis*; and being WTO compatible; EPAs must be instruments for development that contribute to the integration of the ACP states into the world economy, and to poverty eradication. In this context, it is imperative that, under the EPA process, capacity should be built first, then markets enlarged through the removal of barriers to trade and through improving the predictability and transparency of the regulatory framework for trade, thereby creating the conditions for increasing investment and mobilising private sector initiatives and enhancing the supply capacity of the ACP states. To achieve this, the principle of asymmetry and sequencing should be in-built into an ESA EPA, and due account taken of specific economic, social, environmental and structural constraints of the ESA region, as well as of their capacity to adapt their economies to the EPA process. They further need to take account of the development policy objectives of the ESA region.

Although the EPA process has been on-going for nearly four years, there are still some issues as regards coverage and content of EPAs that are still not clear, such as the following:

1. **Whether the EPA process is just an FTA negotiating process or something more than this.** The EPA negotiations only take account of negotiations on trade and trade-related aspects. This is reinforced by the fact that DG Trade sup-

plies the Chief Negotiator and that the EC's position on development is that this is covered by the EDF programming activities. The EC has consistently stated that the finances available for development are those allocated to the EDF, which will be used in accordance with the EDF's agreed Regional and National Indicative Programmes (RIPs and NIPs). Realistically, (or unless there is a significant change of heart by the EU and its Commission) between now and when the negotiations on EPAs are to be concluded (end-2007) there is little that can be negotiated in the development context which is not already agreed in the EDF9 NIPs and RIPs.[3]

2. **Whether there is a policy or political dialogue, which should take place under EPAs.** There is no provision, either in the negotiating structures or the Cotonou Agreement, for a political dialogue, but the Cotonou Agreement is supposed to be a partnership agreement and, as EPAs are a major component of the Cotonou Agreement, it would follow that provision should be made for a policy or political dialogue. Under most negotiations with the EU, such as the TDCA, provision is made for initial discussions on the scope and depth of the negotiations. Unless this is considered to have been included in Phase I (all-ACP) of the EPA negotiations, no provision is made for this dialogue with the EC.

The ACP countries are also experiencing serious problems in accessing money which is allocated to them through the EDF. Although EDF resources are substantial, the EDF9 procedures the EC insists on applying significantly reduce both the efficiency and availability of these funds. As part of the negotiations some regions wish to include talks to explore ways in which the EDF procedures could be interpreted in a more liberal manner so that the implementation efficiencies of previous EDFs can be regained, without sacrificing transparency and accountability in any way.

In the case of the ESA Group, a Trade Negotiation Facility was negotiated with the European Commission to assist with the financing of preparations for an EPA. The facility, which was for just under €2 million, was intended to finance short-term technical assistance to carry out technical studies and to finance the regional meetings necessary to build consensus in the region before it could negotiate with the Commission. Owing to the procedures involved in recruiting locally based consultants,[4] the bulk of the funds provided under the EDF9 Regional Indicative Programme in support of EPA negotiations have been used to finance meetings. This has led to an impression being created in some parts of the European Commission that the ESA region's sole activity in preparing for EPA negotiations has been to hold workshops and meetings. This is, in fact, far from the truth. A significant number of studies have been carried out, and papers written, either by staff of the COMESA Secretariat and other Secretariats of Regional Organisations, or by consultants financed using other sources of funds.

Development negotiations

Economic Partnership Agreements are supposed to be both trade and development oriented and, in this respect, the ACP Group has continuously stressed the importance of the development component both as a cross-cutting issue and as a stand-alone issue. This is in recognition of the need to remove supply-side constraints if the region is to be able to take full advantage of the liberalised trade environment that the successful negotiation of EPAs implies.

1. For most negotiating regions, the development component of EPAs is the most important component as unless the benefits of economic liberalisation can be demonstrated to the electorate of ESA countries the process will be unsustainable and doomed to failure. It is only by addressing the supply-side constraints bilateral and multilateral economic liberalisation, in which trade liberalisation plays a part, will be realised.

2. The main concerns in terms of the development dimension are:

- how to measure the costs of implementing EPAs;
- how to access funds to meet the costs of adjustment, given that the EC consistently states that the only funds available to the ACP from the EU

are those in the European Development Fund; and

- how to implement a series of programmes that will remove supply-side constraints in the ESA region and so make the region more competitive so that it is able to participate in the global economy in a more sustainable and meaningful way.

Sectoral issues

As stated above, development issues are both sectoral and cross-cutting. Dealing with sectoral issues first, each ACP negotiating region needs to determine the sectors in which they require development assistance. These will probably include the sectors of sanitary and phytosanitary; standards; fisheries; trade facilitation (including upgrading of infrastructure); trade in services; and intellectual property. In these sectors, needs assessments will be required and, based on these assessments, a costed proposal could be produced. If the example of SPS is used, an ACP negotiating region will first need to carry out a stock-taking exercise of what is in place at present. Based on the stock-taking, the group could then do a needs assessment to meet a particular target, such as being able to conform to EU Food and Feed Regulations in cut flowers and fruit and vegetables. This needs assessment could then be costed and the resultant proposal could form the basis of negotiations with the EU. This exercise could take place in each relevant sector. It is not necessary to complete these negotiations by 31 December, 2007 to comply with WTO provisions but it may be necessary to complete this exercise as soon as possible to ensure that the EU makes the necessary budget provisions to meet these requirements.

Removal of supply-side constraints

Development as a cross-cutting issue refers to meeting adjustment costs and removing supply-side constraints. There has been a lot of emphasis placed on the demand-side of the development equation, meaning that if the ACP puts in place regulatory systems that are transparent, rules-based and investor friendly, foreign direct investment will flow into ACP countries and development will take place. It is, however, probably too simplistic to argue that once the demand side is taken care of, and economic distortions are removed, each country will have a competitive advantage in something and will be able to supply this to the rest of the world. What is required by the ACP countries is a set of tools that address the removal of supply-side, not just demand-side, constraints. The supply side involves ensuring that an infrastructure to support competitive production is put in place.

In the past, attempts to remove supply-side constraints have been general and generic. For example, there have been attempts to get donors to finance the rehabilitation and/or reconstruction of national transport networks, with varying degrees of success. A more targeted approach to the removal of supply-side constraints, which is linked to increases in productive capacity, could be a more effective and efficient strategy to adopt. An example of this more targeted approach could be linked to the Integrated Framework process in countries where there is an IF process. If the country does not have an IF process it could follow a similar process as follows:

1. The Diagnostic Trade Integration Study (DTIS) or similar process would include an analysis of which products or sector(s) in the country for which the study is being done has a competitive advantage in. The analysis should look at the whole value chain, and analyse the Production-Marketing-Distribution-Transport (PMDT) chain and examine what would need to be done for the country to be able to supply the regional and/or international market in the product selected.

2. Once a product or sector has been identified, negotiations with a major company involved in production, processing and supply of this product could take place. The purpose of these negotiations would be to determine what the company's requirements would be to invest in the country to produce the product identified for the regional and/or international market. For example, if the country was assessed to have a competitive advantage in coffee, an alliance could be made with a regional or European company to process coffee, and so add value to the coffee, and to sell this processed coffee on regional, European and international markets.

3. If the major company's requirements are acceptable, government could then start to meet those requirements it can meet (such as allocation of land, licenses, work permits, etc.).

4. If the company has requirements that have an infrastructure component (such as a requirement to get the product transported to a port at a predetermined tonne/kilometre price that will require an upgrade in the railway system to the port) the government will then be able to approach the European Union in the first instance for assistance to finance the infrastructure. The government will be able to show that the economic effect of the infrastructural improvement, will be in line with efforts to reduce poverty and meet the Millennium Development Goals.

These infrastructural upgrades would need to be done whether or not they have a positive economic rate of return over the immediate future. If this targeted approach to addressing supply-side constraints was taken on a regional basis, a number of multipliers would come into effect and other investors would be attracted to the country and the region in which the LDC is located.

In addition to supporting the above-mentioned activities, the European Union could also assist with the preparation of detailed product studies, which would identify five to ten non-traditional export products that have the potential to add significant export earnings (say over $10 million per sector per product per year) and to develop a programme that provides technical and financial support to the export producers in the form of production, processing/manufacturing, logistics and international marketing. This programme would need to be accompanied by improving the overall capacity of the national trade promotion organisation (such as an export promotion agency) and increasing levels of professionalism, in order to increase the competitiveness of the export sector and trade promotion organisation's impact on expanding the export capacity of the country; training trainers of local export consultants, including the development of training modules, in all aspects of export consulting for (potential) exporting enterprises; and setting up of information networks for exporters.

Adjustment costs

The EU could also support the development sector under EPAs through the creation of an Adjustment Facility. Trade liberalisation has provided opportunities for economic growth but a number of areas need to be addressed in the process, including how to make up for short-term losses of public revenue and how to improve competitiveness. As public finances are already in a precarious situation in all ESA EPA countries, any fall in customs revenue could have an adverse impact on budgetary balances. If this translates into public expenditure reductions, it should be recognised that these cuts could lead to political and social instability. It will be difficult to justify continued trade reform if this entails further immediate reductions in the population's welfare.

The COMESA Secretariat, on behalf of the ESA EPA Group, has submitted a Financing Proposal to the European Community for an adjustment facility, called the Regional Integration Budget Support (RIBS) Facility. The RIBS Facility arose from demands from the ESA countries to develop a mechanism that would assist them to counteract the short-term adverse effects of implementing economic policy changes associated with globalisation and growth. The direct result will be the implementation of macroeconomic reform programmes that will strengthen regional integration (by allowing ESA countries to be a part of regional free trade areas and customs unions) which, in turn, will drive the process of Economic Partnership Agreements and the implementation of the Doha Development Agenda of the WTO.

The RIBS Facility is designed on a need-assessment basis and takes into account the need for countries to qualify for budgetary support, with trade liberalisation being part of a package of macro-reform measures. At the same time as trade reforms are taking place, ESA countries are addressing other macro-economic issues such as restructuring their revenue collection systems, using monetary instruments to control inflation, building capacity in financial and economic management, letting the market set interest rates and exchange rates, privatising state-owned industries and services, etc.

For a country to qualify for budgetary support under the RIBS Facility, it must be in conformity with Cotonou Agreement's Article 67 (which addresses Structural Adjustment Support) as well as Article 61.2 (which requires that public expenditure management is sufficiently transparent, accountable and effective; that a well defined macroeconomic or sectoral policies are in place; that public procurement is open and transparent; and that Public Finance Management (PFM) indicators are met).

In addition, a country should:

- be a COMESA or EAC member state and an ACP country signatory to the Cotonou Agreement;
- have prepared, negotiated and signed a Country Strategy Paper (CSP) with the EC and have an on-going indicative programme for the CSP; and
- be implementing a programme of trade tax adjustments in order to join or align itself with a CU or FTA promoted by COMESA or EAC.

Once a country qualifies for budgetary support, the level of budgetary support that could be provided will depend on what adjustments will need to be made to implement the regional liberalisation programme and cover the short-term financing gap that there will be as a result of the implementation of the liberalisation measures and which cannot be covered from the budget.

The fund allocation mechanism from the RIBS Facility would be based on the following principles:

(a) An eligible COMESA or EAC member state will notify the COMESA Secretariat that it proposes to reduce its trade taxes in line with a COMESA or EAC programme and will give specific details of the proposed tariff reduction, including timing of the reduction.

(b) The member state will, with the assistance of the COMESA and EAC Secretariat, if necessary, estimate the potential loss of revenue as a result of the tariff reduction in the first six months after the tariff reduction takes place.

(c) The member state will also outline measures that it will take to balance its budget within six months of the implementation of the tariff reduction so that the tariff reduction does not become a permanent reduction of public revenue.

(d) The revenue loss calculation will be a static analysis as follows:

- calculation of the theoretical tariff revenue for the six-month period of a year previous,[5] not taking into account exemptions or exclusions, but taking into account existing preferences. This calculation will be done by multiplying the values of imports to which tariffs are applied (taking account of preferences) with the tariff rate of each tariff band;
- calculation of the theoretical tariff revenue for the six-month period after the tariff cuts come into effect, using the same values of imports as the reference period; and
- subtracting the theoretical tariff revenue total of the six-month period after the tariff cuts have been made from the theoretical tariff revenue total for the reference period. This will give the amount that the member state will be eligible to claim from the RIBS Facility.

(e) The amount of budgetary support each qualifying member state will be entitled to claim from the RIBS Facility will be calculated by the formula:

$$\sum_n((x_n y_n)-(a_n y_n))$$

where:

x_n is the tariff rate for band n for the reference period

y_n is the value of imports for tariff band n for the reference period

a_n is the tariff rate for band n in the period after the tariffs have been reduced

(f) In case the total amount applied for by the eligible member states (and accepted as justified) exceeds the value of the Facility (€80 million), then the allocation of the Facility will be done pro rata to the amount that each applicant country would otherwise qualify for.

(g) In case the total amount applied for by the applicant countries (and accepted as justified) is less than the value of the Facility, then the balance of funds will be brought forward to a second annual round of applications.

(h) Budget support will be granted as Direct Budget Support without earmarked use.

The ESA EPA Group has also expressed concern about the large debt overhangs that are a common problem for ESA EPA countries. Countries recognise that unsustainable debt perpetuates domestic macroeconomic instability, causes stagnation or reduction in real outputs, and adversely affects their international trade performance, so weakens the multilateral trading system.

What is required, possibly under an EPA, is a system that allows countries that have introduced accountable and transparent systems of governance a 'fresh start', without having to atone for the sins of past dictatorships and undemocratic governments that were often propped up, and encouraged to borrow by the Western world that are now the creditors, as part of their cold war strategy.

The long-term solution to the debt problem of ESA EPA countries is not through increased protectionism but through assistance from the European Union and other partners in the developed world to deal with the problem of debt overhang in the short-term through debt forgiveness, debt swaps and debt buy-back schemes and, in the longer term, a combination of levelling of the playing field that is the multilateral trading system, with successful conclusion of the EPA negotiations and the Doha Development Agenda, and a supply-side response resulting in a diversification of exports into competitively priced valued added exports, supported by an ambitious Aid for Trade programme.

The impact of HIV/AIDS, malaria and TB on development

It is a well-known fact that the ESA region is strongly affected by the burden of the three diseases of HIV/AIDS, Malaria and TB. Africa as a whole accounts for 78% of the cases of HIV/AIDS, 88% of people suffering from malaria and 33% of the global burden from TB. Comparing the ESA countries with the developed countries of Europe, Europeans have:

- 20 times the level of GDP per capita;
- double the percentage of their population with access to safe water;
- 70 times the capacity for communication by telephone;
- 45 times the level of health expenditure per capita;
- 33 times the level of provision of physicians per 100,000 population; and
- 50% more of their population with access to essential drugs.

In comparison to their European partners, ESA countries suffer:

- 300 times the burden of disease from HIV/AIDS, malaria and TB per million population;
- 7 times the level of infant mortality;
- much lower life expectancy;
- 50% the overall level of human development, and
- one-third adult illiteracy rates compared to 4% in developed European countries.

There is an urgent need, within the framework of the ESA EPA, to develop an outline for a strategy for addressing the three health problems in the ESA region as part of a programme of economic and social development. Preliminary studies conducted in the ESA region would suggest that significant improvements would be made if a programme costing just over $1.1 billion a year, or $4 per capita, were to be implemented over the next three years. The annual cost of the three diseases is estimated at nearly $60 billion, based on calculations by the *WHO Commission for Macro-economics and Health*, a figure that compares favourably with $1.1 billion annual investment for a period of three years.

Market access

Tariffs

Market access negotiations revolve around negotiating a Free Trade Agreement between each ACP negotiating group and the European Union. This is the part of the EPA negotiations that need to be completed by 31 December, 2007. As things stand at present, if an ACP negotiating group wishes to negotiate an EPA it will need to have negotiated a Free Trade Agreement with the EU, which is in conformity with Article XXIV of GATT 1994 by 31 December, 2007. The main provisions of Art. XXIV to consider are that duties and other restrictive regulations 'are eliminated on substantially all the trade between the constituent territories in products originating in such territories' and the schedule for the formation of a free trade area should be completed within a 'reasonable length of time', which should 'exceed 10 years only in exceptional cases'.

As is well known, the EC requested a waiver in the WTO from its obligations under paragraph 1 of Article I of the 1947 General Agreement on Trade and Tariffs (GATT) with respect to the granting of preferential tariff treatment for products originating in ACP states and this waiver was agreed as part of the Doha Development Agenda. The 'Decision on waiver for EU–ACP Partnership Agreement' which forms part of the Doha Ministerial Declaration considers that the 'Agreement establishes a preparatory period extending until 31 December, 2007, by the end of which new trading arrangements shall be concluded between the Parties to the Agreement'. The waiver is, therefore, time-bound and expires at the end of December 2007. The initial waiver 'cost' the ACP a concession of 25,000 tonnes of tuna imports into the EU from Thailand and the Philippines at reduced tariff rates, which eroded the preference margin for tuna for ACP countries into the EU market. If the ACP countries press for another waiver it is unclear as to what the cost of the waiver to the ACP would be. It is also unclear as to where a challenge would come from but if there is a challenge it will most probably come from non-ACP developing countries.

There is some debate about the whether the ACP should be held to the time limits of the waiver when the Doha Development Round is far from reaching completion point, and has missed the original 'single undertaking' deadline of 1 January, 2005. This is particularly relevant when one considers the close link between EPA negotiations and negotiations taking place at the WTO. However, rather than divert scare resources to debating whether or not the waiver should be extended, emphasis should be placed on whether there is a need for an extension of the waiver, meaning concentrating resources on assessing whether or not ACP regions can complete the components of the EPA negotiations necessary to be completed by 31 December, 2007 in order to be in conformity with WTO requirements.

FTA negotiations with the EU will need to cover trade from the EU into the ACP group and trade from the ACP group into the EU. The latter would not seem to be contentious and the EU must provide each ACP negotiating group with full market access covering 100% of all trade into the EU from the ACP negotiating group. Most, if not all, ACP negotiating groups are a combination of developing countries and least-developed countries (LDCs). The EU has already granted EBA to LDCs so, in order to fulfil the objective of using EPAs to strengthen the regional integration process, it must grant equal market access to all countries in an ACP negotiating group, whether they are developing countries or LDCs. Failure to provide each member state of each ACP negotiating group with equal market access into the EU will preclude the negotiating group from deepening its integration as, for example, the group will not be able to move towards a customs union as it will not be able to implement a Common External Tariff. It can, therefore, be reasonably assumed that the EU will grant 100% market access to ACP EPA negotiating groups and that, unlike EBAs, this market access will be contractual.

The main tariff issue to be addressed by ACP negotiating groups is, therefore, the level of access each group should provide to the EU into its markets. The level of 'substantially all trade' referred to in Article XXIV of GATT is often interpreted by the EU as covering 90% of trade. In the case of the EPA negotiations, if the ACP group has 100% market access into the EU, it could offer the EU 80% market access into its markets, to get an average of

90% of trade covered. However, the 90% definition of 'substantially all trade' used by the EU is generally accepted as referring to FTAs between developed countries. As there has never been an FTA negotiated between a developed country and a group of predominantly LDCs, there is a strong argument to agree the definition of 'substantially all trade' to be significantly lower than a 90% average. There is also a strong argument to suggest that the time period for full implementation should be longer that 10 years as EPA negotiations would surely qualify as an 'exceptional case'.

The EC has consistently stated that ACP countries should first build regional markets and then address trade liberalisation issues with the EU. All countries in the ESA negotiating group are COMESA member states and, as COMESA is aiming to move towards a Customs Union,[6] the emphasis, in terms of market access, should be to build regional markets by first implementing the agreed Common External Tariff and only then to address opening regional markets to the EU.

The approach to negotiations with the EU should, therefore, be to offer the EU a Common External Tariff, with exemptions on sensitive products, and then, where appropriate, to phase in some sensitive products (backloading) after a negotiated period.

The principle of asymmetry should apply, meaning that the ESA region will expect the EU to fully open its markets to ESA exports but that the ESA will not allow market access to 100% of EU exports.

The overall objective should be to negotiate an EPA in such a way as to ensure that the European Union meets the costs of adjustment in meeting an EPA so that EPAs are neutral in effects on revenue and competitiveness and positive in additional resources from the adjustment facility and in the safeguard measures, which would need to be automatically triggered if there are sharp increases in imports from the EU.

Rules of Origin

Rules of Origin (ROO) are required in any preferential trading arrangement. They are usually put in place to ensure trade deflection[7] is at least minimised by ensuring that the product to be exported into the customs territory granting the preference is produced (however that is defined) in the customs territory the preference is granted to. However, Rules of Origin can also have development objectives and can also be used as a means of protection.

Rules of Origin are important in that they can affect the sourcing and investment decisions of companies and can, at the same time, distort the relative prospects of similar firms within a country. The adoption of restrictive rules of origin are more likely to constrain than to stimulate regional economic development and can act to undermine regional trade agreements.

There are three main ways to determine origin, these being:

1. change of tariff classification, usually at the HS 4-digit level;
2. percentage value added and/or maximum value of non-originating materials (including wholly produced); and
3. specific manufacturing process.

The EU–ACP Rules of Origin are a combination of all three of these tests, and there is significant variation in the way these tests are applied and in the combinations they are used. It is, however, not necessary for the EC to use Rules of Origin to control imports as they have a set of safeguard measures, consistent with the WTO Agreement on Safeguards, which can be used for this purpose.

The Cotonou Rules of Origin vary by product in terms of their scope and complexity. It is not clear that they have a development dimension or, conversely, successfully protect the market share of any group of EU producers. There has been no assessment done of the Cotonou Rules of Origin to show that they either promote the interests of the EU or the ACP. What is clear, however, is that the Cotonou Rules of Origin impose a significant cost in terms of compliance to both ACP exporters and customs administrations.

Regarding the current list of goods exported into the EU from the ESA region, the exports that are most affected by Rules of Origin are apparel and fish.

The Rules of Origin for apparel require manufacture from yarn or other natural or man-made fibres. ESA countries are not able to manufacture cloth in volumes necessary to benefit from the economies of scale required for international competitiveness and must source cloth and fabrics from lower cost suppliers if their apparel is to be competitive in world markets.

In the fisheries sector, EU rules confer origin when:

- The vessel is registered in the EU or any ACP state.
- The vessel sails under the flag of any ACP country or the EU.
- The vessels are at least 50% owned by nationals of any ACP or EU state and the chairman and the majority of the board members are nationals of any of those countries. Under certain conditions the EU will accept vessels chartered or leased by the ACP state under the Cotonou Agreement.
- Under the Cotonou Agreement, 50% of the crew, and the master and officers are nationals of any ACP state or the EU.

The main problem with the Rules of Origin is seen to be concerning the vessel's ownership. Vessel ownership rules also affect an exporter when that exporter seeks to add value by processing, such as tuna canning. Although Title V of the Cotonou Agreement provides ACP countries with a right to request suspension of all origin rules for canned tuna and tuna loins within an annual quota derogation, it should be noted that only six ACP countries operate under the current exemption and it is unclear how much of the quota is used in any year.

Apart from the damage caused to ACP exports, it can be argued that the restrictions on ownership are inconsistent with a liberal foreign investment policy. The general consensus has been that developing countries should attract direct foreign investment by offering the appropriate safe and market-driven environment. However having invested, the firms in question find that they do not qualify for preferential treatment on the EU market.

The cumulation rules applied under Cotonou are relatively straightforward in that there is full cumulation between ACP states, meaning that one ACP country can source inputs from another ACP country and, in terms of the Rules of Origin, those inputs will be considered to have originated in the ACP country which is exporting the product to the EU. This should, in theory, encourage the sourcing of inputs from ACP states and so promote regional economic integration. However, the exporters still need to prove origin of these inputs from ACP states and this can be a time-consuming and costly exercise.

Materials originating from the EU or its Overseas Countries and Territories (OCT) are considered as materials originating in the ACP state when incorporated into a product that is exported to the EU by the ACP state.

Materials originating in South Africa are also considered as materials originating in the ACP state when incorporated into a product that is exported to the EU by the ACP state, although there are a number of exceptions and a number of products to which this conferring of origin will either not apply, or which came into force either three or six years after the signing of the Cotonou Agreement.

The Cotonou Agreement provides for a tolerance level (or de minimis) on cumulation, meaning that up to 15% of non-originating materials are tolerated before a good no longer satisfies the EU's origin criteria for imports from the ACP.

The Cotonou Agreement also provides for, on request, materials originating in a neighbouring developing country, other than an ACP state, belonging to a coherent geographical entity, as originating in the ACP state if the materials are used as inputs for the item to be exported to the EU. There are also a number of exceptions to this, including Chapters 50 to 63 (textiles and garments) of the Harmonised System, tuna products and rice.

Both the ACP and the EC agree that the Rules of Origin that apply to EPAs should be simplified. The current thinking in the EC would appear to be that origin should be conferred through a single application, that being the value-added criteria, which is the difference between the ex-factory cost of the finished product and the cost of all the materials used in the production of the finished product.

Although use of value added to determine origin may well be an improvement to the existing method of determining origin under Cotonou, it also has its serious disadvantages. For example, the percentage of value addition is dependent on the value of the currency of the exporter *vis-à-vis* the importer and an overnight appreciation of the currency of the exporter can result in a product no longer conferring to rules of origin, despite the fact that the sourcing of goods and the manufacturing processes have remained the same. Another example is if a manufacturer invests in capital which improves the efficiency of the manufacturing process and reduces the cost of production. He may well find that he has reduced the value added to below the threshold considered to confer origin.

It is also extremely difficult to calculate value addition when multiple products are manufactured from a single raw material. For example, cooking oil, margarine and soap are manufactured from palm oil and it is very difficult to calculate the difference between the ex-factory cost of the different finished products, and the cost of the palm oil and other materials used in the production of the finished products.

The most simple and effective solution would be to use the change of tariff heading (CTH) criteria to confer origin. In such a case, if the manufactured product has a different HS code at the 4-digit level to the raw material it is manufactured from then origin is conferred. However, there are some instances where a process application should also be applied to guard against a simple packaging exercise or, conversely, to confer origin when a fundamental manufacturing process has taken place but the HS code at the 4-digit level has not changed.[8]

Agriculture

The agricultural sector is at the heart of the economies of ESA countries, accounting for a large share of their gross domestic product; employing a large proportion of the labour force; representing a major source of foreign exchange; supplying basic food requirements; and providing subsistence and other income to the bulk of the population.

Agricultural trade is already a major source of export earnings for ESA countries, particularly for products covered by the Commodity Protocols. However, despite this, participation of the ACP countries in international trade is severely limited by a number of structural factors as well as unfavourable market access conditions in markets of greatest export interest to them, including the EU.

Under the Cotonou Agreement trade in agricultural products is governed by specific rules and disciplines and access to EU markets is subject to a series of constraints in the form of separate commodity protocols, tariff rate quotas, seasonal and ceiling restrictions, etc.

Erosion of preferences

EU–ACP agricultural trade preferences, apart from those covered by the Commodity Protocols, have been continuously eroded in size, product coverage and effectiveness over time. GSP duties for most tropical products have been progressively reduced and in some cases eliminated by the EU. The EBA Initiative has further eroded the preference of all ACP states, including ACP LDCs.

According to a FAO study the estimated potential value of preference on ACP agricultural exports to the EU was €710 million in the year 1996, or roughly 14% of the total value of agricultural imports by the EU from the ACP countries and was projected to decline to less than €600 million in 2000. About 52% of the total value of preference is due to sugar alone, followed by bovine meat (21%), tropical beverages (10%) and bananas (8%).

High tariffs

Above-quota tariffs are often high or prohibitive for ACP suppliers. ACP tariff quotas are specifically defined in terms of quantity and rates, thus expansion of ACP exports to the EU is hindered except for ACP LDCs under the EBA.

Seasonal tariffs are still high for certain agricultural products and some fruits and vegetables are subjected to seasonal restrictions based on European horticultural calendars. Quotas limit entry to the EU market though within quotas, exports benefit from CAP prices that are higher than world prices. Beyond those quotas, which are governed by the

'Commodity Protocols' and the duty-free access to out-of-season products, there are instances of tariff escalation along the processing chains.

The issue of tariff escalation in agricultural products is very important given that growth in world agricultural trade is shifting more to processed products. ACP countries with high dependence on commodity exports have a strong interest in this matter as they are trying to escape from the circle of producing and exporting primary products only.

The effects of the reform of the Common Agricultural Policy (CAP) on ESA

CAP reform is having the following general effects:

- substantially lower prices for affected agricultural products on the EU market, which reduces the value of ACP trade preferences;
- reductions in prices generated by CAP reform make the raw material costs of EU food and drink manufacturers cheaper, leading to an expansion of simple value food product exports from the EU to the ACP in product chains linked to the basic agricultural raw materials whose price has fallen; and
- the process of price reductions induced by CAP reform reduces the need for EU export refunds and high levels of tariff protection, which then brings the EU's agricultural policy more into line with the WTO provisions.

The impact of CAP reform on ACP countries can be divided into four main areas:

- the reduction of the value of preferential access to the EU market, as a result of the reduction in EU prices arising from the shift from price support to direct aid payments;
- the enhanced price competitiveness of EU agricultural and value-added food products on both domestic and overseas markets;
- the increased costs and difficulties in securing market access as a result of the EU's strengthened food-safety policy; and
- the growing product differentiation within the EU market and associated divergent price trends, which will require ACP importers to concentrate on developing appropriate marketing strategies into specific markets in the EU.

The ESA region will need to define sensitive products in terms of the EPA negotiations. Sensitive products should be to defined within the context of product chains if the aim is to increase local value-added processing to serve regional markets. Sensitive products can be protected through the following mechanisms:

- **backloading** – whereby tariffs are eliminated only at the end of the phase-in period;
- **exclusions** – whereby products are excluded from the process of tariff elimination;
- **special arrangements** – whereby some form of tariff rate quota (and associated administrative arrangements) is established, as a means of reconciling divergent regional interests in the product concerned; and
- **pre-emptive safeguards** – whereby tariffs may be maintained or reduced, but the trade is subject to close monitoring and surveillance so that where a threat of market disruption emerges, pre-emptive action can be taken to prevent the actual disruption of the markets concerned.

Inland fisheries

The inland fishing industry is an important source of food for the region, as well as constituting an important source of exports. As most fish that is exported, or has the potential to be exported, is caught in lakes that are on the borders of ESA countries, so shared between countries, inland fishing promotes co-operation between countries that share these common resources.

The EU has enacted specific legislation concerning fish products,[9] which are also applied to imports, including:

- health conditions for the production and placing on the market of fish products;
- freshness of fish products;

- restrictions on veterinary medicines concerning aquaculture animals and products; and
- the obligation to introduce a system based on the principles of Hazard Analysis Critical Control Point (HACCP) in fish-processing companies.

In addition to this, all fish products (fresh, chilled, smoked, frozen, canned, salted or dried) imported from third countries must come from a preparation, processing, packing or storage facility approved by the national competent authority.

In effect, the EU has tried to move from a process of end-product inspection and certification to a preventative assurance approach. This approach means that producers must allow investigations to be carried out during the production phase of various products and must record the data for a supervisory authority.

The ESA inland fishing industry has suffered from a number of bans and restrictions put into place by the EC. In each of these cases the EU has imposed import restrictions (testing and/or bans), although the exporting countries concerned remain unconvinced of the scientific evidence justifying the import restrictions, and this position would appear to be re-enforced by the findings of the WHO and FAO, as concerns the cholera case at least. The impact of these import restrictions on fish products has been severe.

The ESA Region has prepared a programme in support of the inland fisheries sector and this is being discussed with the EC.

Sanitary and phytosanitary measures (SPS)

A major challenge faced by ACP countries is raising the SPS/TBT standards to at least internationally recognised levels. ACP countries face an additional challenge when the EU, on risk assessment grounds, adopts higher standards than those currently recognised by international standard-setting bodies. Most ACP states lack the capacity and regulatory mechanism to both participate in the setting of international standards and meet those standards.

SPS issues that will directly affect levels of exports from the ACP into the EU include the fact that each EU member state has its own approval system for agrochemicals. Similarly, for pesticide residues, there is no harmonised system, with each EU member state having its own Maximum Residue Level (MRL) for chemicals used to grow crops. If field trials have not been done for a particular chemical, which is not unheard of, as ACP producers often make use of chemicals that have been discontinued in other parts of the world for economic rather than health and safety reasons, the MRL is set at zero.

Another major concern for ACP agricultural producers is the EU system of traceability, which covers the complete food chain from the farm to table. Many small production entities will not be able to comply as mixing produce from different production sources is a common feature in ACP countries.

SPS measures, therefore, represent a particularly difficult barrier to the successful achievement of increased market access for all African countries. For this reason the focus must be moved from continually pushing for more market access to the more useful one of freeing up and increasing the actual capacity of the ACP region to avail itself of the access that is being made available.

Concentrating on identifying what precisely is needed to achieve this objective and how much this will cost will provide the basis for a more positive and targeted negotiating position with the EU. It would seem a reasonable position to adopt for ACP countries to link the reciprocal aspects of EPA trade to the provision of sufficient assistance from the EU (EDF or otherwise) to enable exporters to be on the same level playing field (as EU exporters) as regards their ability to meet EU SPS requirements. The large amounts of assistance provided to the new EU members can be cited in evidence that the EU accepts that very significant aid is needed for countries outside its region to actually be able to meet its new ' equivalent ' standard.

The WTO SPS Agreement includes (Art. 10) provisions relating to SDT in respect of SPS measures. They state that 'where the appropriate level of SPS protection allows for the phased introduction of new SPS measures, longer time frames for compliance should be accorded on the products of interest to developing country members so as to maintain

opportunities for their exports'. Also that, 'with a view to ensuring that developing country members are able to comply with the provisions of this Agreement the Committee is enabled to grant such countries, upon request, specified, time-limited exceptions in whole or in part from the obligations under this Agreement, taking into account their financial, trade and development needs'.

This possibility of 'phasing' in of SPS requirements is an important element to be actively pursued in negotiations. Provisions exist for such phasing in of the measures needed under the Food and Feed Control Regulation 882/2004 and for account to be taken of the ability of counties to comply. This provision basically reflects the WTO SPS Agreement noted above.

Marine fisheries

ESA countries that have a marine fishing industry have prepared a draft Fisheries Framework Agreement (FFA) that is designed to protect the interests of the ESA states who have access to stocks of ocean fish and avoid a depletion of fish stocks, upon which many ACP coastal and island states are economically dependent, while at the same time preserving the sovereignty of ACP states to negotiate national access agreements with the EU. The FFA does not replace a bi-lateral agreement with the European Union. It should, rather, be seen as a minimum set of conditions within which a fisheries agreement on access to fish stocks in each Exclusive Economic Zone (EEZ) will be negotiated by each country.

The main features of the FFA are the Basic Principles; Fisheries Management and Conservation Issues; Financial and Trade Measures; Vessel Management and Post Harvest Arrangements; and Development Issues. However, the EC has proved itself reluctant to negotiate a regional FFA. The reasons for this would appear to be the alternative views on FPAs that exist in the Commission itself. The Common Fisheries Policy of the EC is couched in very general language that can be interpreted in a number of ways and which took 17 months for the EU to reach a compromise agreement on. In the Commission itself, at least four Directorate Generals (DGs) have an interest in Fisheries Partnership Agreements, these being DG Fish, DG SANCO, DG Trade and DG Development. In simplified terms the interests of the various DGs are as follows:

- DG Fish – looking after the interests of the main (Spanish and French) EU national distant-water fleets (DWFs);
- DG SANCO – implementing the food and feed regulations (Sanitary and Phytosanitary) of the EU;
- DG Trade – ensuring that the FPAs and CFP are WTO compatible, particularly in the way subsidies, rules of origin and preferential access agreements are applied; and
- DG Development – seeing how the fishing industry could contribute to the economic development of the appropriate country or region.

There is, therefore, a real or potential conflict of interests within the Commission itself as regards the negotiations of FPAs. However, to date, the responsibility for negotiating FPAs remains firmly with DG Fish and they do not regard fisheries negotiations as part of EPA negotiations and seem not to be in favour of a regional FFA, despite the fact that the fish resource is at least regional.

Trade in services

Preparations for negotiations with the EU on trade in services should be guided by the provisions of Article 41 of the Cotonou Agreement and Article XIX of GATS, with particular focus been given to Mode IV.

In the case of the ESA EPA, in preparing for the EPA negotiations as agreed in the Negotiating Guidelines, Mandate and Work Programme, a regional assessment of the state of trade in services is necessary. This regional assessment, which is being financed through the DFID-financed Regional Trade Facilitation Programme (RTFP), is ongoing and covers 18 COMESA member states, these being all the ESA countries plus Swaziland and Egypt. This approach will enable adequate preparation for request and offers with the EU under EPAs, negotiations in the GATS and the development of a regional programme in trade in services and the further integration of the sub-region.

The assessment covers the financial, telecommunications, transport, construction and related engineering, professional, tourism, health, education, business, computer and energy services. The temporary movement of labour (Mode IV) is treated as a horizontal issue.

The assessment is based on the collection of regulations in trade in services and the conversion of this regulatory information into GATS-type language. In addition to this the prevailing regulatory and policy environment, market structure and sector performance in each country is being analysed. These national assessments will be discussed at national level and the output will be used to develop a regional assessment that will be used to develop a strategy for the EPA negotiations, WTO negotiations and the development of a regional programme on trade in services.

The trade in services assessment began with the development of National GATS Templates for each member state and government experts have been trained in the conversion of all regulations for all service sectors into GATS-type language. At the same time, COMESA pre-tested available assessment questionnaires for the in-depth sector analyses and embarked on the development of questionnaires for sectors for which questionnaires currently did not exist. Teams of national experts were trained on how to undertake in-depth sector assessments in February 2004. The GATS templates and the sector assessments will, together, form the National Assessment Reports.

Part of the work in trade in services covers Mode 4 issues, specifically temporary migration of nurses from the region to Europe. The departure of healthcare workers for posts in Europe is a serious concern. Britain is the main recipient country. In 2002 and 2003, more than 6,500 African nurses were admitted to the British Registry. The most severe problem generated by the exodus of nurses is the shortage of qualified healthcare workers in African countries. For example, Malawi has a ratio of nurses per 100,000 people of 29, while in Britain the ratio is 840. The result is poor and worsening treatment in African hospitals and poor working conditions for the nurses that remain.

The outflow also implies that African countries are subsidising industrial countries, by paying the investment costs in workers that eventually leave. And, as more nurses leave, conditions facing those that remain worsen. There may also be less incentive for governments to invest in training nurses if their duration of service declines. While Britain has imposed guidelines to reduce recruitment by national agencies, it does not stop recruitment from developing countries by the private sector. Nor do the guidelines stop nurses from abroad from applying directly for health service posts in Britain. This problem is only likely to worsen in the coming years as more nurses will be required to tend to the ageing population in Europe.

The on-going ESA EPA study is evaluating the mutual gains, and identifying the major problems, of a pilot scheme to bring nurses from selected ESA countries to certain EU countries for limited periods, probably between three and five years.

Trade-related issues

The position of the ESA region is not to start negotiations on trade-related issues, especially on competition policy, public procurement and investment. However, the region has started by examining in detail trade-related issues and is assessing whether there is any value added in including trade-related issues in an EPA or whether these issues should be negotiated under the framework of the WTO, if at all.

The assessment as to whether EPA negotiations should include trade-related issues should be done at two levels. The first level is to assess whether negotiating trade-related issues in a EPA will compromise the countries' negotiating positions in the WTO.

A second issue is to assess at what level negotiations on trade-related issues should be. For example, in competition, the ESA region may find it useful to have an agreement with the EC's Directorate General on Competition to exchange information at the regional and national levels. A number of ESA countries have competition commissions or authorities and COMESA has agreed a regional competition policy and regulations and to establish a Regional Competition Commission. If anti-competitive

behaviour is cross-border in nature it may well be extremely useful for COMESA's Competition Commission to share information with DG Competition so as to build a case against the individual or company involved in such anti-competitive behaviour, which usually results in distortions or restrictions in trade flows.

A further example may be in agreeing on a bilateral investment programme between the EU and the ESA region where, for example, companies in Europe are given tax breaks as incentives for investing in the ESA region.

Conclusion

In conclusion, it can be said that a considerable amount of effort and resources have been expended by the ESA countries and the Secretariats of the Regional Integration Organisations in preparing for the EPA negotiations. These preparations will have benefits not only for the actual EPA negotiations but also for other negotiations ESA countries will be involved in at the WTO and regional levels. The emphasis placed on ensuring adequate preparations have been made for the negotiations has allow the ESA region to develop negotiating positions by consensus so that common positions have evolved. The next phase of the negotiating process is the actual negotiations with the EC and it is important that during this phase the Group's cohesion is maintained, along with the support structures already put in place through the Regional Integration Organisations.

Endnotes

1. This waiver was agreed at the 4th Ministerial Conference in Doha. The Ministerial Decision of 14 November, 2001 (WT/MIN(01)/15) states, among other things, that 'Subject to the terms and conditions set out hereunder, Article I, paragraph 1 of the General Agreement shall be waived, until 31 December, 2007, to the extent necessary to permit the European Communities to provide preferential tariff treatment for products originating in ACP States as required by Article 36.3, Annex V and its Protocols of the ACP–EC Partnership Agreement, without being required to extend the same preferential treatment to like products of any other member.'
2. The countries that are part of the ESA EPA negotiating group are: Burundi, Comoros, Djibouti, DR Congo, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia and Zimbabwe.
3. In the framework of the all-ACP–EC negotiations, the ACP side has consistently expressed the view that EDF and other resources, which are currently available to the ACP, are insufficient to meet the needs of ACP countries, particularly for eliminating obstacles to trade including those related to infrastructure. For this reason, additional resources are required so that ACP can effectively implement development-oriented EPAs. The EC has made its view clear: the resources available for financing of development co-operation in the next five years have been agreed in the framework of the Cotonou Agreement, and that this question is not up for renegotiations in the framework of EPA negotiations.
4. Under EDF9 procedures it is relatively simple and quick to recruit consultants if the cost of the consultancy input is less than €5,000, but much more complicated and time-consuming to recruit consultancy inputs above €5,000. To carry out studies and technical assessments for the ESA Group, comprising 16 countries, the costs of consultancy inputs for any one activity is invariably more than €5,000 so it has been difficult to use the funding provided under the Trade Negotiating Facility to finance consultancy inputs.
5. For example, if a country states it will reduce tariffs in January 2006, the tariff revenue for January–June 2005 will be calculated and compared to the theoretical tariff revenue loss with the tariff reduction in place and the same volume of goods for the period January–June 2006.
6. The COMESA Council of Ministers decided, at their meeting in Kigali, Rwanda, in May 2005, that 'Member States should work towards attaining a Customs Union by December 2008 but, in the event that some Member States are not ready to implement the Customs Union in December 2008, those that are ready should proceed with implementation'.
7. Trade deflection is taken to mean the export of products originating in a third country which does not have preferential access into a first country being re-routed through a second country which does have preferential access. This re-routing could take the form of simple transhipment or could involve a simple operation, such as repackaging the goods.
8. For example, if a refrigerator manufacturer imports compressors, the HS code of the compressor is the same as that of the refrigerator at the 4-digit level, so a process application would need to be applied so that the refrigerators were considered to originate from the country they were manufactured in.
9. These health conditions are laid down in Directives 91/493/EEC and 91/492/EEC.

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The Impact of Economic Partnership Agreement Negotiations on Southern Africa

Talitha Bertelsmann-Scott

Introduction

The states of Southern Africa are currently in negotiations with the European Union (EU) on Economic Partnership Agreements (EPAs). The negotiations result from the Cotonou Agreement between the EU and 77 developing countries in Africa, the Caribbean and the Pacific (the ACP states). Cotonou came into effect in 2000 in succession to the Lomé Convention, which was an 'aid and trade' agreement between the ACP group and the EU.

The Cotonou Agreement encourages signatories either to conclude trade agreements with the EU by no later than 31 December, 2007, or to reach alternative arrangements. The negotiations are of critical importance to the ACP countries, given that for most of them, the EU is by far their major trade and development partner.

The EPAs are being negotiated as regional rather than national agreements, and their eventual outcome could have a significant impact on regional integration in Southern Africa and on the future shape of regional organisations. It is for the Southern and East African states to decide on the nature and composition of the EPAs, although the EU has stated on several occasions that it would like them to become engines for regional integration. The situation in the region is extremely complex, however, and it seems at the moment that the EPA talks are frustrating, rather than facilitating, regional cooperation. One reason for this is that Southern and East African states formed two new groups for negotiating purposes, having decided against negotiating through existing regional groupings. Since all these states already belong to at least one of a series of regional organisations that overlap in membership and goals, the two new groups are likely to further complicate the situation.

This chapter looks at the EPA negotiations, what they entail and what progress has been made towards reaching agreements. It also examines the move towards regional integration in Southern Africa and how this process might be influenced by the EPA talks. It argues that the EU's overall negotiating approach in part rests on the premise that successful regional organisations already exist (or will exist by 2008) to form the basis of the EPAs. Unfortunately, in Southern Africa this is not so. For this reason the implementation of the EPAs could have a negative impact on the region, unless the agreements address issues of development and supply-side constraints.

The problem faced by Southern African governments in negotiating EPAs that will contribute to their development is threefold. The first difficulty is a lack of progress towards regional integration, the second, a lack of uniform policies and practices among the states that inhibits regional integration, and the third arises from traditional constraints such as rules of origin (see below) that have hindered Southern African exports to the EU.

Background to the EPA negotiations

The Cotonou Agreement has its origin in the Lomé Convention, which dates back to the Treaty of Rome (1957) that established the European Economic Community (EEC). The EEC had committed itself to the economic development of its member states' former colonies; a commitment later translated into the Yaoundé Agreements, the forerunners of the Lomé Convention. At the time, the

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Caribbean and Pacific islands opted to ally themselves with the African states, which (ironically perhaps) enjoyed substantial political clout with the EEC. The resultant ACP grouping has, over the past few decades, grown into the largest single global instrument of North–South co-operation.

Initial steps towards dismantling the Lomé Convention were taken in 1996, when the EU released a Green Paper on the future of the Convention. Lomé had served as the principal tool for the EU to promote the development of its former colonies and their integration into the global economy. Its effectiveness had, however, come under question, in particular because despite the trade preferences they enjoyed under Lomé, ACP countries had not been able to diversify their production base (see Annex 1) or make real progress towards participation in the global economy. It was feared that the preferences were in practice locking countries into a rigid production and marketing regime rather than encouraging a search for new areas of comparative advantage. In addition, the preferences began to come under increasing pressure from the World Trade Organization (WTO). Lomé IV bis was legitimised through a waiver from general obligations under the WTO's forerunner, the General Agreement on Tariffs and Trade (GATT), but this became increasingly difficult to defend as the 'banana regime' case demonstrated (see Annex 2). (The Cotonou Agreement currently also has a waiver from the WTO, which will expire in December 2007.) The EU would prefer a future trade agreement with the ACP that would require no waivers from the WTO.[1]

Successive Lomé Conventions (Lomé II, III and IV, respectively in 1979, 1985 and 1990) brought with them increasingly cumbersome and complex instruments for development co-operation and aid disbursement, while a weakening of political ties between member states of the EU and their former colonies, in the wake of the expansion of EU and ACP groups and a changing geo-political climate, was a further factor to be considered.

Aside from these compelling arguments, the EU's desire to move from Lomé was informed by an ideology of liberalisation and globalisation in which colonial ties and preferences had no place. During the early 1990s serious doubts were raised among donor countries about the effectiveness of aid and trade preferences. Many donors believed that it was trade and not aid that would ultimately lift poor countries out of their cycle of poverty. It was felt that aid recipients had become overwhelmingly corrupt and incapable of government, let alone of using donor funds effectively. In Europe the welfare state was on the decline, budgets had became increasingly tight and European electorates objected to their taxes keeping corrupt foreign leaders in place and palace. These sentiments were unaffected by the wave of democratisation that swept through the ACP group. Increasingly, the EU began to attach political conditions to its development assistance – a move the ACP found highly offensive and one that put a severe strain on political relationships under the Lomé Convention.

With the establishment of the WTO as successor to GATT in 1995, the EU began increasingly to rely on the WTO to provide the primary framework for its trade relationships with the world and the Lomé Convention fell well outside that structure. In addition, while the EU was anxious to be seen as a driving force at the WTO it came under frequent criticism, in particular for its maintenance of European domestic agricultural subsidies that other WTO interests saw as distorting the international agricultural market. The EU was also involved in a very lengthy dispute at the WTO with the United States and Ecuador regarding its banana regime (see Annex 2), which formed one of the cornerstones of the Lomé Convention. Successive WTO rulings went against the EU.

Against this background the Lomé Convention had become a burden to the EU and needed reform, as was indicated by the publication of the 1996 Green Paper on its future. The paper contained four options for the future of the trade preferences contained in Lomé:

- maintaining the status quo;
- integrating into the Generalised System of Preferences;
- uniform reciprocity; or
- differentiated reciprocity.

Although all four options seemed somewhat unrealistic at the time the Cotonou Agreement, negotiated from 1998 to 2000, managed to strike a fine balance between them, introducing the concept of reciprocity while maintaining the Lomé *acquis*.

According to the European Centre for Development Policy Management:[2]

> *From the outset of the negotiating process, it became clear that the new round would not be business as usual. From an EU perspective, the imperatives were to apply greater aid selectivity and differentiation in the treatment of ACP countries; to link aid and performance; to make the trade régime 'compatible' with the requirements of the WTO; to ensure a closer involvement of civil society, the private sector and the economic and social actors, as well as to rationalise Lomé co-operation instruments.*

The Cotonou Agreement, signed in Benin in June 2000, replaces all the old Lomé conventions. It makes provision for aid and trade. Under aid, it identifies three main areas of support: economic development, social and human development and regional integration and co-operation. In addition, it stresses the pivotal role of the private sector in development. An investment facility has been created to assist the banking sector to finance local business ventures and the agreement provides for the establishment of an ACP–EU private sector business forum (see Annex 3 for information on the role civil society is expected to play).

In an effort to simplify the instruments of co-operation that had become so cumbersome under Lomé, Cotonou provides only two instruments — the investment facility, and grants. Financial assistance takes place at two levels with two different kinds of financial structures. They are, respectively:

- regional indicative programmes, with grants to regional integration organisations, targeting schemes that are regional in nature but mainly concern regional integration, trade and infrastructure; and
- national indicative programmes, with grants to ACP governments aimed at long-term development projects in limited areas in line with partner countries' national development plans.[3]

Joint institutions have been put in place to administer the agreement, including the ACP–EU Council of Ministers, the Joint Parliamentary Assembly and the Committee of Ambassadors.[4]

It was agreed that the ACP and the EU would negotiate trade agreements to replace the old Lomé provisions by December 2007, when the WTO waiver will expire. The new agreements, or forms of alternative arrangement, are supposed to be in place by the time the old Lomé preferences end. The negotiations are, however, still a long way from complete. Only the EU objectives are clear, although even there some contradictions can be found.

The European point of view

In line with the thinking behind the negotiations that led to the Cotonou Agreement, the EU is focusing strongly on developing regional integration among the ACP states. Although Cotonou provides for states to opt out of negotiating a regional EPA, the EU mandate focuses exclusively on options for regional agreements. Several EU officials have also pointed out that they would prefer to see progress towards regional integration between ACP countries before other talks begin, but this approach seems unrealistic, given that successor agreements must be in place by the time the Lomé trade preferences expire.

The preamble to the EU's negotiating mandate refers to 'the commitment of the parties to support the regional integration process within the ACP states and to foster regional integration as a key instrument for the integration of ACP countries into the world economy.'[5] In spite of this expressed aim, however, many observers in non-government organisations suspect that the EPA talks may be merely part of an aggressive strategy to open up opportunities for EU business in the ACP countries.

The overall aim of the EU is to establish free trade agreements (FTAs) between the EU and the ACP. These agreements should be WTO-compatible and therefore cover 'substantially all trade', but the exact definition of what constitutes substantially all trade is still up for debate. During South Africa's negotiations with the EU, the latter stated that the term means 'on average 90% or more of all

trade flows'. Despite this, however, South Africa eventually managed to secure only an 86% liberalisation level for its trade with the EU, with the EU liberalising more substantially to reach the 90% average. The ACP can probably expect an even lower level of coverage than South Africa achieved.

During the Cotonou negotiations it was agreed that no ACP country should be worse off under an EPA than it was under the Lomé Convention. ACP countries are therefore offered improved market access to the EU and it is generally understood that this will mean duty- and quota-free access for all of them. This may bring significant adjustment costs to some, if their preferential advantage *vis-à-vis* ACP competitor countries is eroded. Negotiators, therefore, must consider how to compensate the countries in question, or find a way to maintain their preferences without breaching WTO rules. To maximise gains from market access, they will also have to simplify and optimise rules of origin and address the difficulties ACP countries encounter in meeting the EU's stringent sanitary and phytosanitary (SPS) rules. Suggestions so far have leaned towards a simple 25% value-added requirement for rules of origin, with full 'cumulation' (that is, recognition of third-party value-added processes) with all developing countries, including South Africa.[6] The ACP should be closely involved in setting SPS standards and significant EU support should go to establishing regional centres of excellence capable of standards verification.

For its part the EU will expect liberalisation of ACP markets for EU products. The least-developed ACP nations will not be under an obligation to reciprocate unless they accept reciprocation as part of the agreement (this would be the case only if they decide to enter into a FTA with the EU, not if they opt for the Everything But Arms – EBA – option (see below) or the EU's Generalised System of Preferences – GSP). The negotiating mandate acknowledges that asymmetrical time frames and implementation periods are necessary. It is not clear, however, what exact measures are permissible as special and differential treatment (SDT). This is still under negotiation at the WTO; but one might expect a reduced level of product coverage and a lengthy implementation period, similar to concessions granted South Africa in the South Africa–EU Trade, Development and Co-operation Agreement (TDCA).

Controversially, trade-related areas such as investment, competition, procurement and trade facilitation, as well as trade in services, will be included in the talks. This has led many to comment that the EPA negotiating agenda is more ambitious than under the WTO and it is feared that the ACP will commit to concessions they would not have made within the WTO context. For example, since no decision has been reached in the WTO on preferences and SDT, it would seem sensible not to push the issue in the EPA talks.[7] (Ironically, the Common Market for Eastern and Southern Africa [COMESA] is quite advanced in formulating regional policy on these issues, but at present is not willing to discuss them with the EU.)[8]

Chief EU negotiator Karl Falkenberg contends that the EPAs will create regional markets that will eliminate the small fragmented markets currently common in the ACP and that the creation of competition, investment and procurement rules based on these enlarged markets will be to the benefit of the ACP:

> *When India argues that investment rules should not be negotiated internationally, from an Indian perspective, this may make sense. From a Burkina Faso or Mali or Mauritian perspective it makes no sense. These small economies will have to compete for investment and this competition should be built on a larger internal market, hence regional integration, and more stable, predictable rules for investors, hence inclusion of investment rules in EPAs.*

Falkenberg further argues that investment rules will be designed to favour small- and medium-sized enterprises and not necessarily large companies that manage to operate without such rules. On government procurement, the EU argues that:[9]

> *In countries that lack large public budgets, it is even more relevant that the existing resources are used in the best price quality ratio possible. In fact introducing procurement rules will essentially aim at transparency and predictability. The idea of preference in favour of local competition should be acceptable provided it is not to be a discretionary one.*

The European attitude to the EPAs will, therefore, only make sense if approached from a regional standpoint. Yet creating regional groupings capable of negotiating and finalising the EPAs becomes extremely problematic in the context of Southern Africa.

Challenges ahead

There are currently 77 ACP states. Quite aside from the fact that the EU approach to the EPAs is grounded in regionalisation, it is clear that negotiating separate FTAs with each of the 77 would have been excessively cumbersome and time-consuming for the EU. Logic might suggest that a regional grouping can only enter into an FTA with another region if the respective member states have established a customs union. The EU has stated, however, that regions that have made sufficient progress towards implementing free trade among themselves will also be considered for regional EPAs.

By presenting EPAs as regional trade arrangements, the EU is placing significant additional pressures on ACP countries. Not only will they have to engage in negotiations with, arguably, some of the most skilled trade negotiators in the world, but also a significant proportion of their preparations and discussions must be directed towards their neighbours rather than solely to their EU counterparts.

In Southern and East Africa, countries belong to an alphabet soup of overlapping regional organisations (see Table 1). This has posed – and to some extent still poses – a problem in deciding which countries will negotiate as a unit. The biggest difficulty is caused by the overlap between the Southern African Development Community (SADC) and COMESA membership. Most countries that are members of both have decided to negotiate within the COMESA fold. COMESA (minus Egypt) has established the Eastern and Southern Africa (ESA) negotiating group that in turn launched talks with the EU on February 7, 2004 (see Annex 1 for COMESA and SADC membership). The remaining SADC states, now called 'SADC-minus' – which includes the Botswana, Lesotho, Namibia and Swaziland (BLNS) group and Tanzania, Angola and Mozambique – were late in launching talks with the EU. They formally kicked off on 8 July, 2004.

The concern regarding the Southern and East African groupings is that there is little uniformity among them. In the first place, neither of the two has as yet established a customs union, nor a full free trade area. Furthermore, four of the member states are part of a customs union that already has an agreement with the EU through the TDCA. Finally, most of the Southern and East African states are classed as least-developed countries (LDCs). Under current WTO rules, developed countries are allowed to grant special preferences to LDCs without entering into FTAs with them, which puts into question the very need to negotiate EPAs with Southern and East Africa at all.

Only 11 of the 19 COMESA member states have free trade between themselves. A customs union has been postponed indefinitely; although December 2004 was initially set as the date for its implementation, some major issues (notably the common external tariff) still need to be resolved. The biggest problems are presented by Egypt, Zimbabwe and Mauritius, which still maintain very high tariffs on a few products and are reluctant to bring them down to 40% or less. The contrast with Uganda, for example, which maintains low tariff levels, is so marked that creating a common external tariff for COMESA has become almost inconceivable.

The SADC Trade Protocol aims to establish free trade in the region by 2008, but not all SADC states are on time, with Angola especially laggardly. Free trade within SADC-minus by the time the Lomé preferences expires is highly unlikely while a customs union for SADC remains a distant prospect (its Regional Indicative Strategic Development Plan states that it is committed to the creation of a union only in 2010).[10]

According to Meyn (2004), delay in progress towards integration in SADC is to some extent due to the different trade profiles of member states. Whereas countries such as Mauritius trade predominantly with the EU, Mozambique's exports are mainly aimed at South Africa. Botswana concentrates on the diamond trade, Angola has hardly any trade interests apart from oil and oil-related products and Lesotho is currently focusing on the US market through the Africa Growth and Opportu-

nity (AGOA) scheme. Common interests and opportunities are therefore hard to find.[11]

The absence of customs unions means that negotiating units will have no mandate to sign a collective regional agreement with the EU. Presumably individual countries will eventually sign separate bilateral deals, although possibly some of these bilaterals will be identical in content. Although it still makes sense to pool resources and negotiate as a group, rather than as 77 individual countries, the real benefit to regional integration of such a convoluted process becomes dubious.

More than half the members of the SADC-minus group are also members of the Southern African Customs Union (SACU), which includes South Africa, which in turn already has an FTA with the EU. Although the BLNS group was not directly involved in negotiations for the TDCA, that agreement is de facto between SACU and the EU, because the BLNS share a common external tariff with South Africa. This means that their imports from the EU are governed by the TDCA but their exports still enjoy a significant preferential margin above those from South Africa. Hence, while it might seem a simple option officially to incorporate BLNS into the TDCA, such a process would mean the BLNS losing some existing preferences which conflicts with the Cotonou Agreement stipulation that no ACP country should be worse off under the new arrangements than under Lomé. It is not easy to see how the BLNS dilemma might be resolved.[12]

Perhaps the most striking aspect of the two negotiating groupings is that of the 23 Southern and East African countries and excluding South Africa, only seven are not classed as LDCs. In SADC-minus only Namibia, Botswana and Swaziland fall outside this definition; and in the COMESA group, only Kenya, Mauritius, Seychelles and Zimbabwe. It is generally not expected of LDCs to negotiate free trade agreements. The EU is, however, encouraging such countries to participate in the EPA talks. But whereas in its negotiations the EU is pushing the ACP for substantial liberalisation, it is taking a more protectionist view in talks with the WTO regarding special and differential treatment. ACP countries can and should take advantage of this to use the WTO forum to push its EPA agenda.

Why are LDCs willing to negotiate?

Many analysts are unconvinced that reciprocity is to the benefit of the LDCs or that their economies can support the strain that liberalisation would place on them. The most significant problem facing LDCs will be that of finding alternative revenue sources. Some ACP countries are looking towards introducing a value-added tax to compensate for tariff-revenue losses.

The COMESA secretariat summarises the benefits of EPA negotiations for LDCs under four headings:

- LDCs have nothing to lose from participating in the negotiations, even if in the end they decide not to sign;
- the developmental aspect of the EPAs will be to the LDCs' benefit, especially where regional centres for skills transfer and capacity building are to be established;
- the process of negotiation makes LDCs aware of the importance of sound trade policy formulation, which can only redound to their benefit; and
- with EU expansion, existing minimal levels of attention to Africa and LDCs generally will further reduce; LDCs have an opportunity now to ensure secured and continued benefits in their trade relationship with the EU rather than face further marginalisation.[13]

There are not many options available to LDCs apart from negotiating EPAs with the EU. One that does exist, however, is to employ the EU's EBA initiative once Lomé trade preferences expire. All LDCs (even non-signatories to the Cotonou Agreement) enjoy duty-free, non-reciprocal access to the EU market under the EBA. They can export all originating products except for munitions (and rice, sugar and bananas over a transitional period) duty-free and without any quantitative restrictions. In addition, the EBA preferences are set to last indefinitely. One should keep in mind, however, that the EBA is not a contractual agreement but a preference granted by the EU that could be revoked at any time.

At the moment, ACP countries still prefer to export under old Lomé provisions rather than the EBA. This no doubt reflects some significant differences between the two agreements, one of which centres on rules of origin. While the requisite degree of processing tends to be the same in both agreements, a number of general rules vary substantially. These include the stipulation that 'diagonal' cumulation can only take place within four non-ACP regional groupings. This means that cumulation is not available to ACP states under the EBA, whereas Lomé allows for cumulation between ACP states and in some instances even with South Africa.[14] LDCs would, therefore, do well to negotiate EPAs that secure rules of origin similar to those under Lomé, rather than merely opt for participation in the EBA.[15] Under EBA they would not, however, have to introduce reciprocal liberalisation measures whereas an EPA will oblige them substantially to liberalise all trade with the EU.

LDC participation in EPA negotiations could be seen as tacit acknowledgement of the economic theory that argues in favour of extensive trade liberalisation, even for LDCs. Whatever its negative impacts, liberalisation should lead to deeper regional integration. At the political level the EPA could become an effective means of locking LDC countries into economic policies that cannot be changed on short-term political considerations or simply on whim. But creating a theoretical climate to promote domestic investment is no guarantee that this will happen. Foreign investors might indeed view EPAs as part of an EU-enforced policy that has little to do with real commitment to the interests of the people on the ground.

Potential impact of EPAs on the ACP

At a practical level, the negotiations should be seen as an opportunity for ACP states to gain some serious international political influence. Previously, benefits were granted to these countries without much negotiation, but the ACP can now legitimately demand certain compromises from the EU within the negotiations, and exercise some leverage in other international talks. While Lomé and Cotonou have always laid stress on the theoretical degree of partnership embodied in the EU–ACP relationship, the ACP will only achieve true partnership with serious clout if and when it is seen as a genuinely equal signatory to an internationally recognised trade agreement.[16]

Further, it may be argued that participation in EPA negotiations is probably the only way in which the ACP can hope to maintain unity.[17] It is clear that the EU would prefer to work with smaller groups, rather than with all 77 ACP countries banded together as one unit, whereas the ACP countries have tended to the view that their strength lies precisely in their numbers as a group. Negotiating similar EPAs, and participating in the remaining provisions of the Cotonou Agreement, will foster continued cohesion among the 77. The alternative, which would be for each of the 77 countries to tailor its own specific agreement with the EU, would effectively end the ACP as an entity, which would be detrimental to the separate political interests of the 77.

The likely impact of the EPAs on the signatories is a much-debated topic. In the first instance it will depend on the level of integration among the regional organisations that are signatories to the EPA, since the deeper those levels are, the better they will prepare the ACP for the implementation of reciprocal trade agreements. Szepesi (2004) argues that the impact will broadly depend on three factors:

- the economic character of each of the ACP states;
- the final provisions of the EPAs; and most importantly,
- the institutional capacity of individual ACP countries.[18]

A growing body of literature argues that the greatest single factor in determining the ability of developing countries to escape the poverty trap is the quality of their institutions. The contention is that the content of trade policy matters less than how the policy is formulated and implemented. This is a strong argument in favour of ACP officials basing their negotiating stance on developmental aspects and capacity building.[19]

Clearly, lack of capacity does not centre only on the institutional question. The biggest constraints to participation in global trade lie in the ACP struggle to adhere to very strict rules of origin and SPS. In addition, they find administrative burdens and product standards act as effective non-tariff barriers that leave them permanently unable to export to the EU. Furthermore, an inability to find alternatives to tariff revenues prevents the ACP from fully embracing liberalisation, and could hinder implementation of the EPAs, as is not unusual with past bilateral or multilateral agreements.

For EPAs to have a positive impact on Southern and East Africa, the negotiations must focus the remaining time almost exclusively on ways to overcome the constraints dealt with above. Failing this, the impact will most likely be negative, with high revenue losses for the governments involved and little prospect for adequate progress towards poverty alleviation and development.

Progress towards regional integration in Southern Africa

The EU and the ACP states have reiterated that the EPAs should contribute to regional integration and the development of the ACP countries. ACP countries have also voiced their belief that the EPA process should not interfere with current initiatives towards regional integration.

Table 1 shows that among regional integration efforts in East and Southern Africa, except for Mozambique all countries have overlapping memberships of at least two organisations aimed at establishing free trade areas and customs unions. Progress in these respects is very slow and frustrated by members' conflicting loyalties and commitments.

The two major organisations, SADC and COMESA, have each adopted a different approach to regional integration. SADC's is based on principles of co-operation and development. The organisation has concluded protocols over a wide range of activities, of which trade is only one. By contrast, COMESA drives integration through trade and focuses almost exclusively on tariffs and other impediments to trade. This means that while COMESA is progressing a little more quickly towards free trade, SADC is addressing issues of supply-side constraints before attempting to open up trade. There could, therefore, be a reasonable argument for membership of both organisations. Indeed, the Democratic Republic of Congo, Malawi, Madagascar, Zambia, Zimbabwe, Angola, Mauritius and Swaziland already belong to both.

A recent World Bank report argues, however, that the overlap between the organisations will become increasingly untenable:[20]

> *Whilst it is technically possible (although difficult) for the* COMESA *and SADC FTAs to co-exist, it will be impossible for any member state to belong to more than one regime when (if) they adopt a Common External Tariff (CET) and become a Customs Union (CU), unless each regime adopts the same CET and the same CU regulations. In addition, for Namibia*[21] *and Swaziland, their joint membership of* COMESA *and SACU has become a dilemma with the introduction of the* COMESA *FTA. These countries have been unable to implement preferential tariffs for other* COMESA *countries and cannot introduce free trade for imports from other* COMESA *countries in terms of this FTA. The SACU agreement CET cannot be broken by some members granting preferences in terms of other FTA regimes, unless all the other members agree to this arrangement.*

Slow progress towards free trade and customs unions in Southern and East Africa means that these countries do not have a unified negotiating base. Before 2008 they will have to find some common ground if regional negotiations are to carry serious weight.

Implications of the EPA negotiations for the region

The composition of the two EPA negotiating groups does not appear to the strategic advantage of Southern Africa in particular or conducive to regional integration in general.

Given their membership of SACU, which includes South Africa and which already has a free trade deal with Brussels, the BLNS are a special case. It therefore makes little sense for Tanzania, Mozambique and Angola to negotiate with them.

Tanzania is one of three countries in the East African Community (EAC) that formally signed a customs union in March 2005 but in which the other two members – Kenya and Uganda – are negotiating within the ESA grouping. Mozambique is not in COMESA but is a member of SADC and received its invitation to join ESA by virtue of that status. Angola is a member of COMESA and could easily have joined the ESA group.[22] All in all, it would have made sense for SACU states to negotiate as a separate bloc, while the other East and Southern African states launched an ESA grouping.

The EU itself seems wary of the composition of the negotiating groups. Commissioner Hubner said at the launch of the SADC–EU EPA talks that:[23]

> *Let's face it – a number of question marks do remain as regards the geographical configuration within which you have chosen to negotiate ... EPA negotiations should provide scope for possible changes in their geographical coverage, which could happen in parallel with their progress on the substance of the issues at stake.*

Unhappiness does not arise only from the difficulties the two blocs pose in negotiating agreements when no common ground exists among them. It is also a consequence of implementing two different EPAs, respectively in Southern and East Africa. As Meyn points out:[24]

> In [the] *case that the SADC EPA agrees on different tariffs for EU imports than the ESA EPA, the inspection of origins of imports from the EU will not only be an enormous administrative burden but also hardly feasible, taking the imperfect supervision of rules of origin in Southern Africa into account. To avoid smuggling, trade diversion and economic polarisation in Southern Africa and to promote intra-regional trade and regional integration, the SADC and ESA EPA should therefore agree on a CET toward the EU. However, although a common external trade policy toward the EU would be in the best interest to promote intra-regional trade in Southern Africa, such a joint approach is rather unrealistic because of countries' different interests.*

There is suspicion in the region that South Africa played a dominant role in fragmenting the ESA group. Although, as mentioned earlier, South Africa will not be allowed to participate in the negotiations, it enjoys observer status and may advise its partners throughout. The conspiracy theory stems from the EU–South Africa Trade, Development and Co-operation Agreement (TDCA). Although it was signed only by South Africa and the member states of the EU, the fact that South Africa is a member of SACU means that all the SACU states effectively have an agreement with the EU through TDCA. It is argued that South Africa will use these EPA negotiations to reopen the TDCA and secure additional benefits for itself, and that a smaller group of countries is easier for South Africa to influence; *ergo* South Africa pushed its SADC partners to stay outside the COMESA negotiations. Clearly, South Africa has stronger political ties with SADC than with COMESA, of which it is not a member.

The South African government would do well to be aware of the existence and strength of these negative sentiments. South Africa's objectives are viewed with suspicion in Sub-Saharan Africa and its interests are not served by allowing the perception to persist that it is fragmenting the region.

Regional suspicions of South Africa were also reported in the December 2003 issue of *Trade and Development Update*: [25]

> *The TDCA itself is due for re-negotiation in 2004 and some East African states believe that South Africa is attempting to use the EPA process as a means to lever influence for these talks. South Africa might indeed have liked to draw more SADC countries into its orbit, an approach that has caused ructions with those attempting to build a joint SADC–COMESA position. COMESA's own press release, announcing the ESA group, recognised that, 'It is an open secret that this historic decision has not been welcomed in some quarters whose preference is that EPA negotiations with the EU should be on the basis of regional organisations.' Erastus Mwencha, Secretary General of COMESA, has argued in the East African Financial Standard ... 'While South Africa is not a party to these EPA negotiations, except as an observer, she is openly advocating a SADC EPA... SADC countries with a real stake in EPA negotiations – mainly the non-SACU members – have*

opted to negotiate under ESA in spite of intense pressure from South Africa. If SACU states are put under pressure to go with South Africa, the states that face serious challenges are the three non-SACU states: Angola, Mozambique and Tanzania.'

The extent to which the review of the TDCA is important to either South Africa or the EU is, however, open to debate. One area potentially of interest to both is liberalisation of the services sector. At the moment, the TDCA only covers trade in services through committing the parties to the WTO's General Agreement on Trade in Services (GATS). It also commits them to explore the possibility of further liberalisation in services under the Co-operation Council, no later than five years after the implementation of the agreement. Thus far, South Africa has been reluctant to open its services sector, not only to the EU but also to the US, which leads some to comment that the EU would have more to gain from reopening the TDCA than would South Africa.

South Africa's influence over Southern and East Africa negotiations probably has more to do with the fact that its non-LDC SADC partners were afraid of being presented with a TDCA-like liberalisation schedule, such as that which the BLNS countries have to accept due to their membership of SACU. Mozambique, Angola and Tanzania have nothing to fear from the TDCA's being used as a blueprint, as they are LDCs and do not have obligations of reciprocity with the EU; their interest in the negotiations lies purely in improved market access to the EU and any other benefits that could accrue to them under development co-operation. The other, non-LDC SADC countries, Zimbabwe and Mauritius, would not be ready to accept liberalisation modelled on the TDCA. (The uneasiness in the region created by the EPA configuration has led some to comment that it might spill over into the cohesiveness of the G20 group of developing countries in respect to global trade negotiations.)

Conclusion

It is difficult to get a true sense of the EU's motives in negotiating EPAs with the ACP group. The process could be driven by self-interest and a ruthless liberalisation agenda. Although one should not entirely discount this possibility, any such approach would be tempered by the EU's genuine concern over the development and integration of the ACP into the world economy. The focus on partnership and development assistance, so important under Lomé, is by no means diminishing. Free trade is added as just another, although very important and defining, aspect of the relationship.

It is also clear that regional integration is emerging as the defining aspect of the EU's approach to the EPA negotiations. Although the theory behind this is sound, the reality in Southern Africa is that regional integration has not progressed much further than attempts to create FTAs among some states, and talks about possible customs unions. Integration is certainly not especially evident between the two groups that have emerged as EPA negotiating blocs. Apart from encouraging further regional integration, the negotiations, therefore, will have to focus strongly on development issues and on factors that keep the ACP from exporting to the EU, such as rules of origin and SPS.

It is further evident that ACP states are somewhat ill-prepared for the negotiations and that the bulk of the preparation for free trade areas will be homework, rather than discussions with EU technocrats about a multitude of tariff lines. Unfortunately, because the EU will probably not be able to conclude EPAs with defined regional organisations, any final agreements will not encourage either SADC or COMESA to finalise the implementation of free trade areas or customs unions in Southern Africa. The EPAs will, however, have a positive effect on regional integration insofar as they force Southern African states closely to examine their trade regimes, and to promote regular contact with their partners in the region. The spin-offs of such a process will far outweigh any benefits that EPAs might offer.

Table 1. Membership of regional organisations in Southern and Eastern Africa

	ESA-EU EPA	SADC-EU EPA	SADC	COMESA	IOC	RIFF	EAC	IGAD	SACU
Angola		X	X	X					
Botswana		**X**	**X**						**X**
Burundi	X			X		X			
Comores	X			X	X	X			
Djibouti	X			X FTA				X	
Drc	X		X	X					
Eritrea	X			X				X	
Ethiopia	X			X				X	
Kenya	**X**			**X FTA**		**X**	**X**	**X**	
Lesotho		X	X						X
Madagascar	X		X	X FTA	X	X			
Malawi	X		X	X FTA		X			
Mauritius	**X**		**X**	**X FTA**	**X**	**X**			
Mozambique		X	X						
Namibia		**X**	**X**			**X**			**X**
Rwanda	X			X		X			
Seychelles	**X**			**X**	**X**	**X**			
South Africa			**X**						**X**
Sudan	X			X FTA				X	
Swaziland		X	X	X		X			X
Uganda	X			X		X	X	X	
Tanzania		X	X			X	X		
Zambia	X		X	X FTA					
Zimbabwe	**X**		**X**	**X FTA**		**X**			
Aim	**EPA 2008**	**EPA 2008**	**FTA 2008**	**CU 2004**			**CU 2004**		

Countries in bold are non-LDCs.

Annex 1. Making trade preferences more effective[26]

Do trade preferences work? They are intended to help developing countries export. But do they? There is lively debate over whether the 'gains' for favoured states are 'paid for' by other countries that may be equally poor. Even for the favoured states, though, questions have been raised over how far their producers benefit. Does the small print of the trade preferences prevent exporters in general (or poor producers in particular) taking full advantage of them? Who gains most: poor-country exporters or rich-country importers? These questions have been addressed in a paper by the Institute of Development Studies (IDS), which compares trade preferences offered by Canada, EU, Japan and the US (the 'Quad') to Africa. IDS concludes that EU preferences have had a significant positive impact on the relatively small number of African states that are able to export preferred products, and that the US's African Growth and Opportunity Act has boosted clothing exports. The principal areas for further action are on the supply side, to facilitate diversification into preferred goods by a larger number of countries and to assist countries to meet increasingly onerous sanitary and phytosanitary standards. But there is also a need to change rules of origin that restrict trade.

Annex 2. The banana regime case[27]

The EU imports about one-third of all traded bananas – about the same amount as the US, but more than three times as much as the third biggest importer, Japan. EU policies therefore have a major impact on the world trade in bananas. The EU has the only major managed banana market in the world. The US and Japan allow bananas in freely, without any tariffs and with no limits on volumes imported. The EU produces almost 20% of its total banana consumption in the Canary Islands (Spain); in the French overseas Departments of Martinique and Guadeloupe; in Madeira and the Azores (Portugal); and (in very small quantities) in Crete (Greece). The remainder are imported from former Caribbean and African colonies (ACP bananas), and from Latin America (dollar bananas).

Historically, special ties developed between certain consuming countries within the EU and some producing countries, often within the context of a common colonial history. Until the Single European Market countries such France and Britain mostly imported the fruit from their old colonies. Other EU members imported the cheapest bananas available, which are from the large plantations of Latin America.

From July 1993 until February 2000 a dozen ACP countries, which traditionally exported bananas to the EU market, benefited from duty-free access to the EU market under the so-called 'Banana Protocol' of the Lomé Convention. In June 2000, the EU and 77 ACP countries signed the Cotonou Agreement, which replaced Lomé. Traditional ACP banana-exporting countries continued to enjoy duty-free access for their product. The main 'traditional' ACP banana-exporting countries are Ivory Coast, Cameroon, St Lucia, Jamaica, Belize, St Vincent and the Grenadines, Dominica, Suriname, Somalia, Grenada and Cape Verde. More recently the Dominican Republic joined the ACP and Ghana started exporting bananas for the first time. The EU regards both of these, however, as 'non-traditional' banana exporters.

So-called dollar-banana exporting countries are in Central and South America. In descending order of export volume they are: Ecuador, Costa Rica, Colombia, Guatemala, Panama, Honduras, Nicaragua, and Venezuela. They are called 'dollar' countries because they traditionally fall within the influence of the US dollar, but also because their banana industry is usually associated with US-based multinational companies that directly or indirectly control around 60% of their banana exports. Even in Ecuador, where multinationals own almost no land of their own, Dole, Del Monte and Chiquita are responsible for a substantial proportion of exports. Bananas represent a very important source of income for Ecuador, Costa Rica and Honduras in particular.

With the establishment of a single European banana regime in 1993, the EU set itself a number of objectives, which were not always easy to reconcile. Indeed, it was not possible to satisfy all members and the import regime was to become a source of major international trade friction. The objectives of the EU were to:

- harmonise the different pre-1993 national regimes;
- protect banana production in EU member states;
- supply European consumers with 'reasonably' priced bananas;
- respect European obligations towards ACP countries, as defined by the Lomé Convention, in order to support the economic development of these countries; and
- reconcile international obligations (notably under GATT) with national interests.

In most of the 12 traditional ACP banana-exporting countries, the cost of production was approximately twice as high as for dollar bananas. In the case of European producers, the cost could be up to three times higher. Higher production costs meant that these countries and regions could only sell on a protected market. Conscious of this, the EU set up a system of quotas and tariffs (and a system of direct support to its own banana farmers) to limit the entry of dollar bananas. The resulting internal price on the European market, substantially higher than the world price, enabled ACP and European producers

to survive. Preferential access to the European market protected them from direct competition with dollar bananas.

In 1996, a little more than a year after the establishment of the WTO, five countries – Honduras, Guatemala, Ecuador, Mexico and the US – lodged a complaint against elements of the European banana regime, which they considered to be 'discriminatory' to their interests. Honduras, Guatemala and Ecuador, the world's biggest exporter, claimed that they did not have sufficient access to the European market. The dispute continued for several years. Although the WTO ruled several times against the EU banana regime, it was not until 2001 that agreement was finally reached between the EU, the US and Equador. Under the agreement, EU import licenses will be allotted based on the way they were distributed during a 'historical reference period' of 1994–1996. The European Commission will also initiate the necessary procedures to propose to the EU Council of Ministers an adjustment to expand access for Latin American bananas and to secure a market share for a specific quantity of bananas of ACP origin.

According to European Trade Commissioner Pascal Lamy, the new scheme still guarantees ACP producers a share of the EU market but would not contravene WTO rules. A special quota of 750,000 metric tonnes of ACP-produced bananas – a slightly smaller amount than the 850,000 metric tonnes proposed previously – will still be allowed to enter the EU duty-free.

Since quotas are being treated as a transitional measure, the EC will begin negotiations with main suppliers as mandated by WTO rules (Article XXVIII GATT) in time to introduce a flat-tariff system ('tariff-only') in 2006. The Commission has also agreed to table the necessary proposals to the EU Council of Ministers and the European Parliament in order to fully implement the agreement as soon as possible.

Annex 3. Civil society participation in the Cotonou Convention[28]

Successive Lomé Conventions have often been considered a 'closed shop', reserved for central governments. The Cotonou Partnership Agreement breaks with this tradition. For the first time, a wide range of participants, many of them from outside government, has been invited as genuine development partners in ACP–EU co-operation. The idea is not only to involve the newcomers in project implementation, but also to associate with them in political dialogue and policy formulation. Their involvement poses challenges for the ACP and EU governments that signed the Partnership Agreement and to the many non-governmental interests that seek active involvement in the process.

In Africa generally, post-independence development strategies gave central governments the lead in promoting growth and development. Successive Lomé Conventions largely followed this line, providing only limited opportunities for other development players (for example, civil society, private sector or local governments) to participate in policy formulation and implementation or to access resources. While special provisions were made for micro-projects under Lomé I (1975–80) and for decentralised co-operation under Lomé IV (1990–95), participation was usually confined to project implementation at the local level and involved relatively small financial resources. There were virtually no opportunities for structured dialogue on policy issues or on co-operation priorities.

When the European Commission started the Green Paper consultation process on future ACP–EU relations in 1996 (see main text), non-state observers generally considered Lomé as belonging to central governments. This monopolistic state of affairs was seen as running counter to major changes taking place in ACP societies (such as economic liberalisation, democratisation and decentralisation). Broadening participation in the partnership emerged as a priority issue in the negotiations on a successor agreement to Lomé IV. It proved to be a difficult issue to resolve, both for political reasons (some ACP states resisted the idea) and for practical reasons (there was little past practice or expertise on how best to broaden participation). As far as participation is concerned, the new Agreement is a radical break with the past. It contains many provisions that offer opportunities for new development players to participate in ACP–EU co-operation. It is notable that 'participation' is defined as a *fundamental principle* of co-operation (Article 2).

Endnotes

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2. ECDPM, *Cotonou Infokit: History and Evolution of ACP–EU Co-operation*, 3, ECDPM, Maastricht, 2001.
3. Comments received from Thomas Feige, Regional Economic Advisor, EC-Delegation, Botswana.
4. For detailed discussions of the changes to the Lomé Convention, see various infokits at www.ecdpm.org.
5. European Union, *Directives for the negotiations of Economic Partnership Agreements with ACP countries and regions*.
6. ILEAP, 'Negotiating EPAs between African sub-regions and the EU: Some concrete suggestions on market access', in *TNI*, 3, 4. July 2004.
7. According to the World Bank, the EU believes that, on the basis of a recent WTO ruling in a complaint that India brought against its GSP, the EU may be able to revise its GSP to provide greater unilateral preferences for selected non-LDCs (including many of the ACP countries that are non-LDCs). Such a revision could eliminate the need for the EU to enter into an FTA with the non-LDC ACP countries in order to maintain or enhance its current ACP trade preferences in a WTO compatible manner. Hence, in deciding how to proceed with the EPA process, the non-LDC ACP countries also need to consider the likely implications of a revised GSP system. Comments received from Lawrence Hinkle, Lead International Economist, Africa Region, World Bank.
8. Comments received from Mark Pearson, COMESA Secretariat, Zambia.
9. K Falkenberg, 'EPAs and DDA – Parallelism or crossroads?', in TNI, 3, 4, July 2004.
10. Comments received from Thomas Feige, Regional Economic Advisor, EC-Delegation, Botswana
11. M. Meyn, *Are Economic Partnership Agreements likely to Promote or Constrain Regional Integration in Southern Africa? Options, Limits and Challenges Botswana, Mauritius and Mozambique are Facing*. Conference paper prepared for the Namibian Economic Policy Research Unit (NEPRU): Monitoring Regional Integration in Southern Africa, Windhoek, 12–13 June 2004.
12. Comments received from San Bilal, ECDPM, Maastricht.
13. Interview with James Musonda, Senior Trade Advisor, COMESA Secretariat, on 2 June, 2004, Lusaka.
14. For a more detailed discussion of the varying rules of origin, see N. Joubert, L. Padayachee & G. Erasmus, *The SA–EU TDCA: A Comparison of the TDCA, Cotonou, EBA and AGOA*. Tralac Paper prepared for the World Bank.
15. Interview with Neil Joubert, Trade Law Centre for Southern Africa, on 17 May, 2004.
16. Interview with Hennie Erasmus, SADC Secretariat, on 27 May, 2004, Gaborone.
17. Some have argued that the exact reverse argument can be made as well: what will be left of the ACP group once regional EPAs are in place? What systemic difference will there be for instance between a SADC EPA and an EU–MERCOSUR FTA? Therefore, many have seen the EPAs move as a shift away from the ACP group. Comments received from San Bilal, ECDPM, Maastricht.
18. S. Szepesi, 'Coercion or Engagement? Economics and Institutions in ACP–EU Trade Negotiations', *ECDPM Discussion Paper* 56. ECDPM, Maastricht, 2004.
19. Ibid.
20. L. Kritzinger-Van Niekerk & E. Pinto Moreira, *Regional Integration in Southern Africa: An Overview of Recent Developments*. World Bank, Washington, 2002.
21. Namibia has withdrawn its membership from COMESA, effective June 2004.
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23. Launch of Trade negotiations between the EU and the South African Development Community (SADC). Opening Statement by EU Commissioner Danuta Hübner, Windhoek, Namibia, 8 July, 2004 downloaded 19 July, 2004 from http://europa.eu.int/comm/commissioners/hubner/speeches_articles/spdh07_en.htm.
24. Op. cit.
25. SADC split by EU trade talks', *Southern Africa–Europe, Trade & Development Update*, 3 2, December 2003, www.actsa.org.
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The Impact of ACP–EU EPAs on ECOWAS Countries: An Empirical Analysis of the Trade and Budget Effects

Matthias Busse, Axel Borrmann and Harald Grossmann

Introduction

A major objective of the Lomé IV Convention and its precursors was to improve the trade performance of the African, Caribbean and Pacific (ACP) group of countries, with the ultimate aim of promoting their economic growth and development. For that purpose, the European Community (EC) offered non-reciprocal trade preferences to products originating in ACP countries. The Cotonou Agreement, which was concluded in June 2000, provides for a shift from the system of non-reciprocal trade preferences to Economic Partnership Agreements (EPAs) by the end of 2007. ACP countries that enter into EPAs are required to set up a free trade area (FTA) with the European Union (EU). This means that they would have to open up their domestic markets for almost all products from the EU within a twelve-year period, which should last from 2008 to 2020. Apart from a gradual and managed liberalisation of trade barriers *vis-à-vis* EU imports, the main objectives of the EPA process include an enhanced market access for ACP countries to the EU, negotiations on trade in services, a deepening of the regional integration process between ACP countries, and increased co-operation in trade-related areas like competition and investment.

The driving force behind the EU's search for new trading arrangements was the need to ensure World Trade Organisation (WTO) compatibility of future ACP–EU trade relations. Non-reciprocal trade preferences granted under the Lomé Conventions required an exemption from WTO rules, because they were neither available to all developing countries nor restricted to just least-developed countries (LDCs). At the Fourth WTO Ministerial Conference in Doha, the EU was granted the last waiver under the Lomé Convention allowing it to maintain the preferential tariff treatment for products originating in ACP countries. Accordingly, ECOWAS members and other ACP countries will continue to enjoy duty-free access to EU markets for all industrial and a large part of agricultural products until the end of 2007.

Negotiations on EPAs, which started in September 2002, are expected to be concluded by 31 December, 2007 at the latest. The Cotonou Agreement largely leaves it to the ACP countries to decide on the geographical configuration of future EPAs. Yet the EU is not inclined to negotiate bilateral FTAs with such a large number of countries, but rather prefers to conclude EPAs with various regional groupings of ACP countries. So far, the EU has already started negotiations with all groupings or will start them soon (see Table 1). One of these regional groupings will be the Economic Community of West African States (ECOWAS), on which this study focuses. Founded in 1975, ECOWAS is a regional group of fifteen West African countries that has reduced trade barriers between its members' countries and aims to create a customs union by 2005 with a common external tariff and a common trade policy.[1]

An EPA would pose a major challenge to the governments of ECOWAS member states. While ECOWAS countries may benefit from improved or more secure access to EU markets, it is less clear whether ECOWAS countries will be in a position to open up their domestic markets. The fear is that the

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Table 1. Regional grouping in the EPA negotiations and timing of negotiations

Regional grouping	Timing of negotiations
ECOWAS[a] and Mauritania (Western Africa)	Negotiations began in October 2003
CEMAC[b] and Sao Tome and Principe (Central Africa)	Negotiations began in October 2003
16 countries[c] of COMESA (Eastern and Southern Africa)	Negotiations began in February 2004
15 countries[d] of CARIFORUM (Caribbean)	Negotiations began in April 2004
7 countries[e] of SADC (Southern Africa)	Start of negotiations foreseen in July 2004
14 ACP Pacific countries[f]	Start of negotiations foreseen in September 2004

Source: European Union (2004a).

Notes:

[a]Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo

[b]Cameroon, Central African Republic, Chad, Republic of Congo, Gabon, and Equatorial Guinea

[c]Burundi, Comoros, Djibouti, Democratic Republic of Congo, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia, and Zimbabwe

[d]Antigua and Barbuda, The Bahamas, Barbados, Belize, Commonwealth of Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago

[e]Angola, Botswana, Lesotho, Mozambique, Namibia, Swaziland, and Tanzania

[f]Cook Islands, Fiji, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Niue, Palau, Papua New Guinea, Solomon Islands, Samoa, Tonga, Tuvalu, and Vanuatu

elimination of customs duties on essentially all products from the EU will lead to a significant decline in government revenue and to an increase in unemployment, provoking heightened economic insecurity and political instability. Therefore, each government of ECOWAS member states and the grouping as a whole has to assess the likely impact of opening up their domestic markets and thoroughly consider all policy options.

The Cotonou Agreement most certainly acknowledges that some of the ECOWAS countries and the other ACP countries might not be in a position to enter into EPAs. The EU would then examine all alternative possibilities in order to provide these countries with a new framework for trade that is equivalent to their existing situation and in conformity with WTO rules. Under present circumstances, ECOWAS countries that decide not to participate in an EPA would have no other alternative but to export under either the EU's Generalised System of Preferences (GSP) or the Everything But Arms Initiative (EBA).

There is a considerable body of literature on the likely impact of an EPA. Yet most studies discuss various policy options for ACP countries or EU–ACP economic relations in general rather then assess the possible impact of the EPAs on trade flows or government revenue.[2] For West Africa, so far the only quantitative assessment of the trade and budget effects has been published by CAPE (2002), a research institute based in Benin.[3] Though the study, commissioned by the UEMOA Commission, was limited to the group of eight UEMOA countries,[4] it forms an important starting point for our own empirical analysis, and we will compare our results with those of the CAPE study.[5]

Accordingly, this study will analyse the impact of the EPA on ECOWAS countries and Mauritania[6] using a comprehensive dataset that draws on various sources. Importantly, the analysis focuses on the impact of the EPA on West African countries only and not on the European Union, as the effects for the EU are likely to be very small. In particular, it focuses on the trade and budget effects that might occur if West African countries open up their domestic markets for EU imports.

For two reasons, we have refrained from computing the effects if ECOWAS countries do not sign an EPA with the EU, implying that they would switch from ACP to GSP (or EBA) preferences instead. First, the resulting change in tariff preferences from ACP to GSP would harm only the three non-LDCs: Côte d'Ivoire, Ghana and Nigeria. All other West African countries would receive the more generous

EBA preferences. Also, rather than having an impact on the majority of their exports, only very specific products would be affected in these three countries, though at the highly disaggregated product level, the impact could be considerably large. Second, in comparison to the ACP system of preferences, the more restrictive rules of origin in the EU's GSP and EBA schemes have the potential to harm West African exporters both from LDCs and non-LDCs considerably. The computation of changes in the rules of origin, however, is somewhat arbitrary, as it requires assumptions on how importers and exporters will react to differences in the rules of origin.[7]

This study is based on a Friedrich-Ebert-Stiftung/HWWA co-operation to analyse the likely consequences of the EPAs on West African countries and to consider the various policy options available. Preliminary results have been presented and discussed at various joint workshops in Bonn, Brussels and Hamburg in 2003 and 2004. Participants of these workshops, who represented different ministries of trade from ECOWAS countries, the EU Commission, the UEMOA Commission and the ECOWAS Secretariat, provide us with very helpful comments and suggestions.[8] In comparison to the preliminary study, we extended the analysis to all ECOWAS countries (and Mauritania), except Liberia and Sierra Leone, since we did not get sufficient data for these two countries. Unfortunately, we could not incorporate domestic production, as the data were not available on a comparable level for all West African countries, that is, they are not made comparable by international organisations such as the United Nations Industrial Development Organisation (UNIDO). Likewise, the sometimes significant informal sector had to be excluded, as there is no reliable data or any information on how to estimate its size at the required product level.

Following up on various suggestions and comments, we extended the study to a more disaggregated level, namely we expanded the analysis to the four-digit level of the Harmonised System, which ensures a highly disaggregated approach and enables us to identify the most affected products. Also, based on the results of the study, we added various policy options and recommendations for policymakers in ECOWAS countries. Naturally, the study cannot cover all issues and aspects that are at stake with respect to the impact of the EPAs on ECOWAS countries. For example, any dynamics of regional integration in West Africa or the impact on poverty or gender issues have not been covered, as the focus is on the direct impact on trade flows and budget revenue. Nevertheless, regarding these effects, we think that the study provides policymakers with important information on the likely impact of the EPAs on ECOWAS countries.

Against this background, the study provides some information on the issues involved in the debate as well as outlining the aims, method and results of our empirical estimation of the effects. To begin with, we highlight some key economic and trade indicators for West African countries, followed by an explanation of the methodology and the data used. Due to data limitations, a partial equilibrium model has been used for the analysis. We present the empirical results, then discuss the results comprehensively and examine the general impact of EPAs on ACP countries. Based on the results, we compare an EPA with other policy options ECOWAS might consider and, finally present basic prerequisites for the EPA option.

Trade flows, data and model structure

Key economic indicators and trade flows

We start the empirical analysis with a rough overview of some economic and social indicators of West African ACP countries. As can be seen from Table 2, ECOWAS countries are relatively poor regarding income levels, measured by gross national income (GNI) per capita. With the exception of Cape Verde, all West African countries have a GNI per capita of below $1,000. Among the 15 poorest countries in the world measured by GNI per capita, five are from the West African Region (Guinea-Bissau, Liberia, Mali, Niger and Sierra Leone).[9] Also, the Human Development Index (HDI)[10] for West Africa is among the lowest in the world. If low life expectancy rates, high poverty, infant mortality and illiteracy rates are taken into account as well, the picture of the relatively low levels of development of the region becomes even clearer.

Table 2. Poverty and social indicators of ECOWAS countries and Mauritania

	HDI value	Population mid-year (millions)	GNI per capita	Poverty[1] (%)	Life expectancy at birth	Infant mortality (per 1000)	Illiteracy rate[2] (%)
Country	**2001**	**2002**	**2002**	**1993-00**	**2001**	**2001**	**2002**
Benin	0.411	6.6	380	–	50.9	94	60
Burkina Faso	0.330	11.8	250	61	45.8	104	74
Cape Verde	0.727	0.5	1,250	–	69.7	29	24
Côte d'Ivoire	0.396	16.5	610	12	41.7	102	49
Gambia	0.463	1.4	270	59	53.7	91	61
Ghana	0.567	20.3	270	45	57.7	57	26
Guinea	0.425	7.7	410	–	48.5	109	–
Guinea-Bissau	0.373	1.4	150	–	45.0	130	59
Liberia	–	3.3	140	–	47.0	157	44
Mali	0.337	11.4	240	73	48.4	141	73
Mauritania	0.454	2.8	280	29	51.9	120	59
Niger	0.292	11.4	170	61	45.6	156	83
Nigeria	0.463	132.8	300	70	51.8	110	33
Senegal	0.430	9.8	460	26	52.3	79	61
Sierra Leone	0.275	5.2	140	57	34.5	182	–
Togo	0.501	4.8	270	–	50.3	79	40
Average[3]	0.430		314	49	49.7	109	53

Sources: World Bank (2004ab), UNDP (2003) and HWWA calculations.

Notes:

[1]Percentage of population living under US$1 a day.

[2]Percentage of population 15 years of age and above that is illiterate.

[3]Unweighted averages, except GNI per capita, which is weighted by the population.

Table 3 presents key government revenue indicators of West African countries and gives an impression of the importance of customs revenue for each country. The first two columns indicate the net financing requirement of the government. Most West African countries show significant budget deficits of up to almost 12% of GDP. If capital grants[11] are excluded, the ability of West African governments to fund their activities from their own revenues becomes more visible. Now, the budget deficits are much larger, indicating the dependency of West African countries on foreign grants.

The third and fourth columns of Table 3 give a first impression of the significance of customs revenue with respect to total GDP and total government revenue for West African countries. In general, customs revenue consists of import and exports duties and other statistical fees, taxes and surcharges related to trade. With respect to the EPA, only import tariffs *vis-à-vis* EU imports will be eliminated. The following analysis will, hence, only concentrate on import duties collected. Import duties as a share of GDP range from 1.1% in Guinea and Niger up to 5.4% in Gambia. Import duties as a percentage of total government revenue, on the other hand, vary from 4.7% in Nigeria to 33.7% in Gambia. Based on these two indicators, Gambia and Cape Verde are highly dependent on import duties to finance government expenditure. Apart from these two countries, the percentages in Benin, Ghana, Senegal and Togo are also relatively high, indicating the potential significance of the impact of the EPA on government revenue if import duties decline to a considerable extent.

The importance of import duties becomes more apparent if the relative magnitude of imports and protection levels of West African countries *vis-à-vis* imports from the EU are taken into account (Table 4). On average, one half of total West African imports are from the European Union. Yet this figure

Table 3: Key government revenue indicators of ECOWAS countries and Mauritania, 2001

Country	Government deficit (-)/ surplus (+) (incl. grants) % of GDP	Government deficit (-)/ surplus (+) (excl. grants) % of GDP	Import duties % of GDP	Import duties % of government revenue[1]
Benin	-1.5	-4.2	2.5	18.1
Burkina Faso	-4.0	-11.3	1.5	12.0
Cape Verde	-5.2	-11.0	5.1	24.8
Côte d'Ivoire	0.9	0.3	1.4	8.2
Gambia	-6.3	-9.8	5.4	33.7
Ghana	-10.1	-14.6	2.7[3]	15.5[3]
Guinea	-4.4	-7.8	1.1	9.4
Guinea-Bissau	-11.7	-26.2	1.7	8.5
Liberia	-	-	-	-
Mali	-5.1	-9.5	1.8	10.7
Mauritania	-1.8	-5.7	2.4	12.8
Niger	-2.4	-7.1	1.1	12.3
Nigeria	-1.5	-1.5	2.3[3]	4.7[3]
Senegal	-2.0	-3.9	3.2	17.8
Sierra Leone	-11.4	-18.6	-	-
Togo	-2.1	-2.6	2.4	17.1
Average[2]	-4.6	-8.9	2.5	14.7

Sources: World Bank (2004b), UNCTAD (2004), ITC (2004) and HWWA calculations.
Notes: [1]Excluding grants. [2]Unweighted averages. [3]2000.

Table 4. Key trade and tariff indicators of ECOWAS countries and Mauritania, 2001

Country	Imports from the EU % of GDP	Imports from the EU % of total imports	Tariff rate total imports %[2]	Tariff rate EU imports %[2]
Benin	11.3	44.4	12.6	12.6
Burkina Faso	9.9	44.6	11.0	10.5
Cape Verde	31.2	74.3	15.4	15.8
Côte d'Ivoire	11.1	57.4	10.7	10.0
Gambia	36.4	61.8	11.8	11.8
Ghana	25.1	43.1	16.2	18.8
Guinea	9.8	49.0	6.0	6.3
Guinea-Bissau	18.2	59.7	14.2	15.3
Liberia	-	-	-	-
Mali	13.8	36.3	10.6	9.6
Mauritania	17.7	47.5	8.7	8.5
Niger	4.8	28.9	12.9	12.0
Nigeria[1]	6.8	47.9	20.0	19.5
Senegal	19.3	51.8	9.4	10.4
Sierra Leone	-	-	-	-
Togo	12.1	43.0	10.9	10.2
Average[3]	16.3	49.3	12.0	12.0

Sources: UNCTAD (2004) and ITC (2004).
Notes: [1]2000. [2]Import-weighted averages. [3]Unweighted averages.

can be much higher for individual countries, such as Cape Verde (74.3%) and Gambia (61.8%). In these two countries, the share of EU imports in GDP reaches 31.2 and 36.4% of GDP, respectively, which indicates a very high dependency on EU imports to these countries. On the other hand, Niger imports less from the EU (28.9%) in comparison to its neighbours.

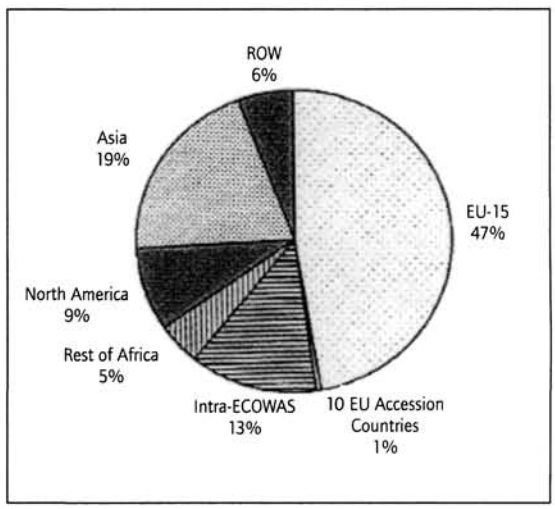
The two remaining columns of Table 4 give an impression of the protection levels of West African countries *vis-à-vis* total imports and EU imports with respect to tariff barriers. While the average import tariff rate for all West African countries is 12%, the same figures for total imports and EU imports for Nigeria are 20 and 19.5%, respectively. For the majority of West African countries, the import-weighted tariff rate for EU imports is in the range between 10 and 15%, indicating moderate levels of (tariff) protection.

The vast majority of imports in all West African countries consist of manufactured commodities, such as machinery, electrical appliances, cars, trucks, etc. Apart from Guinea-Bissau, the share of manufactures in total imports from the EU in West African countries is even higher than the same figure for total imports from all countries, indicating that these countries predominately import manufactured goods from the EU. Apart from Guinea and Ghana, West African countries apply lower tariff rates on raw materials than on agricultural or manufactured goods.[12]

The EU, conversely, imports predominately agricultural products and raw materials from ECOWAS countries (see Table 6). The trade structure between the EU and West Africa is, thus, fairly typical for developed and developing countries. In 2002, the EU had an overall trade surplus *vis-à-vis* ECOWAS of some $1.7 billion.

Not surprisingly, imports from France and the United Kingdom, the former colonial powers in West Africa, dominate total imports from the EU (see Figure 1). Other important trading partners are Germany, Italy, and the Benelux countries.

Figure 1. ECOWAS imports from the EU by countries, 2001



Source: ITC (2004)

At the time of concluding the EPA, scheduled for December 2007, West African countries will eliminate tariff barriers on imports for all 25 (or possibly more) EU members. The following analysis, however, will exclusively focus on the 15 members of the European Union in 2001, the base year for trade and tariff data. The ten accession countries that joined the EU in May 2004 will be excluded from the

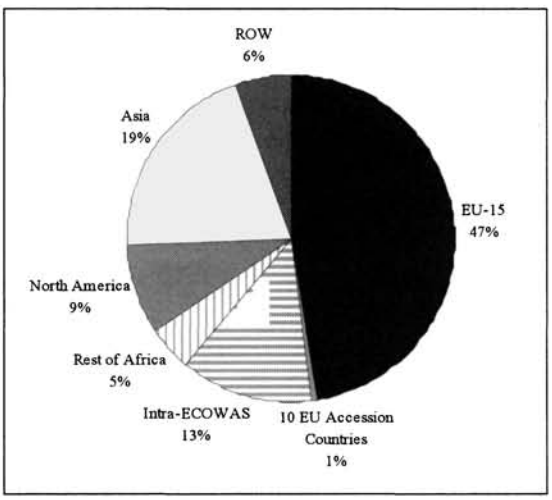
Table 5. EU-ECOWAS trade structure, 2002

	EU exports to ECOWAS		EU imports from ECOWAS	
Product category	**US$ (millions)**	**%**	**US$ (millions)**	**%**
Agricultural products	1,864	17.0%	2,902	31.3%
Raw materials	806	7.3%	5,231	56.4%
Manufactured goods	8,301	75.7%	1,147	12.3%
Total	10,971	100.0%	9,280	100.0%

Source: ITC (2004).
Note: Mauritania is included in the ECOWAS group.

analysis. The trade and budget effects are thus likely to be larger, depending on imports and duties collected on imports from EU accession countries. For the year 2001, total imports by ECOWAS countries from the ten accession countries were relatively small in comparison to the 15 old EU members (see Figure 2). Their share of total imports only amounted to 1% in 2001, far less than the same figure for the EU–15 (47%). Other important trading partners of ECOWAS countries were Asia (19%), the intra-ECOWAS trade (13%) and North America (9%).

Figure 2. Structure of ECOWAS imports, 2001



Source: ITC (2004).

Data and model structure

On the whole, the quantitative analyses of the impact of an EPA on trade flows are typically performed in either a partial or general equilibrium framework. By their very nature, partial equilibrium models allow highly detailed studies on the impact of trade policy changes to be made. In contrast, general equilibrium models attempt to describe the effects of discriminatory tariff preferences on the economy as a whole and the intersectoral linkages in particular. In most cases, general equilibrium models are thus more suitable to analyse the overall trade and welfare effects. Yet they require a so-called social accounting matrix with detailed information on each of the involved economies, such as sectoral production data or substitution elasticities.

Since the required data is not available for all West African countries, we have to rely on an appropriate partial equilibrium model. More specifically, the model of Verdoorn (1960) will be used to estimate the impact on trade flows and budget revenue in West African countries. Despite its age, it is a suitable partial equilibrium model for the analysis of trade flows in the proposed EPA.[13] In the spirit of the 'Armington assumption' (Armington 1969), this model assumes product differentiation between supplying countries. Imported goods from different countries are considered to be imperfect substitutes in use. This assumption seems reasonable, since the majority of African imports consist of manufactured goods (see Table 5).

Verdoorn's model is based on the normal assumptions of partial equilibrium analysis, such as no repercussions on exchange rates or incomes due to changing trade flows, iso-elastic import-demand functions, and infinite supply elasticities. The latter assumption, frequently applied in models of international trade, seems appropriate in the case of the European Union, since the EU is relatively large and its exports to ECOWAS countries account for only 0.5% of total EU exports in 2002 (ITC 2004), or other major exporters, such as the United States. Yet it might be some cause for concern for smaller export nations, such as other African countries. In reality, their elasticities of supply are less than infinite. Yet the share of exports to ECOWAS countries in domestic production is usually not very large. For these reasons, expected changes in total domestic production are likely to be small and the assumption of horizontal supply curves seems appropriate.

To analyse the different trade effects the EPA may have, let us consider a particular commodity category (Q), such as shoes. The consumer wishes to maximise his utility

$$(1) \quad U = f[f_1(Q_1, Q_2), Q_3]$$

where the branch of the utility function f_1 is homogeneous. Q_1 and Q_2 denote imports of shoes from preferred and non-preferred countries, and Q_3 represents domestically produced shoes. The assumption of homogeneity of the utility function implies that total imports $(Q_1 + Q_2)$ are substituted equally for domestic production. By using import demand elas-

ticities, we can thus employ import data without having to rely on domestic production data. This particular assumption is not only convenient, but rather necessary for the majority of West African countries. To include domestic production in the calculations, we would have to obtain highly disaggregated data at the four-digit level of the International Standard Industrial Classification (ISIC), compiled by the UNIDO (2004). Apart from Senegal, this data is either not available or obsolete. We have thus excluded domestic production in the following analysis of the effects of the EPA on West African countries.

Tariff and trade data, on the other hand, are accessible. The tariffs were obtained from the UNCTAD (2004) Trade Analysis and Information System (TRAINS), which is a comprehensive computerised information system at the tariff-line level using, among others, the Harmonised System (HS) of product classifications. For Cape Verde, Guinea and Gambia, TRAINS does not report any tariff information. Hence, we had to rely on other sources, that is, for Cape Verde we used the national six- to ten-digit HS tariff schedule, provided by the Cape Verde Ministry of Economics (2004), and aggregated it to the four-digit HS level, using the appropriate trade figures.[14] For Guinea, we obtained the HS tariffs from the WTO (2004) Integrated Database, which is a similar database for trade and tariffs, but covers fewer countries and years in comparison to TRAINS.

In the case of Gambia, we could not obtain disaggregated tariffs and thus used the import-weighted tariff rate for total imports, reported by the IMF (2004). Among ECOWAS countries, Sierra Leone and Liberia had to be excluded from the analysis, as tariff data for both countries could not be obtained. Hence, the empirical analysis has been performed for a total of 14 West African countries, that is, 13 ECOWAS countries plus Mauritania. The base year is 2001, or the most recent year for which reliable trade and tariff data were available.[15] Finally, the trade data were extracted from the COMTRADE database, which is available online and on CD-ROM (ITC 2004), and TRAINS (UNCTAD 2004).[16]

Verdoorn's model focuses on imports from different sources, that is, imports from preference beneficiaries and from non-beneficiaries. The model is based on two key assumptions. First, the demand function of the preference donor (ECOWAS) for any single good takes the following form:

$$(2) \quad Q_1 + Q_2 = \beta P_1^{\varepsilon\alpha_1} P_2^{\varepsilon\alpha_2}$$

where P_1 and P_2 are the prices of beneficiaries' and non-beneficiaries' imports, α_1 and α_2 are share coefficients ($\alpha_1 = Q_1/(Q_1 + Q_2)$ and $\alpha_1 + \alpha_2 = 1$), β is a parameter and ε represents the elasticity of import demand.

Second, the elasticity of substitution (σ) of preferred and non-preferred imports can be defined as:

$$(3) \quad \frac{Q_1}{Q_1} = \gamma\left(\frac{P_1}{P_2}\right)^{\sigma}$$

If the tariff (t) is eliminated only on preferred imports Q_1 and supply elasticities are infinite, then the price of the beneficiaries' imports P_1 changes by

$$(4) \quad \frac{\delta P_1}{P_1} = \frac{\delta t}{1+t}$$

Then the total expansion of imports from the preferred country's viewpoint due to the trade preferences can be expressed as follows:[17]

$$(5) \quad \frac{\delta Q_1}{Q_1} = (\alpha_1\varepsilon + (1-\alpha_1)\sigma)\left(\frac{\delta t}{1+t}\right)$$

The chain reaction comes in two stages: first the tariff is eliminated only on Q_1, and P_1 falls, and then the consumer substitutes Q_1 for Q_2. Equation (5) can be rearranged by substituting α_2 for α_1:

$$(6) \quad \frac{\delta Q_1}{Q_1} = (\varepsilon + \alpha_2(\sigma - \varepsilon))\left(\frac{\delta t}{1+t}\right)$$

The total change in preferred imports can be split into trade creation (TC) and trade diversion (TD). The former is defined as the change in imports from beneficiaries' countries and consists of the consumption effect, that is, the increase in overall consumption due to lower prices, and the displacement of domestic production.[18] This effect can be determined from the preferred country's point of view as follows:

$$(7) \quad TC = Q_1\varepsilon\left(\frac{\delta t}{1+t}\right)$$

Similarly, trade diversion is defined as the substitution of preferred for non-preferred imports due to the preferential tariff elimination:

$$(8) \quad TD = Q_1 \alpha_2 (\sigma - \varepsilon) \left(\frac{\delta t}{1+t} \right)$$

Finally, the expected change in import duties (ID) is equal to the sum of import duties for imports from preferred countries Q1, which are now excluded from import tariffs, and the replacement of imports from non-preferred countries (TD) multiplied by the import tariff:

$$(9) \quad \delta ID = Q_1 t_1 + TD t_2$$

where t_1 and t_2 represent the tariff rates for preferred and non-preferred imports, respectively.

The estimation of trade creation and diversion and the changes in import duties has been conducted at the four-digit HS level. At that level of aggregation, the HS schedule consists of 1,241 goods. In comparison to an estimate at a more aggregated level, this highly disaggregated approach ensures an accurate estimation of trade effects, since it takes – in the case of trade diversion – competition from various countries at an appropriate level into account. Also, it allows the identification of the commodities that are most likely to be affected by the EPA.

As can be seen from (7) and (8), estimation of TC and TD in the differentiated product model requires estimates of import demand and substitution elasticities. Reliable estimates for both elasticities for West African countries at the four-digit HS level are not available. As a remedy, we assumed values for these elasticities. More specifically, we set up three scenarios: low, mid and high. The scenarios differ with respect to the assumed elasticities. To address differences in elasticities that are based on the degree of homogeneity of the products, we differentiated between agricultural products, raw materials and manufactured goods (see Table 6). In particular raw materials are more likely to be substituted, as they are more similar in comparison to manufactured or agricultural goods. In contrast to the import demand elasticities, the assumed values for the elasticity of substitution are higher, because imports from, for instance, the United States and the EU are more likely to be substituted than EU imports and domestically produced goods. From our perspective, the mid scenario is the most likely outcome of the EPA between ECOWAS countries and the EU. The low and high scenarios, on the other hand, provide lower and upper bound estimates of the trade and budget effects of the EPA.

Elasticities at the four-digit level are usually higher than those at a more aggregated level, as we can expect a higher degree of competition among more similar goods. For example, if two different products (e.g. aeroplanes and motor vehicles) belong to a given category (transport equipment), then we can expect that the elasticity of substitution among imports of motor vehicles from different countries would be higher than the one between motor vehicles and aeroplanes. Only the more disaggregated level allows a differentiation between such goods, implying higher elasticities. In general, our assumed figures are well within the range of similar elasticities of other developing countries.[19]

For Gambia, we assumed values for both elasticities at the aggregated level, that is, total imports, as disaggregated tariff data could not be obtained (see Table 7). In comparison to the figures for the other West African countries, both elasticities are lower, as the degree of substitutability is likely to be smaller on a more aggregated level.[20]

Table 6. Assumed values for the elasticities, four-digit level

	Import demand elasticity			Elasticity of substitution		
Product category (HS chapters)	**low**	**mid**	**high**	**low**	**mid**	**high**
Agricultural products (01–24)	0.4	0.7	1.0	1.0	2.0	3.0
Raw materials (25–27)	0.6	0.9	1.2	2.0	3.5	6.0
Manufactured goods (28–97)	0.8	1.1	1.4	1.8	3.0	4.0

Note: The elasticities refer to the four-digit HS level for all ECOWAS countries and Mauritania except Gambia.

Table 7. Assumed values for the elasticities, total imports, Gambia

	Import demand elasticity			Elasticity of substitution		
Product	**low**	**mid**	**high**	**low**	**mid**	**high**
Total imports	0.5	0.7	0.9	1.3	2.0	2.5

Information on import duties has been obtained from IMF staff reports on each West African country (IMF 2004). Based on the IMF data, we have computed collection ratios, that is, the share of duty collected on the c.i.f. value of imports.[21] Collection ratios are clustered in the range 5 to 10% in half of West African countries, with Cape Verde and Nigeria above and Ghana and Mali below that range (Table 8). Collection efficiency ratios, defined as the percentage of the collection ratio of import-weighted tariff rates, have also been calculated. They provide information on whether there are particular exemptions, such as special trade preferences, due to export-processing zones, and/or deficiencies in the duty collection due to red tape, smuggling or corruption. Also, since there are no preferential tariff rates for West African countries included in the TRAINS database, the reported import-weighted tariff rates are naturally larger than the collection rates.

By this measure, Guinea and Senegal are particularly good performers, collecting 90% and more of their statutory rates. Ghana, Guinea-Bissau and Mali, on the other hand, have a rather poor record in collection efficiency, with ratios below 35%. Importantly for the empirical results, only the actual collected import duties will be incorporated into the analysis, as these duties are subject to elimination as part of the EPA.[22]

Impact assessment for ECOWAS countries and Mauritania

Empirical results

After describing the model and the data used, we turn now to the estimation of the trade and budget effects of the EPA on ECOWAS countries and Mauritania. As a start, we have to make an assumption about the timing of trade liberalisation, as stip-

Table 8. Efficiency of import duty collections, 2001

Country	Collection ratio[1] (%)	Import-weighted tariff rate (%)	Collection efficiency[2] (%)
Benin	9.7	12.6	76.5
Burkina Faso	6.8	11.0	61.3
Cape Verde	12.1	15.4	78.7
Côte d'Ivoire	7.4	10.7	68.8
Gambia	9.2	11.8	78.3
Ghana[3]	4.7	16.2	29.1
Guinea	5.4	6.0	89.9
Guinea-Bissau	5.4	14.2	38.2
Mali	4.6	10.6	43.7
Mauritania	6.4	8.7	73.3
Niger	6.9	12.9	53.4
Nigeria[3]	15.9	20.0	79.7
Senegal	8.5	9.4	90.0
Togo	8.4	10.9	77.0
Average[4]	8.0	12.2	67.0

Sources: HWWA calculations based on IMF (2004), UNCTAD (2004) and ITC (2004) data.
Notes: [1]Percentage of duty collected of the c.i.f. value of imports. [2]Collection ratio divided by import-weighted tariff rate. [3]2000. [4]n-weighted averages.

ulated in the proposed agreement between ECOWAS countries and the EU. Under the likely terms of the EPA, tariffs will be eliminated within a period of up to 12 years for the most part, although a few import-sensitive goods are likely to be excluded from the agreement. An examination conducted by the WTO's Committee on Regional Trade Agreements suggests that FTAs typically cover between 80 and 95% of the trade between FTA members (WTO 2002). In our analysis, however, we have assumed a complete tariff liberalisation at the time of the base year and focused on the final stage of trade barrier elimination instead of calculating the effects at each stage. Thus, our figures are likely to be upper bound estimates of the static trade and budget effects, depending on how many products will be excluded from the agreement.

As can be seen from Table 9, in the case of a complete tariff liberalisation *vis-à-vis* EU imports in all West African countries, total imports from the EU are expected to increase in the mid scenario in the range of 5.2% (Guinea-Bissau) to 20.8% (Nigeria). Apart from Nigeria, relatively high trade effects can be expected in Benin (increase in total imports by 11.6%), Cape Verde (11.7%), Senegal (11.5%) and Togo (10.9%). The reasons for this outcome are mainly above-average tariff rates for EU imports and/or relatively high import-duty collection-efficiency ratios. In absolute terms, the increase in total imports in Nigeria is by far the largest in West Africa, due to the magnitude of both overall and EU imports.

The low and high scenarios give an impression of the expected range of the trade effects. In general, the results for the high scenario are roughly twice as large as those for the low scenario, since the assumed values for the elasticities in both scenarios are – on average – also roughly twice as large. There are, however, differences at the country level, since the import structure in West African countries differs. This applies in particular to Ghana and Togo, as in both countries imported raw materials from the EU make up a relatively large share in total imports.

Trade creation exceeds trade diversion (in absolute levels) in all scenarios and all West African countries. For trade creation, the increase in EU imports in the mid scenario ranges from 3.6% in Mali to 12.5% in Nigeria. Again, relatively high trade barriers *vis-à-vis* EU imports are the main reason for the larger trade effects in Nigeria. The trade diversion effects are somewhat smaller. From the perspective of non-preferred imports, the largest decline can be expected (again) in Nigeria with a decrease of $229 million or 7.6%. At first sight, the larger trade creation figures are somewhat surprising, given the fact that the assumed values for the elasticity of substitution is in all cases larger than the import demand elasticity.[23] This assumption is reasonable, since imports from different sources, say, the European Union and the United States, are much more likely to be substituted than EU imports and domestically produced goods. This holds in particular for manufactured goods like machinery, cars, etc., which make up the bulk of ECOWAS imports. Nevertheless, the results are plausible, if we take into account that the estimation of the trade effects has been performed at the four-digit HS level. At that level of disaggregation, there are only or mostly imports from the EU for a considerable number of products and, thus, no or very small trade diversion effects.[24]

From an economic point of view, trade creation is welfare improving, as consumers substitute lower cost beneficiary imports for goods produced at home. Trade diversion, on the other hand, will decrease welfare, as a more efficient source of imports will be displaced by a higher cost producer. From this perspective, the EPA between the EU and ECOWAS countries and Mauritania is likely to increase overall welfare levels in West African countries. Yet this does not hold for all products, as at the highly disaggregated level trade diversion can exceed trade creation.

Importantly, these trade effects do not occur immediately after the tariffs have been removed. To begin with, the tariffs are likely to be phased out over a period of 10 to 12 years. The effects would, hence, depend on the timetable of tariff elimination in West Africa. There are further time lags, since relative prices do not adjust immediately after changes in tariff rates. As a consequence, it will take some time before an increase in total EU imports and the replacement of non-EU imports can be observed in ECOWAS countries. The speed of the

Table 9. Trade effects of EPA on ECOWAS countries, 2001

		Trade creation		Trade diversion		Total trade effect	
Country	Scenario setting	US$ (millions)	% of preferred imports	US$ (millions)	% of non-preferred imports	US$ (millions)	% of preferred imports
Benin	Low	13.8	5.2%	5.6	1.7%	19.4	7.2%
	Mid	20.4	7.6%	10.7	3.2%	31.1	11.6%
	High	27.0	10.1%	15.5	4.6%	42.6	15.9%
Burkina Faso	Low	9.9	4.0%	5.1	1.7%	15.0	6.1%
	Mid	14.1	5.7%	9.8	3.2%	23.9	9.7%
	High	18.3	7.4%	14.4	4.7%	32.8	13.3%
Cape Verde	Low	11.5	6.3%	2.4	3.7%	13.8	7.5%
	Mid	16.9	9.2%	4.5	7.1%	21.5	11.7%
	High	22.3	12.2%	6.5	10.2%	28.8	15.7%
Côte d'Ivoire	Low	48.4	4.2%	13.1	1.5%	61.5	5.3%
	Mid	69.3	6.0%	25.3	2.9%	94.7	8.2%
	High	90.3	7.8%	35.9	4.2%	126.2	10.9%
Gambia	Low	5.9	4.1%	3.6	4.1%	9.5	6.7%
	Mid	8.2	5.8%	5.8	6.6%	14.0	9.9%
	High	10.6	7.4%	7.2	8.2%	17.7	12.5%
Ghana1	Low	31.6	2.5%	21.2	1.3%	52.9	4.2%
	Mid	45.8	3.7%	40.2	2.4%	85.9	6.9%
	High	59.9	4.8%	59.2	3.6%	119.1	9.5%
Guinea	Low	9.8	3.3%	5.2	1.7%	15.0	5.1%
	Mid	14.3	4.9%	10.0	3.3%	24.3	8.3%
	High	18.8	6.4%	15.6	5.1%	34.4	11.7%
Guinea-Bissau	Low	1.1	3.0%	0.1	0.5%	1.2	3.4%
	Mid	1.6	4.5%	0.3	1.1%	1.9	5.2%
	High	2.2	6.0%	0.4	1.5%	2.5	7.0%
Mali	Low	9.3	2.5%	4.3	0.7%	13.6	3.7%
	Mid	13.3	3.6%	8.3	1.3%	21.6	5.9%
	High	17.4	4.7%	11.8	1.8%	29.1	7.9%
Mauritania	Low	6.9	3.9%	2.8	1.5%	9.7	5.5%
	Mid	9.8	5.5%	5.4	2.8%	15.2	8.6%
	High	12.7	7.2%	7.9	4.0%	20.6	11.6%
Niger	Low	3.0	3.2%	1.8	0.8%	4.8	5.1%
	Mid	4.6	4.9%	3.5	1.5%	8.1	8.6%
	High	6.1	6.5%	5.3	2.3%	11.4	12.1%
Nigeria[1]	Low	244.5	8.8%	118.6	3.9%	363.1	13.1%
	Mid	348.3	12.5%	229.1	7.6%	577.4	20.8%
	High	452.1	16.3%	327.6	10.8%	779.7	28.0%
Senegal	Low	49.2	5.5%	16.3	2.0%	65.6	7.3%
	Mid	71.2	8.0%	31.4	3.8%	102.7	11.5%
	High	93.2	10.4%	45.7	5.5%	138.9	15.5%
Togo	Low	6.9	4.5%	3.4	1.7%	10.3	6.8%
	Mid	10.1	6.6%	6.5	3.2%	16.6	10.9%
	High	13.2	8.7%	10.1	5.0%	23.3	15.3%

Source: HWWA calculations
Note: [1]2000

adjustment to changes in relative prices depends on the behaviour of EU and non-EU exporters and West African importers and/or wholesalers. If there is less competition, relative prices will adjust more slowly and, hence, any changes in the import structure and domestic production will take their time.

Apart from the impact on trade flows, the tariff elimination will lead to a decline in import duties and, hence, total government revenue. In absolute terms, the decline in import duties in the mid scenario ranges from $2.2 million in Guinea-Bissau to $487.8 million in Nigeria (see Table 10). As a share of total import duties, the decrease will be largest in Cape Verde, with a decline of 79.9%. More importantly, import duties can be a significant source of total government revenue. A considerable decline might then affect the public financial positions of West African governments and their ability to provide public goods. From this perspective, Cape Verde and Gambia will be particularly affected with an estimated decline in total government revenue in the mid scenario of 19.8 and 21.9%, respectively. As a share of GDP, the percentage figures for both countries amount to 4.1 and 3.5, which are very large numbers. Based on these calculations, both countries would face a severe impact on their economies.[25]

The reasons for the far above average (relative) decline in import duties and government revenues are Cape Verde's and Gambia's relatively large share of EU imports to their GDP, their dependence on import duties to finance public expenditures, and their relatively high collection efficiency ratios (see Table 11).

In contrast to Cape Verde and Gambia, the overall impact on government revenue would be somewhat smaller in other West African countries. Still, considerable effects can be expected in Ghana and Senegal with a decline in government revenue in the magnitude of 10 to 11% (see Table 10). If we take into account that these countries already have relatively large budget deficits (see Table 3), the importance of the impact of the EPA on government revenue becomes clearly visible.

In comparison to the trade effects, the differences in changes in import duties in the low and high scenarios in Table 10 are much smaller, since EU imports will be duty free after an EPA comes into force and only small losses in import duties are due to trade diversion effects. The precision of the estimated losses in import duties is therefore much higher. This is, however, not the case in Ghana, where import duties will decline between $80 million and $102 million. In this country, large trade diversion effects occur in a single product category (petroleum oils, HS heading 2710), implying a severe impact on government revenue.

An important advantage of the partial equilibrium approach is the ability to identify the most affected products of the EPA at a fairly disaggregated level. To single out the sensitive products and product categories, we have sorted the disaggregated effects both by absolute changes in import duties and by changes in total EU imports. For losses in import duties, Table 12 lists the five most important products for each country at the four-digit HS level.[26] Though the products can vary significantly from country to country, there are a few products that are among the top five most affected products in a number of countries, such as motor cars for the transport of people (HS heading 8703) and of goods (8704), milk and cream (0402), cane or beet sugar (1701), and petroleum oils (2710). Despite the fact that the results are partly driven by identical tariff protection rates for UEMOA countries for EU imports, a few similar categories can be found in the other ECOWAS countries as well. Above all, this applies to motor cars and petroleum.

In addition to the budget effects, we identified those products for which far-above-average trade effects are likely to occur due to the EPA. Among the numerous products affected, we also identified (more aggregated) product groups to single out groups of similar products. For this exercise, we were able to sort the total trade effects by absolute or relative changes. To ensure that both indicators for changes in EU imports, that is, absolute and relative changes, were taken into account simultaneously, we standardised both indicators in a first step:

$$(10) \quad Z_{ij} = \frac{X_{ij} - \mu_j}{\omega_j}$$

where the standardised score (z) of product i on indicator j (1, 2), namely absolute and relative changes

Table 10. Decline in import duties in ECOWAS countries, 2001

Country	Decline in import duties				
	Scenario setting	US$ (millions)	% of total import duties	% of total government revenue[2]	% of GDP
Benin	Low	26.7	46.0%	8.3%	1.13%
	Mid	27.6	47.4%	8.6%	1.16%
	High	28.3	48.7%	8.8%	1.19%
Burkina Faso	Low	16.8	45.0%	5.4%	0.68%
	Mid	17.5	46.8%	5.6%	0.71%
	High	18.2	48.5%	5.8%	0.73%
Cape Verde	Low	23.5	78.0%	19.4%	3.99%
	Mid	24.0	79.9%	19.8%	4.09%
	High	24.5	81.5%	20.2%	4.17%
Côte d'Ivoire	Low	81.2	54.4%	4.5%	0.78%
	Mid	82.9	55.5%	4.6%	0.80%
	High	84.3	56.5%	4.6%	0.81%
Gambia	Low	13.5	63.8%	21.5%	3.47%
	Mid	13.8	65.0%	21.9%	3.54%
	High	14.0	65.8%	22.1%	3.58%
Ghana[1]	Low	80.3	58.7%	9.1%	1.61%
	Mid	90.8	66.4%	10.3%	1.82%
	High	102.4	74.9%	11.6%	2.06%
Guinea	Low	16.3	50.6%	4.8%	0.55%
	Mid	16.7	51.6%	4.9%	0.56%
	High	17.0	52.7%	5.0%	0.57%
Guinea-Bissau	Low	2.14	65.2%	5.5%	1.08%
	Mid	2.16	65.8%	5.6%	1.09%
	High	2.18	66.3%	5.6%	1.09%
Mali	Low	16.0	34.3%	3.7%	0.60%
	Mid	16.6	35.6%	3.8%	0.63%
	High	17.1	36.7%	3.9%	0.65%
Mauritania	Low	11.4	47.8%	6.1%	1.13%
	Mid	11.8	49.3%	6.3%	1.17%
	High	12.1	50.5%	6.5%	1.20%
Niger	Low	6.3	28.3%	3.5%	0.32%
	Mid	6.6	29.6%	3.6%	0.34%
	High	6.9	30.8%	3.8%	0.35%
Nigeria[1]	Low	460.1	49.7%	2.4%	1.12%
	Mid	487.8	52.7%	2.5%	1.19%
	High	512.8	55.4%	2.6%	1.25%
Senegal	Low	85.8	58.6%	10.4%	1.85%
	Mid	87.9	60.0%	10.7%	1.89%
	High	89.7	61.3%	10.9%	1.93%
Togo	Low	12.5	41.8%	7.2%	0.99%
	Mid	12.9	43.2%	7.4%	1.02%
	High	13.3	44.6%	7.6%	1.06%

Source: HWWA calculations.
Notes: [1]2000. [2]Excluding grants.

Table 11. Combined tariff, trade and government revenue indicators, 2001

Country	Imports from the EU in % of total imports	Import-weighted tariff rate EU imports (%)	Import duties in % of total government revenue	Import duty collection efficiency ratio in %
Benin	44.4	12.6	18.1	76.5
Burkina Faso	44.6	10.5	12.0	61.3
Cape Verde	74.3	15.8	24.8	78.7
Côte d'Ivoire	57.4	10.0	8.2	68.8
Gambia	61.8	11.8	33.7	78.3
Ghana	43.1	18.8	15.5	29.1
Guinea	49.0	6.3	9.4	89.9
Guinea-Bissau	59.7	15.3	8.5	38.2
Mali	36.3	9.6	10.7	43.7
Mauritania	47.5	8.5	12.8	73.3
Niger	28.9	12.0	12.3	53.4
Nigeria	47.9	19.5	4.7	79.7
Senegal	51.8	10.4	17.8	90.0
Togo	43.0	10.2	17.1	77.0
Average	49.3	12.0	14.7	67.0

Sources and Notes: See Tables 3, 4 and 10.

in total EU imports, was derived from the actual score (x) minus the arithmetic mean of this indicator for all products (μ) adjusted by the standard deviation (ω) of the indicator over all products.

The standardised values were combined by taking the unweighted arithmetic mean of both scores:

$$(11)\quad \text{Standardised changes in } Q_1 = \frac{\sum_{j=1}^{2} z_{ij}}{2}$$

A higher standardised score implies that both relative and absolute changes will occur in this product category. After this procedure we obtained a list of all products at the four-digit level (HS heading). To identify which product groups are most likely to be affected by the EPA, we computed the occurrence of the top 100 four-digit products at the two-digit level (HS chapters) and divided the number by the total number of headings per chapter.

As can be seen from Table 13, if 20 to 33% of all four-digit categories per HS chapter are listed in the top 100, we observe a moderate impact at the two-digit level (figures in italic). For the more affected products, ranging from greater than 33% up to 50%, the figures are given in bold type. The figures for the most affected commodities with relative occurrences of greater than 50 up to 100% are shown in heavy type.[27]

The results clearly indicate that a few product categories are sensitive in almost all West African countries with respect to changes in trade flows. More specifically, apparel and clothing (HS chapters 61 and 62), other made up textile articles (63), and footwear, gaiters and the like (64), will be highly affected by an EPA. To a lesser degree, but still considerably affected are: sugars and sugar confectionery (17), preparations of cereal, flour, starch/milk (19), essential oils and resinoids (33), soap and organic surface-active agents (34), manufactures of straw, esparto and other (46), cotton (52), carpets and textile floor coverage (57), knitted or crocheted fabrics (60), cars, trucks, motorbikes (87), furniture, bedding, mattress (94), and toys, games and sports requisites (95). For these products, the changes in total imports, measured in absolute and relative terms, are far above average.

Looking at these product categories, we have to keep the limitations of our approach in mind, that is, we excluded domestically produced goods. Therefore, the identification of the most affected product categories is related only to changes in total imports. Domestically produced goods will, thus, not auto-

Table 12. Top five most affected products, budget effects, 2001

Benin	Burkina Faso	Cape Verde
Meat & edible offal, poultry (0207)	Motor cars, vehicles, for transport of people (8703)	Beer made from malt (2203)
Worn clothing (6309)	Petroleum oils etc., not crude (2710)	Motor cars, vehicles, for transport of people (8703)
Motor cars, vehicles, for transport of (8703)	Cane or beet sugar (1701)	Waters, sweetened/flavoured (2202)
Milk and cream (0402)	Motor vehicles, for transport of goods (8704)	Meat, edible offal, of poultry (0207)
Woven fabrics of cotton (5208)	Motorcycles, sidecars (8711)	Glazed ceramic flagstones and paving (6908)
Côte d'Ivoire	**Ghana**[1]	**Guinea**
Motor cars, vehicles, for transport of people (8703)	Petroleum oils etc., not crude (2710)	Petroleum oils etc., not crude (2710)
Fish (0303)	Worn clothing (6309)	Cane or beet sugar (1701)
Milk and cream (0402)	Motor cars, vehicles, for transport of people (8703)	Motor cars, vehicles, for transport of people (8703)
Petroleum oils etc., not crude (2710)	Milk and cream (0402)	Cigars, cigarettes, cigarillos (2402)
Iron and steel products (7210)	Artificial corundum etc. (2818)	Wheat and meslin (1001)
Guinea-Bissau	**Mali**	**Mauritania**
Motor cars, vehicles, for transport of people (8703)	Motor cars, vehicles, for transport of people (8703)	Motor cars, vehicles, for transport of people (8703)
Beer made from malt (3203)	Cane or beet sugar (1701)	Automatic data processing machines (8471)
Soya-bean oil (1507)	Malt extract etc. (1901)	Tubes, pipes etc. of cast iron (7303)
Waters, sweetened/flavoured (2202)	Cigars, cigarettes, cigarillos (2402)	Parts of machinery (8431)
Wine of fresh grapes (2204)	Insulated wire, cable etc. (8544)	Soya-bean oil (1507)
Niger	**Nigeria**[1]	**Senegal**
Cane or beet sugar (1701)	Motor cars, vehicles, for transport of people (8703)	Motor cars, vehicles, for transport of people (8703)
Wheat or meslin flour (1101)	Rice (1006)	Petroleum oils etc, not crude (2710)
Cigars, cigarettes, cigarillos (2402)	Extracts, essences of coffee, tea (2101)	Cane or beet sugar (1701)
Milk and cream (0402)	Medicaments (3004)	Malt extract etc. (1901)
Motor cars, vehicles, for transport of people (8703)	Electrical transformers, static converters etc. (8504)	Soya-bean oil (1507)
Togo		
Petroleum oils etc., not crude (2710)		
Motor cars, vehicles, for transport of people (8703)		
Cigars, cigarettes, cigarillos (2402)		
Insulated wire, cable etc. (8544)		
Meat, edible offal of poultry (0207)		

Notes: Four-digit HS codes in parenthesis. [1]2000.
Source: HWWA calculations.

matically be displaced to the same extent. In general, the trade-creation effect consists of two effects: the consumption and the production effect. The latter relates to the displacement of domestically produced goods by more competitive preferred imports, whereas the former gives information on the change in total consumption, since import prices will decline due to the EPA. As there is no or very little domestic production in ECOWAS countries for a number of EU imports, the production effect is zero or very close to zero for numerous manufactured goods, such as cars or electrical machinery. For the identification of the most sensitive products regarding domestically produced goods, one has to compare the production structure in each West African country with the list of changes in total imports.

Likewise, though we do incorporate collection efficiency ratios to control for tariff preferences and

Table 13. Relative frequency of HS chapter occurrence (%), trade effects top 100, 2001

HS no.	HS chapters	Benin	Burkina Faso	Cape Verde	Côte d'Ivoire	Ghana[1]	Guinea	Guinea-Bissau	Mali	Mauritania	Niger	Nigeria[1]	Senegal	Togo
01	Live animals	0	0	0	0	0	0	0	0	0	0	0	0	0
02	Meat and edible meat offal	10	0	*30*	0	0	0	10	0	0	0	0	0	10
03	Fish & crustacean, mollusc and other	0	0	14	14	0	0	0	0	0	0	14	0	14
04	Dairy products, birds' eggs	10	0	10	10	10	0	10	10	10	10	10	0	10
05	Products of animal origin	0	0	0	0	0	0	0	0	0	0	0	0	0
06	Live tree and other plants, bulb, roots	0	0	0	0	0	0	0	0	0	0	0	0	0
07	Edible vegetables and certain roots	0	0	7	0	0	0	0	0	0	0	0	7	0
08	Edible fruit and nuts	7	0	0	0	7	0	0	0	0	0	0	0	0
09	Coffee, tea and spices	0	0	0	0	0	0	0	0	0	0	0	0	0
10	Cereals	0	0	0	13	0	13	0	0	0	0	*25*	13	0
11	Malt, starches	11	11	0	0	0	11	11	0	0	11	0	0	0
12	Oil seed, oleaginous fruits	0	0	0	0	0	0	0	0	0	0	0	0	0
13	Lac, natural gums, resins	0	0	0	0	0	0	0	0	0	0	0	0	0
14	Vegetable plaiting materials	0	0	0	0	0	0	0	0	0	0	0	0	0
15	Animal/vegetable fats and oils	0	0	0	0	5	0	5	0	5	0	0	10	0
16	Preparations of meat, fish or crust	0	0	0	0	0	0	0	0	0	0	0	0	0
17	Sugars and sugar confectionery	0	*25*	*25*	*25*	0	*25*	**50**	*25*	0	*25*	*25*	*25*	*25*
18	Cocoa and cocoa preparations	0	0	0	0	0	0	0	0	0	0	0	0	0
19	Preparations of cereal, flour	0	0	*20*	*20*	0	0	*20*	**40**	0	*20*	0	*20*	0
20	Preparations of vegetable, fruit, nuts	11	0	0	0	0	0	0	0	0	0	0	0	0
21	Miscellaneous edible preparations	0	0	17	17	0	0	*33*	17	0	0	17	17	0
22	Beverages, spirits and vinegar	0	0	*33*	11	0	0	*33*	0	0	0	0	0	0
23	Residues and food industry waste	0	0	0	0	0	0	0	0	0	0	0	0	0
24	Tobacco and manufactured tobacco	0	0	0	0	0	*33*	0	*33*	*33*	*33*	*33*	0	*33*
25	Salt, sulphur, earth and stone	3	7	3	3	0	13	7	7	3	7	3	3	3
26	Ores, slag and ash	0	0	0	0	0	0	0	0	0	0	0	0	0
27	Mineral fuels, oils	6	6	6	6	13	6	0	6	6	6	6	13	6
28	Inorganic chemicals	0	0	0	0	0	6	0	0	0	0	0	0	0
29	Organic chemicals	0	0	0	0	0	5	0	0	0	0	0	0	0
30	Pharmaceutical products	0	0	0	0	0	0	0	0	0	0	17	0	0
31	Fertilisers	0	0	0	0	0	0	0	0	0	0	0	0	0
32	Tanning/dyeing extract, tannins	0	*20*	13	0	*20*	7	13	7	0	*20*	7	0	7
33	Essential oils and resinoids	**43**	0	**43**	14	**57**	0	14	*29*	*29*	**43**	*29*	0	*29*
34	Soap, organic surface-active agents	14	*29*	*29*	0	14	0	**57**	0	0	**43**	*29*	14	**43**
35	Albuminoidal substances	0	0	0	0	*29*	0	0	0	0	0	0	0	0
36	Explosives, pyrotechnic products	0	17	0	17	17	0	17	0	*33*	17	17	0	17
37	Photographic plates, films and rolls	0	0	0	14	14	14	14	0	0	0	0	0	0
38	Miscellaneous chemical products	4	4	0	4	4	0	0	4	0	0	4	0	4
39	Plastics and articles thereof	15	12	12	**4**	12	*31*	15	15	15	19	15	8	4
40	Rubber and articles thereof	6	0	18	6	0	12	0	6	12	6	18	0	0

Table 13 (continued)

HS no.	HS chapters	Benin	Burkina Faso	Cape Verde	Côte d'Ivoire	Ghana[1]	Guinea	Guinea-Bissau	Mali	Mauritania	Niger	Nigeria[1]	Senegal	Togo
41	Raw hides and skins	0	0	18	0	0	0	0	0	0	0	0	0	0
42	Articles of leather, saddlery, etc.	17	0	17	17	*33*	17	17	*33*	17	0	17	17	17
43	Furskins and artificial fur	0	0	0	0	0	0	0	0	0	0	0	0	0
44	Wood and articles of wood	5	5	14	0	19	5	5	5	10	5	0	10	5
45	Cork and articles of cork	0	0	0	0	0	0	0	0	0	0	0	0	0
46	Manufactures of straw, esparto/other	0	**50**	0	**50**	0	0	0	0	**50**	0	**50**	**50**	0
47	Pulp of wood, fibrous cellulose	0	0	0	0	0	0	0	0	0	0	0	0	0
48	Paper and paperboard, art. of paper	13	17	0	17	4	0	9	9	9	9	4	4	4
49	Printed books, newspapers, pictures	9	0	0	0	0	0	0	0	0	0	0	0	9
50	Silk	0	0	0	0	0	0	0	0	0	0	14	14	0
51	Wool, fine/coarse animal hair	0	0	0	0	0	0	0	0	0	0	0	0	0
52	Cotton	*25*	*33*	0	*33*	8	0	8	*17*	**42**	*25*	**50**	*33*	*25*
53	Other vegetable textile fibres	0	0	0	9	0	0	0	0	9	0	0	9	0
54	Man-made filaments	13	13	13	13	13	13	0	0	13	0	*25*	*25*	13
55	Man-made staple fibres	*25*	*25*	6	*31*	*25*	19	6	0	*25*	13	19	13	19
56	Wadding, felt and non-woven, yarns	0	11	11	11	0	*33*	11	0	0	0	0	0	11
57	Carpets and other textile floor cover	*20*	0	**40**	*20*	0	0	0	*20*	0	**40**	0	0	0
58	Woven fabrics, tufted textile fabrics	27	27	0	18	27	9	0	0	18	9	18	**45**	0
59	Impregnated, coated, cover/laminate	9	9	0	18	18	9	9	18	0	18	0	18	9
60	Knitted or crocheted fabrics	0	**50**	0	**100**	**50**	0	0	**50**	0	0	**100**	0	0
61	Articles of apparel and clothing accessories	**71**	**41**	0	**41**	**94**	**65**	12	*29*	**47**	*29*	**53**	**47**	**71**
62	Articles of apparel and clothing accessories, not knitted or crocheted	**59**	*29*	**82**	**35**	**94**	**53**	**35**	12	**47**	**53**	**47**	**59**	**59**
63	Other made up textile articles	**50**	*30*	0	*30*	10	*30*	**40**	**60**	**60**	**60**	10	**40**	**50**
64	Footwear, gaiters and the like	**50**	**50**	**83**	*33*	17	0	**50**	**83**	**83**	*33*	0	**50**	**83**
65	Headgear and parts thereof	14	0	14	14	**57**	14	0	14	0	0	0	0	14
66	Umbrellas, walking-sticks	0	0	0	*33*	*33*	0	*33*	*33*	0	0	0	*33*	*33*
67	Feather preparations, artificial flowers	*25*	0	*25*	0	**50**	*25*	0	0	0	0	**75**	*25*	*25*
68	Articles of stone, plaster, cement	7	*20*	0	7	0	7	13	7	7	7	7	0	7
69	Ceramic products	14	14	*21*	14	0	14	14	*29*	**36**	*21*	*29*	14	7
70	Glass and glassware	*20*	10	15	15	**5**	10	10	5	5	5	15	15	15
71	Natural/cultured pearls, stones	0	6	6	6	0	0	0	6	0	6	6	17	0
72	Iron and steel	7	7	0	7	0	3	3	10	14	10	7	0	10
73	Articles of iron or steel	15	15	8	12	8	8	*31*	**35**	15	19	15	12	12
74	Copper and articles thereof	0	5	0	0	0	0	0	5	0	5	0	0	5
75	Nickel and articles thereof	0	0	0	0	0	0	0	0	0	0	0	0	0
76	Aluminium and articles thereof	6	6	0	0	0	13	0	0	6	13	0	19	19
78	Lead and articles thereof	0	0	0	0	0	0	0	17	0	0	0	0	0
79	Zinc and articles thereof	0	0	0	0	0	0	0	14	0	0	0	14	0

Table 13 (continued)

HS no.	HS chapters	Benin	Burkina Faso	Cape Verde	Côte d'Ivoire	Ghana[1]	Guinea	Guinea-Bissau	Mali	Mauritania	Niger	Nigeria[1]	Senegal	Togo
80	Tin and articles thereof	0	14	0	0	14	0	0	0	0	14	0	0	0
81	Other base metals, cermets	0	0	0	0	0	0	0	0	0	0	0	0	0
82	Tool, implement, cutlery, spoons	7	*27*	0	0	*20*	13	*20*	0	0	7	*20*	0	0
83	Miscellaneous articles of base metal	9	0	0	9	9	18	18	0	0	0	0	0	9
84	Machinery, boilers	1	1	4	4	0	8	5	6	7	5	5	1	1
85	Electrical machinery equipment	8	15	*23*	*27*	0	13	*25*	15	15	13	8	13	*21*
86	Railway/tramway locomotives	0	0	0	0	0	11	0	0	11	0	0	0	0
87	Cars, trucks, motorbikes, bikes, etc.	13	**38**	*31*	*25*	6	*31*	*31*	*31*	*31*	13	*25*	*25*	6
88	Aircraft, spacecraft, parts thereof	0	0	0	0	0	*20*	0	0	0	0	0	0	0
89	Ships, boats and floating structures	0	0	0	13	0	0	0	0	0	0	13	0	0
90	Optical and photo instruments	0	0	0	0	0	0	3	0	0	3	0	0	3
91	Clocks and watches, parts thereof	*21*	*21*	7	0	7	14	7	*29*	0	14	0	*29*	14
92	Musical instruments	0	11	0	0	0	0	0	11	0	0	0	11	11
93	Arms and ammunition	14	0	14	0	14	0	0	0	0	14	0	0	0
94	Furniture, bedding, mattress	0	17	**67**	*33*	*33*	0	*33*	**50**	*33*	**50**	*33*	*33*	17
95	Toys, games and sports requisites	*25*	**38**	**50**	13	0	13	**38**	*25*	*25*	13	13	13	13
96	Miscellaneous manufactured articles	11	17	17	17	*33*	6	6	11	0	11	6	17	11
97	Works of art, collectors' pieces	17	0	0	0	0	0	0	0	0	0	17	17	0

Source: HWWA calculations.
Note: [1]2000.

inefficiencies in duty collection, we do not have the required information at the four-digit level. The estimation of the trade and budget effects and the identification of the most affected products have, thus, to be taken with caution, since the impact cannot be estimated with a very high level of accuracy at the disaggregated level.

Discussion of the results

Our empirical results are based on a number of important features of the analysis, such as the partial equilibrium model and key assumptions about both market structure and consumer behaviour. Using a partial equilibrium model, we restrict the analysis to the static welfare effects of economic integration, that is, we only focus on the static trade and government revenue effects caused by changes in relative prices. Other static welfare effects of economic integration, for example, economies of scale, are not included in the analysis. These may arise in ECOWAS countries, since their economies are relatively small and domestic firms may not reach the minimum efficiency scale, that is, the output level at which average costs per unit are minimised.

More importantly, we have excluded growth and location effects from the analysis. Based on the theory of economic integration, increased competition may improve the economic growth performance of members (Baldwin and Venables, 1995). In principle, trade liberalisation may foster competition as protection levels decrease and may force domestic firms to innovate to increase their competitiveness. Both, in turn, are likely to increase productivity rates of domestic firms and, hence, income rates and national income. Also, ECOWAS countries may attract higher inflows of foreign direct investment, due to the preferred access to the EU, if multinational enterprises use West African countries as an export location to serve European or other African markets. This would increase capital stocks in ECOWAS countries and boost growth rates.

In addition, the EPA may lead to or promote technological spillovers between the EU and ECOWAS countries, either as a consequence of increased trade volumes or because of policies designed to encourage scientific interchange. But integration may also lead to pro-competitive effects, which relate to more incentives to innovate and the reduction of duplication in research and, thus, a more efficient allocation of resources in research and development activities. In sum, all these effects, if they occur, would boost growth rates of ECOWAS countries.

Location effects, which have also been excluded, arise as a consequence of the location of production in space. Economic theory predicts that geographic concentration is due to the interaction of increasing returns to scale, transport costs and demand. There is, however, a trade-off between scale economies and transport costs: if scale economies are large enough, producers prefer to locate in a single place, leading to the agglomeration of industry; if transport costs are large enough, producers want to locate close to consumers, and production will not be concentrated in a single location, leading to a more sparse structure.

Any change in the medium- or long-term growth rate of ECOWAS countries would naturally change trade flows and budget revenue: Higher growth rates would lead to increased imports, from EU and non-EU sources, and enhance import duties collected by the government. As a consequence, our analysis underestimates the impact on trade flows and overestimates the effects on budget revenues. The positive effects on the latter depend, in turn, on the size and growth rate of non-EU imports, since European products will be duty free if the EPA comes into force. Yet it is impossible to provide any estimate of the magnitude of the growth effects, since they are quite difficult to compute and the results depend on a number of assumptions that may not be valid in West Africa. Yet the assumptions for the growth effects and those made in our analysis will have an enormous impact on the final outcome of the impact of the EPA on ECOWAS countries. A careful discussion of the underlying assumptions is, thus, crucial for the interpretation of the results.

To begin with, traditional international trade theory predicts that ECOWAS countries are not likely to suffer from opening up their domestic markets. In fact, it would rather be in their own interest to refrain from imposing trade restrictions, as in this way they could increase their own prosperity. When trade is liberalised, consumers in ECOWAS countries face lower prices of both imported and domestically produced goods. The beneficiaries of free trade may be not only households, whose real incomes rise as prices fall, but also firms, whose international competitiveness is increased by the purchase of cheap investment and intermediate goods or whose domestic sales rise owing to the positive real-income effects.

It cannot be denied that domestic producers might face increased competition from EU suppliers. If domestic producers have a comparative advantage, they can survive by raising their productivity level. If they fail, they will be compelled to cut production and employment or finally give up. In a process of structural adjustment, production factors will be reallocated to other industries where domestic comparative advantages exist and can be tapped. For the economy as a whole, so the theory goes, increased productivity and structural adjustment could increase production and employment and raise overall welfare. This is particularly the case if trade creation is large enough to compensate for welfare-reducing trade diversion. Since this is true for the EPA case, trade liberalisation would not appear to be a major problem for ECOWAS countries.

Yet traditional trade theory (and our model) is based upon a number of assumptions that do not always adequately reflect reality. In particular, it assumes perfect competition, meaning that all agents are price takers in product and factor markets. Additionally, production functions for all products exhibit constant returns to scale. Thereby, the possibility that large firms can abuse their market power or that there are any agreements between firms that restrict competition is excluded. The theory further assumes that factors can move at no cost between industries within a country and that factor returns adjust to ensure full employment. This means that there are no adjustment costs for reallocating resources from producers displaced by imports to other domestic industries. In those circumstances, the

role governments have to play is rather limited. In particular, there is no need for government revenue.

Workers who are displaced from import-competing sectors and thus forced to move to other sectors of the economy may have to forego income and incur other costs while they search for employment elsewhere and/or undergo retraining. Moreover, trade liberalisation may lead to the destruction of much of the productive capacity, as investments of capital may have been sunk into certain economic activities and cannot easily be transferred to other activities. In fact, if one steps out of the ideal world of traditional foreign trade theory, welfare losses as a result of trade liberalisation cannot be ruled out. For instance, the domestic-distortions approach points out that opening up to free trade may lead to overall losses rather than gains when factor-market imperfections or market failures exist. Endogenous growth models show that, under the conditions of monopolistic competition and increasing returns to scale, international openness can lead to permanently reduced rates of growth, for instance, when trade diverts the country's resources away from activities that display economies of scale or other benefits. Under the conditions of oligopolistic competition prevailing on world markets, it could be attractive for governments to create a competitive advantage for domestic industries by using trade restrictions.

Moreover, the estimated trade and budget effects only occur if European exporters lower their export prices in line with the tariff elimination. Yet if EU exporters are 'pricing to market', that is, leaving market prices unchanged and increasing their profits if tariffs are eliminated, the importing country would lose import duties without gaining the advantage of lower import prices. From the importing country's point of view, economic welfare would thus definitely decrease. In general, this outcome is more likely to occur in less competitive markets, where the degree of competition among suppliers is less severe. Even though we cannot predict the market behaviour of international companies operating in Africa, this outcome has to be taken into account for the interpretation of the results.

In addition to theoretical reasoning, empirical studies that test the trade-drives-growth hypothesis have arrived at different conclusions. Some studies suggest that economies with more open-trade policies tend to perform better than those with more restrictive trade policies.[28] In contrast, other studies find little empirical evidence that open-trade policies – in the sense of lower tariff and non-tariff barriers to trade – are significantly associated with economic growth. Rodrik (2001) and Rodrik and Rodriguez (2000) claim that the causality runs from growth to trade, not vice versa. Countries that have achieved long-term growth have usually combined the opportunities offered by world markets with a growth strategy designed to unlock the potential provided by domestic institutions and investors.

In contrast to these findings, Winters et al. (2004) are somewhat more optimistic in their survey of the literature. Although there remains a residual ambiguity about the links between trade and growth, there is strong evidence for the beneficial impact of trade liberalisation on productivity. Concerns that trade liberalisation has generally adverse effects on employment or wages of the poor, or on government spending on the poor due to falling fiscal revenue, are not well founded, even though specific instances of each of these problems can be identified. As to the particular impact on poverty, which is an important issue in ECOWAS countries, Winters and associates could not draw simple general conclusions about the relationship between trade liberalisation and poverty. According to their findings, the beneficial effects of trade liberalisation are based on a number of important assumptions and/or circumstances, such as good governance and strong local institutions that facilitate price effects of liberalisation.

For trade liberalisation in Sub-Saharan Africa, Ng and Yeats (2000) expressed considerable reservations regarding the functioning of resource reallocation, structural adjustment and increased competitiveness. Based on a simple average, the net revealed comparative advantage change for ECOWAS countries between 1990 and 1998 was zero, implying that – despite trade liberalisation and structural adjustment – West African countries did not develop a revealed comparative advantage in the 1990s. In contrast, they were found to have more comparative disadvantages in 1998 than in 1990.

Based on these findings, it becomes clear that

the EPA would involve a number of advantages and disadvantages for West African countries. Governments of ECOWAS member states, hence, must carefully analyse the exact conditions and effects of the EPA in each country and for each major sector and consider all policy options available.

Policy options and EPA prerequisites

EPAs in comparison to other policy options

Basically, ECOWAS and its members can accept the EU's EPA offer or abstain from it and make use of unilateral, non-reciprocal trade preferences instead, which the EU is already granting. In addition, they can continue to manage gradual liberalisation of their trade regime in the framework of ECOWAS/UEMOA, and finally, they can liberalise unilaterally or in the course of current multilateral trade negotiations. Let's focus on EU preferences first.

Since the Cotonou preferences will not be available after 2007 due to their incompatibility with WTO rules and the phasing out of the final waver, LDCs among ECOWAS countries could opt for EBA preferences while non-LDCs could refer to the GSP. How do EBA and GSP preferences compare to market-access conditions under an EPA? In order to answer this question, we should have a look at these preferential systems in more detail.

The EBA initiative took effect on 5 March, 2001 and was later incorporated into the revised GSP scheme. It provides duty-free access to imports of all products (except arms and munitions) from LDCs without any quantitative restrictions. Only three products were not liberalised immediately: bananas, rice and sugar. They will be given duty- and quota-free access by January 2006, September 2009, and July 2009, respectively. In the meantime, duties on these products will be gradually reduced (Olarreaga and Ng 2002). Moreover, there are duty-free tariff quotas for rice and sugar, which will be increased annually.

It is an open question whether an EPA will entail an increase in market-access preferences that ECOWAS countries are already enjoying under the Cotonou Agreement, as the scope for additional trade preferences is rather limited on the Community side, mainly due to the political sensitivity of liberalising trade in agricultural products. Under such conditions, least-developed ECOWAS countries would have little incentive to participate in an EPA, as they benefit from the more favourable EBA preferences, which will gradually become even more generous in the future, when residual tariffs and quotas on bananas, rice and sugar will be phased out.

However, LDCs might hesitate to opt for EBA because its rules of origins are more stringent than those under the Cotonou Agreement (Brenton, 2003; Brenton and Manchin, 2003) and possibly also under an EPA. Under the EBA producers in least-developed ACP countries have to use fewer imported materials, parts and components from other ACP countries (in order not to lose eligibility for duty- and quota-free access to the EU under the cumulation of origins rules) than they would be allowed to use under the Cotonou Agreement and presumably also under an EPA. Due to lack of published data on inter-regional production links and the use of the cumulation provision, it remains unclear how relevant this issue really is for individual ECOWAS LDCs. Nonetheless, the topic has to be clarified in EPA negotiations. While cumulation of different ECOWAS origins would not be a problem, ECOWAS countries could urge the EU to concede cumulation at least from other EPA groupings to preserve existing and allow for future interregional production networking and unrestricted preferential market access in the EU.

LDCs have to consider another disadvantage of EBA preferences. They are granted unilaterally by the EU and can be withdrawn in general or selectively on the basis of the general safeguard clause.[29] Thus, LDCs do not hold a legal right to use them. In contrast, under the EPA, LDCs would be given the right to export on the terms that have been agreed upon in a binding internal treaty and for which arbitration is possible.

Moreover, opting for EBA preferences would imply forgoing an opportunity to enter into a phase of more serious structural adjustment, which these countries cannot escape from anyway if integration into the world economy is an integral part of their development strategy. Although there are many risks involved, which have been mentioned above, an EPA could be perceived as an historic chance to

implement such a policy, if handled with care. Current and future initiatives for structural adjustment, which are frequently subject to an extremely controversial internal debate, could find better domestic support and would thus be more sustainable (lock-in-effect).

Considering the low level of development and the related vulnerability to fundamental policy changes and external chocks, LDCs certainly need a transitional phase with a proper timing and of tariff reductions and complementary reforms and adjustments required. Reliable external commitments regarding technical as well as financial support could encourage them in their decision-making and facilitate the implementation of trade liberalisation. Financial support is particularly needed to offset customs revenue losses, which could be sizeable in a number of West African countries, as the empirical analyses in the previous sections have shown. Opting for EBA preferences, however, might reduce LDCs prospects for such assistance as compared to an EPA, which would explicitly include related EU commitments. However, it may well be that in the EPA negotiations the EU will not agree on a fiscal compensation which exceeds previous levels of aid flows.

Due to LDCs being a majority among the ECOWAS countries, the whole EPA project depends on their participation. To get them into an EPA, the EU not only needs to offer an EBA-like product coverage and equivalent preferential margins, but also has to go even beyond by providing less restrictive and simplified rules of origin, concessions in trade of services and sufficient financial support to cover part of the adjustment costs, and effective technical assistance to manage the whole process of structural change.

Since the ECOWAS EPA as a free trade agreement does not allow for differential treatment of members in trade issues, Côte d'Ivoire, Ghana and Nigeria – as the only non-LDCs in ECOWAS – have to compare the EPA terms for LDCs described above with the conditions under the GSP.[30] As to EU market access, non-LDCs would be better off opting for an EPA. This is because EPA terms need to equal EBA terms to satisfy the LDCs. Moreover, EBA terms are clearly much more favourable than GSP conditions. This holds true not only in quantitative terms but also because size, structure, preferential margin, list of beneficiaries and other conditions of the GSP are subject to a periodic review process and can be modified at discretion or totally withdrawn by the EU. Secured EU market access is a strong argument in favour of an EPA. It provides ECOWAS producers a more stable long-term framework for export-oriented investment decisions. Côte d'Ivoire, Ghana and Nigeria have to balance these EPA advantages with the ambiguous effects of opening up their own markets for EU exports and the challenges of adjustment and structural change. Moreover, it is an open question whether the EU is ready to compensate for revenue losses from tariff reductions and final elimination of the same size as in the case of ECOWAS LDCs at all.

As to the unilateral, regional and multilateral option to liberalise trade, some specific issues are particularly worth considering in the process of EPA negotiations and decision-making. Regional integration processes between developing countries have been suffering from unsatisfactory progress, ineffectiveness, and a lack of sustainability so far. EPA negotiations could become an external driving force that will push regional organisations to rationalise and harmonise their regional trade arrangements, thus strengthening the regional integration process and economies of the region, and assisting Sub-Saharan Africa in becoming a more active partner in the global economy (De la Rocha, 2003). EPAs are also meant to stimulate related new efforts. As intra-regional commitments would be locked into EPAs, regional groupings could benefit in terms of impact and credibility (European Commission, 2004a). This effect can also be used by ECOWAS countries. Intra-regional negotiations have already been accelerated in line with the EPA timetable, and an agreement was achieved to put in place a customs union in 2007, just before the EPA with the EU becomes effective.

The EPA process is also closely interrelated with trade liberalisation on the global level. The outcome of the WTO Doha Round could have far-reaching consequences for EPA negotiations and EPA alternatives. A lowering of MFN tariffs, for instance, would reduce the preferential margin of

both the EU and ECOWAS countries. Moreover, EBA and GSP preferences as alternative policy options for them would be similarly affected. This could tempt ECOWAS countries to undermine related progress in the Doha Round. Apart from the question of whether ECOWAS countries actually hold sufficient bargaining power to prevent the EU from making respective multilateral concessions, adjustment to preference erosion is going to be necessary sooner or later in any case (Hinkle and Schiff, 2004b). If ECOWAS countries understand the EPA project primarily as a concept for providing a new impetus for urgently needed structural adjustment and strengthening of international competitiveness combined with EU commitments for related financial support, it would be somewhat contradictory to try to escape from this strategy again.

Instead of impeding progress in multilateral liberalisation, ECOWAS countries could take part actively. This could be beneficial to them in areas where they liberalise EU imports under an EPA at the expense of non-preferred suppliers of other countries. Such trade diversion implies welfare losses due to the switch to less efficient (non-EU) producers, and, in the case of 'pricing to market', a transfer of tariff revenues forgone to EU exporters. Both effects could be limited by respective multilateral concessions or unilateral tariff reductions for non-EU imports. Though this might imply further government revenue losses to ECOWAS countries, the negative effects of trade diversion would certainly be limited and competition between exports to West Africa increased.

Moreover, ECOWAS could join and support initiatives of other developing countries aiming at liberalising market access in developed countries in key areas of their interest. In particular, pressure on the EU as well as on other developed countries has to be increased in order to reduce or eliminate, among other things, agricultural export subsidies and domestic support for agricultural production of specific interest to ECOWAS and other developing countries. Thus, the Doha negotiations could mitigate EPA negotiations, where the same issues are at stake, but ECOWAS countries would not have enough bargaining power to achieve related concessions from the EU. EPA negotiations could also benefit from the multilateral trade round if progress were achieved in re(de)fining the rules for regional integration. This would allow for a WTO-compatible design of the EPA and avoid reconfiguration and related transaction costs afterwards. Therefore, for ECOWAS countries a timetable that places EPA decisions after an agreement in the Doha Round would be favourable. However, it remains to be seen whether results can really be achieved in line with this schedule.

Basic prerequisites for the EPA option

Given the severe analytical restrictions in our case, it appears to be difficult to select from the various options discussed above on a purely rational economic basis. This is particularly true since the general matter of trade liberalisation is still the subject of considerable, but inconclusive academic debate. The orthodox view, largely guided by traditional theory, is that free-trade orientation is responsible for fast and sustained economic growth. Developing countries should therefore focus on opening up their domestic markets and pursue domestic policies that support economic development. The opposing view, as taken by Rodrik (2001) and others, is that good governance should be placed above openness. Above all, developing countries need to improve their institutions of conflict management in order to maintain macroeconomic stability. If complementary policies and institutions are not in place domestically, openness will not work. At worst, this will cause instability, increasing inequality and social conflict.

The concept of 'mainstreaming of trade' or 'integration of trade', as contained in Poverty Reduction Strategy Papers, may be regarded as a possible compromise between the two approaches mentioned above. It involves the integration of trade-policy issues into the overall framework of a country's development strategy. For trade reform to be successful it must be accompanied by complementary policies. Accordingly, trade liberalisation should be implemented in conjunction with other reforms.[31] It stands to reason that the role of governments is not diminished by the need to mainstream trade into the national development strategy. Firstly, the open-

ing up of domestic markets needs to be well designed, with special attention to country specifics and capabilities. Secondly, complementary policies and institutions have to be tailored to domestic needs and objectives as well as to trade liberalisation.

To control for the obvious risks involved in the EPA project, ECOWAS and its members have little choice but to take up these suggestions. This is a particularly important matter, as the record of previous structural adjustment policies was not satisfying in many cases. Therefore, if they go for an EPA with the EU, it appears it will be indispensable to take structural adjustment more seriously and to manage the process more properly. This includes, among other things:

- preparing for EPA market access negotiations with the EU;
- designing suitable timing and sequencing;
- identifying and implementing complementary measures; and
- reforming the tax and fiscal system.

As to EPA negotiations, ECOWAS countries have to decide on the coverage of the proposed free trade agreement with the EU in line with their individual comparative advantages and disadvantages. This requires the targeting of goods and services where temporary or indefinite protection of ECOWAS industries would still be needed for them to either become internationally competitive (infant industry protection) or, for example, maintain national autarchy in certain areas. In particular, areas have to be identified where the EU inhibits the utilisation of comparative advantages of ECOWAS countries by protectionistic trade practices both on international and on ECOWAS markets. Remaining areas without multilateral concessions of the EU in the Doha Round should be added to the EPA negotiation agenda to try to achieve at least preferential concessions. For example, possibilities could be explored of whether the EU could consider specific interests of ECOWAS countries when applying safeguard measures such as anti-dumping and sanitary and phytosanitary regulations. Services, which are not covered by this study, should also be included in EPA negotiations. Proper timing and sequencing in services appears to be even more important than in agricultural and industrial trade, since liberalisation of service imports will require complementary domestic regulatory reforms that will take their time (Hinkle and Schiff, 2004a).

As to timing and sequencing, the phasing of tariff reductions should earn utmost attention. It is widely accepted that the existence of inter-sectoral adjustment costs calls for a 'gradualist' approach to reductions in trade-protection measures. ECOWAS countries have to establish a timetable for the progressive removal of trade barriers that helps the economy to adjust to increased competition from the EU with a minimum of economic and social upheavals. In sectors where the EU competition could have destructive effects, gradual implementation of trade liberalisation would be necessary in order to preserve domestic production and enable it to build competitiveness or to specialise in 'niche' production that does not compete with EU imports (PricewaterhouseCoopers 2004). Of course, it will not be an easy task for governments of ECOWAS member states to reach an agreement on a common timetable and the final product coverage, because they might wish to follow different strategies, depending on their particular interests.

A 'gradualist' approach is also needed because it takes time to implement the complementary measures that are required to ease the inter-sectoral adjustment process and the reduction or elimination of direct and indirect barriers to trade. Some complementary measures need to be taken well in advance while others could accompany trade liberalisation, depending on the economic, political, social and institutional capacity to absorb adjustment costs. In general, there is no standard solution for the sequencing problem. Complementary adjustment policies typically involve, among other things, labour-market reforms to enhance the mobility of the workforce both between and within industries and training programmes to provide qualified employees for export-oriented companies. Programmes for private-sector development should be considered. This comprises, among other things, technological support to improve the ability of firms to compete against imports. Moreover, improve-

ments in the environment for domestic and foreign investors should be envisaged, as well the installation of an effective domestic competition policy. Furthermore, the 'hard and soft' trade-related infrastructure should be enhanced, including trade facilitation measures, such as the reform of customs administration. There is probably also a need to establish social safety nets that compensate displaced workers and provide the poor with a minimal standard of living below which they should not fall. And finally, macroeconomic stability is a pre-condition for promoting economic development by trade liberalisation.

Complementary measures are also urgently required to ensure that moving from a restrictive to an open trade regime does not lead to a fiscal shock and macroeconomic instability. Therefore, unavoidable short- and medium-term losses in government revenue need to be cushioned. In a number of ECOWAS countries, a more or less comprehensive tax or fiscal reform is required. It is widely accepted that foreign-trade taxes should be replaced with domestic indirect taxes. In theory, it is easy to replace import duties with domestic taxes. An import duty is, for instance, conceptually equivalent to an value added tax on the domestic consumption and a value added subsidy on the domestic production of that product (Tanzi, 1995). In case of large revenue losses, additional measures may be required, including cuts of low priority or inefficient expenditures (Hinkle and Schiff, 2004b). In practice, however, it is extremely difficult to balance the need for government revenue with efficiency considerations. The ability of developing countries to collect domestic taxes for public expenditure programmes will depend not only on the enactment of appropriate tax legislation but also, more important, on the enforcement of compliance (Todaro and Smith, 2003). Tax evasion and avoidance are serious problems in collecting taxes. Given these difficulties, the costs of tax administration have to be taken into account when ECOWAS countries are forced to modify their tax structure.

Tax and fiscal reforms are particular areas where the EU could provide support for the effectiveness of structural adjustment in ECOWAS countries induced by an EPA. This would be in accordance with the Cotonou Agreement, which earmarks transitional support (budgetary support, technical assistance) for this purpose. It is agreed that special consideration will be given to countries that face budgetary adjustments due to regional integration and EPAs (European Commission, 2004a). In the EPA negotiations, the ECOWAS countries should explicitly ask the EU to provide grant-financing for tariff revenue losses until the tax reform is completed in all ECOWAS countries. Also, the EU should assist the LDCs for a longer time to provide them with an incentive to ensure that LDCs benefit as much from the EPAs as the non-LDCs.

EU support could also cover additional trade-related measures. For instance, there is a need to modernise customs administration in ECOWAS and its members. It is necessary to ensure the smooth cross-border transport of goods and to reduce/eliminate delays and unnecessary additional transport costs. Another starting point for EU support could be capacity building dedicated to allowing West African exporters to be able to fulfil the conditions required to access European markets (PricewaterhouseCoopers, 2004). There is a particular need for activities related to sanitary and phytosanitary measures.

To wind up, ECOWAS countries are facing an enormous challenge when assessing an EPA with the EU and considering alternative policy options. A final decision has to be taken under a high degree of uncertainty. This is mainly due to severe analytical restrictions in balancing economic and non-economic costs and benefits. It appears that the commitment to structural adjustment of each country, as well of the regional grouping as a whole, plays a decisive role in decision-making. There are less challenging alternatives to an EPA, like taking further advantage of unilaterally granted EU preferences. This would sustain full autonomy as to the size and depth of trade liberalisation and related structural adjustment measures. On the other hand, an EPA could be considered as an historic chance to lock in economic reforms, which are required anyway if integration into the word economy is part of the development strategy. Thus, an EPA would provide an impetus to implement such a policy effectively. However, lessons from other regional integra-

tion projects including the European case illustrate the need for a gradual and country-specific approach in trade liberalisation and a proper sequencing of complementary, compensatory and institutional measures to counter possible negative repercussions of integration. Trade liberalisation is not necessarily the first step, but should be well prepared and perceived as a part of an overall package of reforms.

Endnotes

1. Within ECOWAS, a (sub-)group of eight countries has achieved deeper integration by forming the West African Economic and Monetary Union (WAEMU or, the French abbreviation, (UEMOA), that is, they have agreed on principles of closer economic relations including a common currency.
2. See Hinkle and Schiff (2004a) and Schiff and Winters (2002) for an overview of policy options and several studies on EPAs. On behalf of the European Commission, PricewaterhouseCoopers (2004) conducted several studies on the EPAs, including the West African region, but did not perform an extensive empirical analysis of the expected effects.
3. CAPE stands for Cellule d'Analyse de Politique Economique.
4. UEMOA consists of Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.
5. Other studies, such as Bussolo (1999) and McKay et al. (2000) focused on Southern and Eastern Africa, respectively. Both analysed the trade and welfare impact and discussed policy options for the regions.
6. Though Mauritania left ECOWAS in 1999, it will be included in the following analysis, as it will take part in trade negotiations and the (West African) regional EPA with the EU.
7. See Brenton (2003) and Brenton and Manchin (2003) for a (verbal) analysis of the impact of EU rules of origin within the EBA and GSP systems of preferences.
8. Also, the authors would like to thank Karl Wolfgang Menck, who contributed parts to Section 1 and Section 4, and Franziska Jerosch and Eva Soebbeke for their excellent research assistance. Very helpful suggestions and comments were provided by Thomas Baunsgaard, Lawrence Hinkle, Jeffrey Lewis, Marcelo Olarreaga, Maurice Schiff and various seminar participants at a World Bank trade seminar in Washington, DC. Special thanks to the UEMOA Commission and ECOWAS Secretariat for providing data. The usual disclaimer applies.
9. The ranking of countries does not change much, if GNI per capita in PPP US$ is used instead of current US$.
10. The HDI is a summary assessment of human development, measuring the average achievements in a country in three basic dimensions of human development: (1) A long and healthy life, as measured by life expectancy at birth; (2) knowledge, as measured by the adult literacy rate (with two-thirds weight) and the combined primary, secondary and tertiary gross enrolment ratio (with one-third weight); and (3) a decent standard of living, as measured by GDP per capita (PPP US$). See UNDP (2002) for details.
11. Grants are non-compulsory transfers, received by government units from other government units or international organisations (IMF, 2001).
12. In 2000, Ghana had very high tariffs for petroleum products of up to 89% in place.
13. It can be shown that the model of Verdoorn is a simplified version of the more general partial equilibrium model of Clague (1971, 1972). See Busse (1996) and Busse and Koopmann (2002) for details.
14. An overview of data sources for all variables used in the analysis is provided in Busse et al. (2004).
15. For some West African countries, tariff and trade data for 2002 and 2003 are available. As the most recent trade figures at the disaggregated level are subject to frequent revisions, we preferred to use the 2000 and 2001 figures. The base year for Ghana and Nigeria is 2000, for all other countries 2001.
16. Trade data in TRAINS, however, is limited to import data and those years for which tariffs and some non-tariff barriers are available.
17. See Busse et al. (2004) for details.
18. The basic concepts of trade creation and trade diversion have been established in the literature by the seminal contribution of Viner (1950).
19. For a survey of trade elasticities, see Sawyer and Sprinkle (1999). More recent estimates are provided by Gallaway et al. (2003) and Kee et al. (2004).
20. Again, these assumed values for Gambia are similar to the estimated figures for other developing countries at this level of aggregation.
21. The abbreviation c.i.f. stands for cost, insurance and freight. In international trade statistics, imports are usually reported c.i.f.
22. In the past, several studies that analysed the impact of trade liberalisation in developing countries relied on import-weighted tariff rates to compute trade, budget and welfare effects. Their estimates are likely to be biased if collection ratios and import-weighted tariff rates differ.
23. This holds even for the differences between the elasticity of substitution and the import demand elasticity, since ε is subtracted from σ in the trade diversion formula.
24. In contrast to trade creation, the trade diversion formula includes the share of non-beneficiary imports α_2). Since EU imports make up – on average – half of total West African imports, TD declines.
25. These calculations are based on the assumption that there will be no other policy changes, such as transfers from abroad or changes in domestic taxes to make up for the loss of government revenues.
26. The comprehensive tables for each country, including the estimated effects for all products at the four-digit level, can be found on the enclosed CD-ROM.
27. Importantly, the following results do not change much if we focus on the top 50 instead of the top 100.
28. See Winters et al. (2004) for a survey of the literature.
29. A safeguard clause enables the EU Commission to suspend tariff preferences and reintroduce common customs tariff duties where a product originating in a beneficiary country is imported on terms which cause, or threaten to cause, serious difficulties to a Community producer of like or directly competing products (European Union, 2004b).
30. As compared to current Cotonou preferences, an EPA would provide them even more favourable access to EU markets if the EPA includes EBA-like terms (except for rules of origins).
31. Winters et al. (2004: 107) also share this view by saying: 'The impact of trade liberalisation particularly on poverty will depend on the environment in which it is carried out, including the policies that accompany it. It depends on the country context.'

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Negotiating an EU–Central Africa EPA: A Brief Overview

Nicolas Gérard and Francesco Rampa

Introduction

Central Africa covers a vast geographical area with a population of roughly 95 million inhabitants. Despite their diversity in size, population density and economic profile, the eight Central African countries (Cameroon, Central African Republic, Chad, Democratic Republic of Congo (DRC), Guinea, Gabon, Republic of Congo, and Sao Tome and Principe) share a number of distinctive features and challenges. A major common concern is the high poverty incidence across the region, which has not declined over the last decades. All countries but Cameroon, Gabon and the Republic of Congo are classified as least-developed countries (LDCs). Social and human development indicators show very low levels, especially in the two landlocked countries (Chad and Central African Republic), which are classified by the United Nations Development Programme (UNDP) as having Low Human Development and where all social indicators are below the Sub-Saharan Africa average. Despite a favourable natural resources endowment, economic growth in the region is low and volatile. Slight improvements have occurred since the devaluation of the 'Franc de la Communauté Financière Africaine' (FCFA) and related accompanying reforms initiated in 1994.[1] The political situation in the region is highly unstable due to both internal conflicts (Chad, Central African Republic, the Republic of Congo) and the adverse effects of conflicts in neighbouring countries.

Central African economies are poorly diversified and highly dependent on natural resources (oil, forests) for their exports and economic growth. In Equatorial Guinea and Republic of Congo for instance, the oil sector accounts for more than 50% of GDP. The tertiary sector (administration, commerce and transport services in particular) is a central economic sector across the whole region, while agriculture plays a significant role in Cameroon, Central African Republic and Chad. Economic disparities among countries are significant: Cameroon and Gabon,[2] accounting respectively for around 36% and 17% of total GDP of the region, are relatively large economies while Chad and Central African Republic figure among the poorest economies in the world, with a GNI per capita which does not exceed US$300.

In spite of regional integration initiatives, intra-regional trade flows remain very limited.[3] As for external trade, Central African economies are very open on the international market. With significant volatility over the years, total exports (in dollar terms) have risen globally by some 50% over the 20-year period to 2000, to reach almost €9.5 million in 2003. The EU, and especially France, is still the major trading partner of the region, although the US also account for a significant part of its exports (see Box 1 for data). Central African exports are concentrated in a few sectors. Oil is the main determinant of the trade performance of the region, with a share of about two-thirds of total exports since 1990, followed by wood and some agricultural products (bananas, cocoa beans, cotton, coffee). Despite liberalisation efforts, Central Africa's participation in world trade remains insignificant. In 2005, its share in EU trade amounted to barely 0.32% of EU exports and 0.46% of EU imports.

Central African regional integration process

The Communauté Economique et Monétaire d'Afrique Centrale (CEMAC)[4] was established in 1994[5] in order to give new impetus to the economic

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Box 1. CEMAC (plus Sao Tome & Principe and the Democratic Republic of Congo)
Trade in goods with the EU (2005)

Exports to the EU: €3,421 million
(growth 2004–2005: 9.8%)
Imports from the EU: €5,393 million
(growth 2004–2005: 23.7%)
Trade balance: €−1,972 million

Share of agriculture in trade:
Exports to the EU: 15%
Imports from the EU: 10%

Participation in EU trade:
Exports to the EU: 0.32%
Imports from the EU: 0.46%

Main trade partners (2003):
Exports: US (34%), EU (33%), China (14%), other (19%)
Imports: EU (54%), US (9%), other (32%)

Source: Comext 2004 EU declarations and IMF 2003 data in Comext

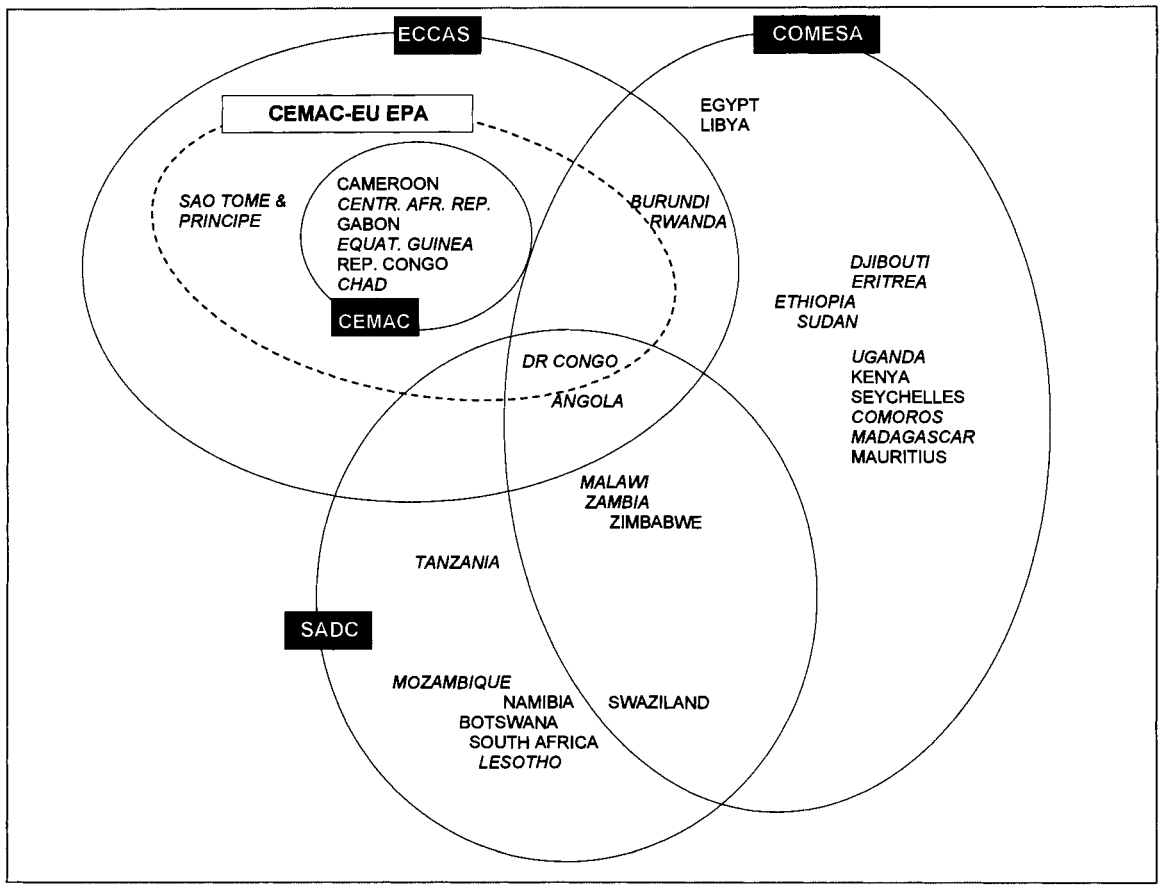
integration process in the region. Taking over from the previous *Union Douanière et Economique de l'Afrique Centrale* (UDEAC) founded in 1964, the CEMAC agenda consists of: the convergence and monitoring of national macro-economic policies; the creation of a single market based on the free movement of goods, services, capital and persons; and the co-ordination of sectoral policies. An action programme covering a period of 15 years (1999–2014) has been defined to reach these objectives. In terms of institutional setting, the CEMAC Regional Executive Secretariat is the main supranational body, in charge of legislative as well as management activities. CEMAC is financed since 2002 through an autonomous financing mechanism based on the collection of an Integration Communitarian Tax.[6]

Looking specifically at trade and economic integration, the CEMAC zone is first of all a Monetary Union (MU) with a common monetary policy, managed by the *Banque des Etats d'Afrique Centrale* (BEAC), and a common currency, the FCFA, pegged to the Euro. Since December 2000, CEMAC is also formally a Free Trade Area (FTA) although many tariff and non-tariff barriers still remain in place. This, combined with serious physical constraints to transport and lack of economic complementarity, hamper the development of intra-regional trade. Finally, the CEMAC region is formally a Customs Union (CU) notified to the World Trade Organization (WTO) and with WTO observatory status since 2000. The regional integration initiatives progressively adopted since 1994 include: major tax and customs reforms; common rules on investment and competition; harmonised VAT system; a Common External Tariff (CET) of four rates (5, 10, 20 and 30%); a common regime of customs valuation and a system of Rules of Origin (ROO). Though some of these reforms are in the process of being implemented progress is slow and their effective application remains largely incomplete.

The key priorities for CEMAC are the progressive elimination of remaining internal trade barriers and the consolidation of the CU, including a possible revision of the CET to align it to the one adopted by UEMOA (Union Economique et Monétaire Ouest Africaine) countries. In December 2004 CEMAC members signed a trade agreement with Sao Tome and Principe (STP), and together they form the regional configuration currently negotiating an EPA with the EU.

The Economic Community of Central African States (ECCAS)[7] was created in 1983 with the ambitious mandate to foster political dialogue, sectoral cooperation and trade integration at the regional level. However, ECCAS has been mainly inactive during its first 15 years of existence due to financial difficulties and institutional weaknesses as well as conflicts in the Great Lakes Area. ECCAS' activities were relaunched at the Malabo Conference in 1999 with a specific focus on conflict prevention and peace consolidation, which are essential prerequisites towards the creation of a Central African Common Market. See Figure 1 for an illustration of how countries memberships in ECCAS and CEMAC overlap.

Figure 1. Central Africa–EU EPA: regional membership



International trade negotiations

In addition to their own regional economic integration process, Central African countries are involved in several external trade negotiations. With the exception of Equatorial Guinea, they are all members of the WTO and therefore participate in the ongoing Doha Development Round (DDR). Moreover, these countries are signatories of the Cotonou Partnership Agreement and thus are currently negotiating an Economic Partnership Agreement (EPA) with the EU, to be concluded by the end of 2007. The Democratic Republic of Congo, previously negotiating an EPA in the East and Southern Africa–EU EPA configuration, joined the CEMAC configuration at the end of 2005. Finally, Central African countries, with few exceptions,[8] benefit from preferential and non-reciprocal access to the US market for a significant part of their exports under the African Growth Opportunity Act (AGOA). These various liberalisation initiatives are meant to be convergent and complementary towards the integration of the Central African region into the world economy.

EPA negotiations

In previous ACP–EU co-operation agreements, all ACP countries enjoyed non-reciprocal tariff preferences for their exports to the EU market. Under the Cotonou Agreement, this will change after 2008 when reciprocal free trade arrangements negotiated between the EU and the six ACP regions will replace the previous preferential trade regime. These new agreements shall be compatible with the rules of the WTO, development-oriented and build upon ACP regional integration initiatives. The new regime shall also incorporate and improve the Lomé/Cotonou *acquis* regarding access to the EU market for the ACP countries.

The Central Africa – EU EPA Negotiations Principles

The Central Africa–EU EPA negotiations shall be guided by a number of principles, as detailed in a 'Joint Road Map' agreed in July 2004. First of all, these trade negotiations foresee the creation of an FTA between the two regional blocks starting in January 2008, in order to fully comply with WTO requirements. If indeed the negotiations are concluded, the principle of reciprocity will be progressively introduced over an indicative period of 12 years.

Another crucial objective of the EPA negotiations is to support and foster the regional integration process in Central Africa, on the basis of the priorities defined by the region. This encompasses notably the harmonisation and implementation of sound macro-economic and sectoral policies as well as the establishment of a monitoring system for the regional FTA. Specific attention shall also be paid to the implementation of the CEMAC CU (which remains problematic) as well as the trade agreement between CEMAC and STP. The pace of bilateral trade liberalisation with the EU shall be flexible and asymmetric, depending on the degree of regional integration achieved within the Central African region.

In line with the goals and principles stated in the Cotonou Agreement, Central African–EU negotiations for an EPA shall above all accord priority to the promotion of sustainable development and poverty reduction in the region. This shall be ensured through the implementation of competitiveness upgrading programmes, with specific focus on those sectors that are more likely to be affected by the EPA or regional integration processes. These capacity-building programmes, by improving the business environment and providing appropriate direct support to enterprises, should help Central African countries to maximise the potential benefits generated by the EPA and adjust their economies to the liberalisation process. In terms of financial coverage, both parties agreed that all the instruments and procedures available in the Cotonou Agreement shall be considered, along with possible complementary resources obtained from co-financing by EU states and other development partners.

Phasing and state of play of the negotiations

After the first phase of negotiations at the 'all ACP' level (which started in September 2002), Central Africa was the first ACP region to launch officially EPA negotiations at regional level with the EU in October 2003. For various political, capacity and substantive reasons, it took however almost a year for both parties to agree on a road map to structure the negotiations. Among the major sticking points figured the question of financial support to address supply-side constraints in the region. The Joint Road Map, very similar to the one agreed between the EU and the West African region, was finally signed in Brussels in July 2004, fixing the main objectives and principles of the negotiations as well as key areas for regional integration and capacity building programmes. It also defines the structure of the negotiations and an indicative calendar, divided into three phases.

Phase I (from September 2004 to July 2005) was dedicated to the identification of key regional economic integration priorities (on the basis of the CEMAC regional integration agenda) and the establishment of an EPA reference framework in these areas. The formulation and implementation of upgrading and competitiveness enhancement programmes also started with Phase I and is meant to continue during the whole negotiating process and beyond. Phase II (from September 2005 to July 2006) involved the definition of the overall EPA architecture as well as a first draft agreement on trade-related issues, agriculture, development issues and fisheries. Negotiations on bilateral trade liberalisation for goods and services will take place during Phase III (from September 2006 to December 2007), leading to the conclusion of the EPA.

The first meeting of the Central Africa–EU Joint Senior Negotiators Committee was held in Brussels in December 2004 to discuss the state of play and constraints in terms of regional integration and to agree on the creation of technical working groups as well as on an indicative calendar and action plan for 2005. Since then, several joint meetings have taken place at technical level, with a focus on Customs Procedures, Trade Facilitation (TF) and Border Protection as well as Technical

Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) measures. The next Central Africa–EU EPA meeting at Ministerial level is scheduled for October 2005.

Negotiating structure

The negotiations of the Central African–EU EPA take place at three levels: the 'Comité Ministériel Commercial conjoint', the 'Comité des Négociateurs' and the 'Groupes des Experts'.

The Central African 'Comité Ministériel Commercial' is composed of the trade ministers of the CEMAC countries and STP and it supervises the negotiations at political level. On behalf of the Central African region, the Committee monitors the functioning of the negotiating structure, approves the results of the negotiations and provides strategic orientations. At senior officials' level, the negotiations are lead by the 'Comité des Négociateurs', chaired by the executive secretary of CEMAC, and vice-chaired by the assistant general secretary of the ECCAS. This committee is in charge of conducting the EPA negotiations at technical level and is assisted by the 'Groupes des Experts', chaired by the directors in charge of trade of the CEMAC–ECCAS. At their first joint negotiation meeting held in December 2004, senior officials from both parties agreed to establish four Technical Negotiating Groups (TNG): CU and TF; TBT and SPS measures; Trade-related issues; and Services and investment.

In parallel to this formal negotiating structure, Central Africa and the European Commission (EC) have set up a joint Contact Group in order to provide secretarial and follow-up services regarding the negotiations and related support. Besides, a joint Regional Preparatory Task Force (RPTF) was created to facilitate the links and coherence between the trade negotiations and related financial assistance. The issue of development support for production capacity reinforcement, competitiveness and compensation for fiscal losses remains, nevertheless, a highly contentious one. Since the launching of the negotiations, Central Africa is asking for the inclusion of these issues into the formal EPA negotiations process. The EU, on the contrary, still maintains that the negotiations should focus on trade aspects only and that capacity-building support is best dealt with by the various Cotonou instruments in the context of the RPTF.

Significantly, the participatory approach agreed upon for the conduct of the negotiations provides for a key role for the private sector and civil-society stakeholders. In principle, they shall be kept informed of the evolution of the negotiations and consulted to express their concerns and defend their interests.

Key issues and challenges

Regional integration process: Regional integration among Central African countries can be a key driving tool for enhanced growth and economic efficiency as well as an important factor of political stability and peace within the region. Its completion, and particularly the consolidation of the CEMAC CU and its extension to STP, is a central objective of the EPA negotiations. The process is, however, far from being completed and there is a huge gap between the existing community legislation, quite comprehensive, and its effective application by the individual member states. Although the CEMAC zone is officially an FTA since December 2000, intra-regional linkages remain very limited and a wide range of political obstacles and administrative barriers still impede the free circulation of goods, services, capital and labour within the region. Besides, many decisions related to the customs and tax regimes are not yet properly implemented, leading to double taxation, exonerations and misclassification problems. Finally, harmonised policies on trade-related areas such as competition, investment, intellectual property rights (IPRs) or TBT/SPS measures are either nonexistent or not respected in practice. A large variety of obstacles and challenges, both internal and external, hamper the regional economic integration process in Central Africa: political instability and inter-country rivalry; lack of human and financial resources; weak institutions and enforcement mechanisms; large economic disparities between landlocked and coastal countries; and serious infrastructural constraints.

Supply-side constraints: The main objective of the Central Africa–EU EPA negotiations is development and poverty reduction in the region. Clear evidence, however, shows that market access in itself does not automatically lead to economic diversification and growth. Given the scarcity of private investment and the serious supply-side constraints the region is facing, sound internal reforms and timely development support measures to improve the business climate and enhance the private sector's supply and export potential will be crucial for Central African economies to benefit concretely from trade liberalisation and attract foreign investments. Priority areas for reform and support include institutional capacity building and good governance, macroeconomic stabilisation, public infrastructures (especially transport, energy and communication), regional integration, human resources development and enterprises upgrading and competitiveness enhancement.

Reciprocity: The impact of offering EU imports and investors improved access to the Central African market is another essential issue for the negotiations. First, the dismantling of tariffs, an important source of revenue for the governments in the region (from 28% to 65% of national budgets), is likely to lead to a significant drop in government resources, with severe consequences on public expenditure and possible detriment to social sectors such as health or education. This challenge may lead to the need for compensation mechanisms to offset tax revenue losses in the short term as well as adequate and stable fiscal reforms to be effectively applied. Secondly, liberalising trade with the EU will have important impact in terms of greater competition on the Central African domestic markets. While overall benefits in terms of consumer welfare and market efficiency (decrease of production costs, greater competitiveness) are expected, many local producers and firms might be unable to compete with EU products and be forced out of business, worsening employment and poverty conditions.

Access to the EU market: All Central African countries but Cameroon, Gabon and the Republic of Congo are LDCs and it can be reasonably assumed that the region will be granted an 'Everything But Arms' (EBA) type of duty and quota-free access to the EU market. However, tariff preferences, steadily eroded in the context of multilateral liberalisation, will not on their own address the trade needs of the Central African exporters and due consideration shall also be given to their capacity to comply with the EU's SPS, TBT and RoO policies.

Key sectors: Central Africa is well endowed with and extremely dependent on natural resources. First, it has vast reserves of petroleum, both offshore (Cameroon, Gabon, Congo, Equatorial Guinea) and inland (Chad), as well as deposits of minerals and metals, including gold, tin, bauxite, uranium and iron ore. **Oil** in particular dominates the economic and trade performances of the region, accounting for close to 25% of CEMAC's total GDP and 70% of CEMAC's exports. Moreover, the **dense forests** the region shares with the DRC represent the second-largest eco-forest zone in the world after the Amazon and logging activities constitute a major source of fiscal revenues, export earnings and employment. The EPA process, notably through regional integration, market liberalisation, and the improvement of the business climate, could further boost the development of these sectors while taking into account potential social and environmental negative impacts (deforestation, preservation of biodiversity). It could at the same time stimulate economic diversification by fostering local industry competitiveness and foreign investments in the region.

Two-thirds of the Central African population lives in rural areas and **agriculture** (including agro-industry) plays a significant economic and social role in the region, particularly in Cameroon, Chad and Central African Republic. The sector is however mainly characterised by subsistence activities with low productivity and could be negatively affected by the EPA through increased cheap agricultural imports and further rural exodus. Due consideration shall therefore be given to the potential effects of trade liberalisation in that sector, taking into account the impact of the EU Common Agricultural Policy (CAP) as well as the EU enlargement process.

The **fishing sector** has some significant potential in terms of trade and food security, especially in coastal countries, and could be developed on a sustainable basis through the EPA process.

Finally, **services** constitute a central element for most economies in Central Africa (up to more than 49% of total GDP in Chad). This sector shows promising results for the future although its expansion is hindered by weak institutions and lack of sound regulations as well as the inertia of other economic sectors. The EPA, by fostering regional integration and improving market access, could have a positive impact on the development of certain service sectors such as tourism (notably eco-tourism thanks to the rich fauna and flora of the Central African forest), telecommunications and financial services.

Endnotes

1. The period 1994–2000 showed a GDP growth of 0.7% per year to reach a total of more than $20 billion in 2004.
2. Gabon is the only country in the region to be defined as a 'middle-income economy'.
3. Trade flows among Central African countries are still below 5% of total trade in the region. These figures do not, however, take into account informal trade for which no data are available.
4. CEMAC includes six countries: Cameroon, Central African Republic, Chad, Equatorial Guinea, Gabon and Republic of Congo.
5. The Treaty instituting CEMAC was signed in 1994 but was formally ratified only in 1999 in Malabo (Equatorial Guinea).
6. This tax consists of a percent fee on the c.i.f value of imports from outside CEMAC.
7. The ECCAS includes the following countries: Angola, Burundi, Cameroon, Central African Republic, Chad, Democratic Republic of Congo, Equatorial Guinea, Gabon, Republic of Congo, Rwanda and Sao Tome and Principe.
8. Central African Republic and Equatorial Guinea.

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The Negotiations of an ECOWAS–EU EPA: Key Features

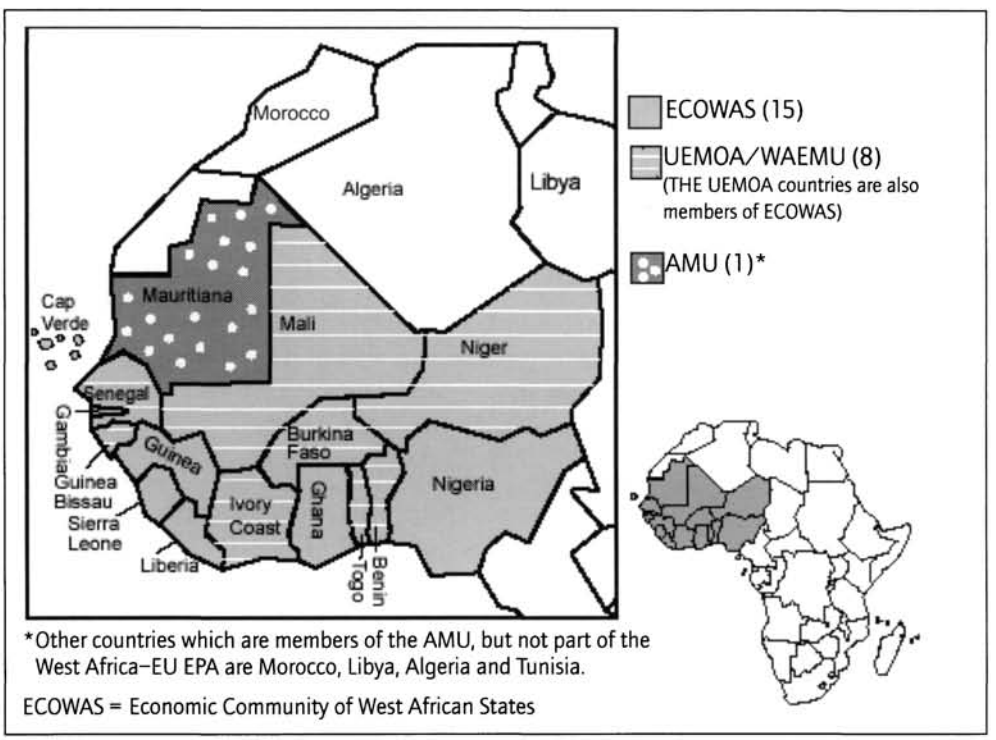
Nicolas Gérard and Sanoussi Bilal

Introduction

West Africa, with a population of 242 million people (including 130 million in Nigeria alone), covers 16 countries (see Figure 1) with diverse political and economic characteristics. A common concern is the high level of poverty across the region. All West African countries but three (Nigeria, Ghana and Ivory Coast) are classified as least-developed countries (LDCs); the average regional GDP per capita was only US$326 in 2004; all basic social indicators are below Sub-Saharan average; and all countries (except Ghana) are classified by the United Nation Development Program (UNDP) as having Low Human Development. Average annual economic growth for the region amounts to about 3% since 1994, remembering that Nigeria accounts for more than half of the regional economy (with a GDP of $41,373 million in 2001). As for the political situation, it ranges from open conflicts and instability close to civil war to consolidated democracies, depending on the country.

Most of the West African economies are not very (or not at all) diversified, with activities concentrated on primary products: agriculture and rearing in all countries, fisheries in coastal countries (especially Mauritania and Senegal), mining in Mali and Mauritania, while petrol dominates the

Figure 1. West Africa–EU EPA: Regional membership



This chapter will also be published in a forthcoming ECDPM InBrief series, *Overview of Regional EPA Negotiations*. ECDPM, Maastricht. www.ecdpm.org/regionalepainbriefs

Nigerian economy. The share of manufacturing industry remains low. These features make the region very vulnerable to and dependent on exogenous factors and external shocks such as prices fluctuations, climate hazards and partners' trade patterns and policies.

Despite regional integration initiatives, official trade flows among West African countries remain low (at around 13% of total regional trade in 2001, compared to 11% in 1996). The reasons lie partly in the lack of complementarity among West African economic structures, the persistent presence of tariff and non-tariff barriers (NTBs), and the inadequate level of infrastructures in the region. These data do not, however, take into account informal trans-border trade, which plays a prominent role in the region.

As for external trade, official statistics show a positive trend in West African exports since 1996, reaching a total of €32,056 million in 2003. The EU is still the main trading partner of West African countries (see Box 1 for data). It is however relevant to underline the growing importance of the US as well as other countries such as India and Brazil (important importers) or China and South Korea (significant exporters) towards the region. Agricultural products account for a significant share of total West African trade with the EU, despite the overwhelming share of Nigerian petrol in regional exports.[1] Despite efforts to foster its integration into the world economy, the region has not been able so far to really benefit from the global trade liberalisation trend. The participation of West Africa in world trade declined sharply over the past 30 years and is presently insignificant. In 2004 its share in EU trade (its major trade partner) amounted to a mere 1.25% of total EU exports and 1.03% of total EU imports.

West African regional integration process

West Africa comprises two key regional integration organisations: the Economic Community of West African States (ECOWAS), which regroups all countries of the region, and the West African Economic and Monetary Union (WAEMU/UEMOA), which covers a subset of (francophone) countries with a deeper integration process (see Figure 1).

ECOWAS was established in 1975 by the Treaty of Lagos with the global objective of creating an economic and monetary union. In view of the lack of progress in terms of implementation, the Treaty was revised in 1993 in order to reinforce the integration process. This led to the setting up of new organisms for monitoring and referring (a Court of Justice and a Parliament) and to the creation of new financial mechanisms based on an automatic deduction on imports. Currently, ECOWAS priorities are the strengthening of its institutions, regional trade liberalisation and the setting up of a Customs Union (CU), as well as the harmonisation of economic and financial policies with the aim of creating a Monetary Union.[2] Besides these regional integration priorities, ECOWAS also plays an active role by devel-

Box 1. ECOWAS (+Mauritania) trade in goods with the EU (2004)

Exports to the EU: € 10.534 million (growth 2003–04: –15.1%)
Imports from the EU: € 12.087 million (growth 2003–04: –1.3%)
Trade balance: € –1.553 million

Share of agriculture in EU–ECOWAS (+ Mauritania) trade:
Exports to the EU: 31%
Imports from the EU: 16%

Participation in EU trade:
EU exports: 1.25%
EU imports: 1.03%

Main trade partners (2003):
Exports: EU (32%), US (27%), India (8%), Brazil (5%), other (28%)
Imports: EU (37%), US (8%), China (7%), South Korea (6%), other (42%)

Source: Comext 2004 EU declarations and IMF 2003 data in Comext

oping sectoral programmes in areas such as infrastructure or the development of the private sector. In January 2005 the ECOWAS Common Agricultural Policy (ECOWAP) was adopted with the aims of ensuring sustainable food security and a decent remuneration for the farmers in the region and to increase inter-regional and international agricultural trade.

Although ECOWAS has officially been a Free Trade Area (FTA) since 1 January, 2000, it is still not fully effective in practice. Tariffs and NTBs, as well as inadequate infrastructures and cumbersome administrative processes, continue to restrain regional trade, which remains low. Similarly, the circulation of people and capital flows in the region is still limited in practice. The ECOWAS heads of state and government agreed in December 2000 to move towards the establishment of a four-band Common External Tariff (CET), in line with the one prevailing in UEMOA. The seven non-UEMOA countries are currently preparing for the harmonisation of their trade policy regime and the accompanying necessary reforms. Some specific provisions should be adopted to protect the agricultural sector, in line with the political orientations of the ECOWAP. A transitional period of three years from January 2005 has been foreseen before the ECOWAS CU comes into effect fully (by the end of 2007). Yet, several non-UEMOA countries have already started to partly apply the new ECOWAS CET.

The other key regional organisation is UEMOA. Officially established in 1994 in the context of the devaluation of the CFA franc, its origin dates back to 1962 with the creation of the West African Monetary Union, which became in 1973 the West African Economic Community. Covering the seven French-speaking African countries from the ex-CFA zone (Benin, Burkina Faso, Ivory Coast, Mali, Niger, Senegal, Togo) and Guinea Bissau, it is so far the deepest and the most solid regional integration process in West Africa in terms of institutions, decision processes, policies implementation and financial resources.

Although UEMOA has been a Customs Union since January 2000, certain aspects of its common external trade policy and internal free trade still need to be consolidated. Being a completed Monetary Union, UEMOA is now moving towards a Common Market, with harmonized laws and regulations affecting trade and indirect taxation as well as free movement of goods, services, persons and capital. Currently, the UEMOA internal agenda is specifically centred on: the consolidation of its CU; the improvement, convergence and monitoring of national macroeconomic policies; and the elaboration and implementation of sectoral policies. Regarding external trade, it has to be noted that the UEMOA Commission has an exclusive competence to negotiate bilateral trade agreements on behalf of its member states.

One of the most crucial challenges for the regional economic integration process in West Africa is the harmonization and convergence of these two regional integration initiatives under the umbrella of ECOWAS, notably concerning: the establishment of an harmonised CET, rules and certificates of origin procedures, tariff preferences, approval procedures, compensation mechanisms for loss of tariff revenues and macro-economic policies.[3]

International trade negotiations

In addition to their own regional economic integration processes, West African countries are also involved in external trade negotiations. As members of the World Trade Organization (WTO) (except for Liberia and Cape Verde[4]), they participate in the current multilateral negotiations in the context of the Doha Development Round. They are also members of the African, Caribbean and Pacific (ACP) Group, signatory of the Cotonou Partnership Agreement which foresees the negotiation of an Economic Partnership Agreement (EPA) with the EU by the end of 2007. These three processes are meant to be convergent and complementary with the aim of fostering the progressive and harmonious integration of the West African region into the world economy.

EPA negotiations

In previous ACP–EU co-operation agreements, all ACP countries enjoyed non-reciprocal tariff preferences for their exports to the EU market. Under the Cotonou Agreement, this should change from 2008

onward, when reciprocal free trade arrangements negotiated at regional level between the EC and the six ACP regions should replace the previous preferential trade regime. These new economic partnership agreements shall be compatible with the rules of the WTO, development oriented, and built upon ACP regional integration initiatives. This new trade regime shall also incorporate and improve the Lomé/Cotonou *acquis* regarding the access to the EU market for the ACP countries. For the purpose of this EPA, Mauritania, which left ECOWAS in 2001, negotiates together with ECOWAS to set a West African–EU EPA.

West Africa–EU EPA negotiation principles

Based on the principle of reciprocity, the EPA shall entail an FTA between the 16 West African countries and the EU, which fully complies with WTO rules. The negotiations shall be guided by the following principles and objectives.[5]

Above all, the West Africa–EU negotiations for an EPA shall accord priority to the promotion of sustainable economic development and poverty reduction in the region, in line with the Cotonou Agreement's goals and principles. In addition, the EPA shall be complementary and mutually supportive of the national development strategies of the West African region. The development dimension of the EPA process shall be ensured through the implementation of competitiveness-enhancement and upgrading programmes meant to improve the business environment and to offer appropriate direct support to the enterprises in the region. These programmes should help West African countries to maximise the potential dynamic benefits generated by the EPA and to help them to adjust their economies to the liberalisation process. In terms of financial assistance, both parties agreed that all the instruments and procedures available under the Cotonou Agreement shall be utilised, and complementary funding obtained, amongst other sources, from co-financing with the EU member states and other donors.

The EPA shall also promote the deepening of the regional integration process in West Africa, on the basis of the priorities determined by the region. It concerns particularly the effective establishment of the West African FTA, as well as the gradual completion of the CU through the extension of the UEMOA CET to the entire community. Co-operation and support measures are also foreseen in trade-related areas such as trade facilitation, quality standardisation and control, sanitary and phytosanitary (SPS) measures, border protection, investment, competition, and intellectual property with the aim of harmonising and improving regional policies and procedures and reinforcing the institutional setting. The degree of regional integration within the West African region shall determine the pace as well as the asymmetry and flexibility of bilateral trade liberalisation with the EU.

Phasing of the negotiations

Following the first phase of EPA negotiations at 'All ACP' level (which started in September 2002), regional EPA negotiations between West Africa (ECOWAS + Mauritania) and the EU were officially launched in Cotonou (Benin) on 3 October, 2003, making them the first ACP region (with Central Africa) to formally engage in the negotiations with the EC. It took, however, almost a year for both parties to agree on a road map to guide the negotiations. Among major contentious points figured the issue of financial assistance and the appropriate integration of the development dimension within the EPA. The Joint Road Map finally agreed in Accra (Ghana) in August 2004 sets the main goals and principles of the negotiations and identifies key areas for economic regional integration and capacity-building programmes. It also indicates the structure of the negotiations and an indicative schedule, organised around three phases:

First phase: Identification of economic and trade regional integration priorities and establishment of an EPA Reference Framework in these areas; and formulation and implementation of a programme to enhance competitiveness and of an upgrading programme (from September 2004 to September 2005).

Second phase: Definition of an overall EPA architecture and proposal of a draft agreement on all trade-related issues (from September 2005 to September 2006).

Third phase: Negotiations on trade liberalisation for goods and services; conclusion of the EPA (from September 2006 to December 2007).

This phasing recognises that the enhancement of the regional integration process and the improvement of competitiveness and supply capacity in West Africa are key issues regarding the EPA process, although they do not constitute *per se* a prerequisite for starting bilateral trade negotiations.

Negotiation structure

The negotiations of the West Africa–EC EPA are conducted, on the side of the West African region, by the Regional Negotiating Committee (RNC) and, on the side of the European Community, by the European Commission (EC). These negotiations take place at three levels, namely: the chief negotiators, the senior officials and the technical experts.

At chief negotiators' level, the RNC delegation is led by the ECOWAS executive secretary and assisted by the president of the UEMOA Commission. In addition, each member state may designate up to three experts as part of the delegation. At senior official's level, the RNC delegation is led by the ECOWAS deputy executive secretary for policy harmonization and assisted by the UEMOA commissioner for tax, customs ad trade policy. At technical level, the RNC delegation comprises notably the directors of trade of the ECOWAS Executive Secretariat and the UEMOA Commission. At the first joint senior official's level meeting that was held in Brussels in February 2005, both parties agreed to establish four joint technical negotiating groups: customs union and trade facilitation; technical barriers to trade and sanitary and phytosanitary measures; services and investment; and trade-related issues. A fifth group, whose precise mandate must be further discussed, should in principle entail the analysis of productive sectors.

In addition to the formal negotiating structure, a joint contact group has been set up to provide secretarial services and co-ordinate support to the negotiations. Moreover, a joint Regional Preparatory Task Force (RPTF) has been created to facilitate the links and coherence between the EPA negotiations and co-operation for development funding. Nonetheless, the question of the inclusion of chapters on resources mobilisation to improve competitiveness and address supply-side constraints in the formal EPA negotiations process remains a major contentious issue, the EC remaining adamant that the EPA negotiating framework should be focused on trade aspects alone while capacity-building support should be dealt with by the other Cotonou instruments in the context of the RPTF.

Also note that the participatory approach agreed on for the conduct of the negotiations provides for a key role to non-state actors (NSAs) who shall be involved at every stage of the negotiations to ensure that their concerns are properly taken into account.

Key issues and challenges

The regional integration process. In spite of recent renewed efforts, the West African economic regional integration agenda remains far from being completed. Key obstacles and challenges include political instability, conflicts and governance issues, a 'colonial' division (among English- and French-speaking countries), the coexistence of parallel regional groupings (ECOWAS and UEMOA) with different levels of coherence and development to be harmonised, insufficient human and financial resources, and limited institutional capacity at regional as well as national level. Besides, Mauritania, while participating in the West Africa–EC EPA negotiations, has not been a member of ECOWAS since January 2001, which could further complicate the regional coherence of the EPA.

Supply-side constraints. A key priority for West African countries is the development dimension of the EPA. However, there is ample evidence that market access alone rarely leads to economic diversification and development, as experienced by most ACP countries under the Lomé non-reciprocal and preferential trade regime. Adequate institutional and policy reforms as well as timely capacity-building initiatives to improve the business environment and to enhance competitiveness and supply capacity will therefore be most needed if West African economies are to effectively benefit from trade liberalisation with the EU and to attract more investment in the region. Potential areas for domes-

tic reforms and support measures should encompass macroeconomic policies, infrastructural services, and enterprises upgrading as well as information and communication technology, transport, and human resources development. Additional measures should include technical assistance and training to develop trade-negotiating skills and analytical capacity to stimulate West Africa's ownership of the EPA negotiations process.

Adjusting to reciprocity – Market access and behind-the-border measures. Several adjustment costs will be associated with the opening of West African markets to EU products. First, tariff liberalisation will lead to a significant decline in government revenues in many countries and therefore to potentially severe cuts in public expenditures, notably for social sectors like health or education. Indeed, the majority of ECOWAS countries are indeed highly dependent on customs duties for their incomes, averaging 14.7% of government revenue and 2.5% of GDP. This is particularly relevant for smaller countries like Cape Verde, Sierra Leone or Gambia that are highly import-dependent and already under pressure as a result of the implementation of the ECOWAS CET. Sound domestic fiscal reforms will be required, as well as various compensation measures and mechanisms to offset tax income losses in the short term and facilitate adjustments.

Secondly, market opening, by increasing competition, might adversely affect some West African domestic industries. Hence the importance for the region of identifying key sensitive sectors and negotiating sound liberalisation schemes. On the other hand, adjustments and accompanying measures may be necessary to facilitate trade liberalisation, address supply-side constraints, and mitigate potentially negative effects on poverty.

At last, for West African countries to effectively benefit from EU market opening, it will be crucial to look beyond tariff concerns and also to address NTBs and regulatory issues. This includes the need to enhance West African exporters' capacity to comply with EU rules of origin (ROO), technical barriers to trade (TBT), standards and SPS requirements.

Key sectors. Agriculture (including agro-industry) is the centrepiece of the West African economy, employing nearly 70% of the working population and generating 30 to 40% of GDP. It is the most important employer in the region and plays a vital role in generating cash income, ensuring food security, and alleviating poverty, particularly in rural zones, which tend to be the poorest and most vulnerable areas. In addition, processed as well as traditional agricultural products (such as cocoa, cotton and out-of-season fruits and vegetables) account for a significant part of ECOWAS' trade flows with the EU and represent one of the main sources of export earnings. The West African agriculture sector is globally characterised by a dominance of the informal sector, low skills and the pre-eminence of traditional technology, low productivity, and concentration of exports in a small range of primary products with declining and volatile prices and serious difficulties in transforming from agrarian or primary production to industrial economies. Given these features and the socio-economic importance of agriculture for the region, EPA negotiations shall give due consideration to the potential effects of trade liberalisation, taking into account regional integration initiatives and the outcome of the Doha round as well as the impact of the EU Common Agricultural Policy (CAP).

Fisheries and marine resources play a vital role in most coastal countries (particularly in Senegal and Mauritania) in terms of export earnings and employment. That sector shall be the subject of a specific approach within the EPA negotiations process, tackling key trade issues such as tariffs, SPS compliance and ROO while also taking into account food security and environmental concerns.

Among other key sectors figure **petroleum** (essentially in Nigeria), **mining products** (particularly in Mali, Mauritania and Niger) and **services** such as tourism and related activities, transport, and communication (in almost all West African countries but especially in Cape Verde) which shall also be specifically considered in the context of EPA negotiations. An EPA should particularly emphasise liberalisation of EU market access in service sectors and modes of supply of export interest to the West African countries (mainly tourism-related activities and Mode 4), while commitments by the West

African states should come in sectors where trade opening would improve efficiency and competitiveness.

Endnotes

1. In 2004, the top two exports of the West African region to the EU were fuels and cocoa, accounting respectively for 45% and 21% of total exports to the EU.
2. The ECOWAS countries that are not members of UEMOA (except for Cape Verde and Liberia) have decided to create a second monetary zone which should merge with the UEMOA to form a single monetary union at ECOWAS level, with a single currency called ECO.
3. Regarding macroeconomic policies, a multilateral monitoring mechanism has been created for the whole ECOWAS region on the basis of the UEMOA *acquis*.
4. Cape Verde only has observer status.
5. See in particular the Cotonou Partnership Agreement, the Joint Report adopted at the 2nd ACP–EU Joint Ministerial Meeting on EPAs (2 October, 2003) and the West African region–EC joint Road Map agreed in Accra in August 2004.

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Many other documents on West African regional integration process and EPA negotiations are also available on www.acp-eu-trade.org and www.hubrural.org

www.uemoa.int

www.ecowas.int

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A Caribbean–EU EPA: Towards an Enhanced Partnership?

Junior Lodge and Sanoussi Bilal

Introduction

The Caribbean region has historically experienced a special and privileged relationship with its European partners. However, the time has come for the Caribbean to fundamentally re-evaluate its partnership with Europe. After more than 30 years of preferential treatment with the European Union (EU), the Caribbean should have the opportunity to enter into an Economic Partnership Agreement (EPA) with the EU by 2008 at the latest.

Following the signing of the Cotonou Partnership Agreement between the African, Caribbean and Pacific (ACP) countries and the EU in 2000, the ACP group started negotiations with the European Commission on an EPA in September 2002. The EPA negotiations represent a major point of departure from ACP–EU trade co-operation relations on two fundamental scores. First, the conclusion of EPAs will mark the end of the non-reciprocal trade agreements – the hallmark of four Lomé Conventions and the present transition period (until December 2007) under the Cotonou Agreement (CA). Secondly, a cluster of distinct regionally based EPAs is most likely to emerge in place of the hitherto traditional all ACP–EU trade agreement.

In parallel, the Caribbean countries are also involved in the redefinition of their trade and integration policy at various levels. First, new multilateral trade negotiations were launched in November 2001 in Doha. The Caribbean countries are also negotiating various regional agreements, on a continental level, in the context of the Free Trade Agreement of the Americas (FTAA), and with other regional partners (Canada, Costa Rica, etc.). Last, but not least, the Caribbean region continues its own integration process.

Undoubtedly, these processes will have significant bearing on the evolution of Caribbean–EU relations. The purpose of this chapter is to discuss some of the factors that will influence their trade relations. The chapter reviews the main trends in Caribbean trade, including with the EU, and presents the Caribbean experience in integrating regionally. The drastic changes in the trade framework between the ACP and the EU and introduced, and their importance for the Caribbean region explained, along with some of the challenges that the Caribbean is facing in negotiating EPAs. To conclude the regional capacity-building requirements needed to face these challenges is stressed.

Main trends in Caribbean trade

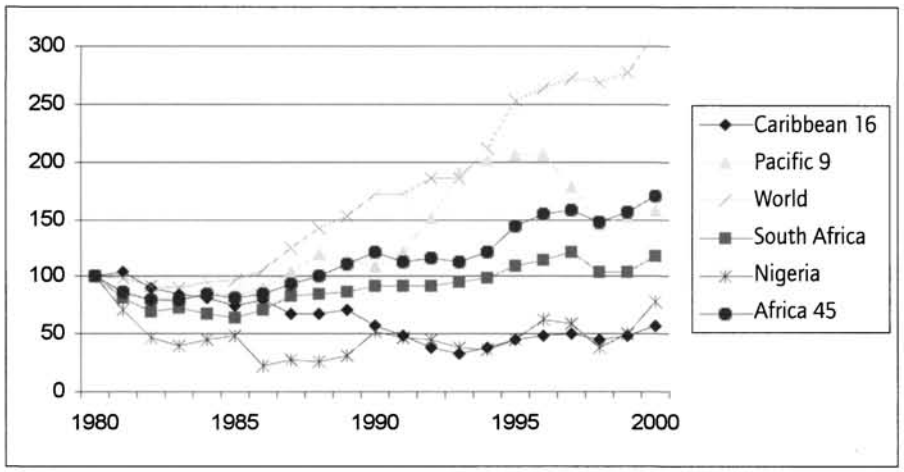
As expected from a region composed of many small islands, trade plays a dominant role in Caribbean economies, accounting for 80% of Caribbean GDP in 1999. In comparison, the share of trade in the GDP of Sub-Saharan countries is 49%, and only 46% for the world average. The trade relations of the Caribbean with their regional partners and other countries and regions are therefore of utmost importance for their economies.

Over the past decades, however, the Caribbean has experienced a sharp fall in its share of world trade. Its share of world merchandise exports has dropped from 1.7% in 1950 to 0.2% in 2000. The relative decline in participation in world trade is a common feature of many developing countries and in particular of the ACP. Yet, the Caribbean is the ACP region that has experienced the sharpest decline (see Figures 1 and 2).

Figure 1 shows that, in absolute terms, the volume of Caribbean exports has been cut by almost

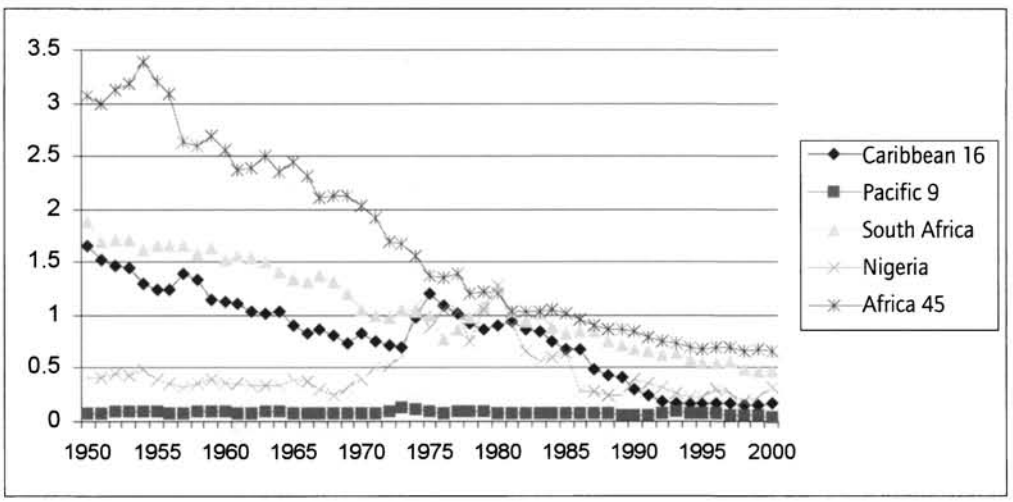
This chapter is a revised version of a paper presented at the BID/Bocconi Workshop 'Europa y América Latina en la Economía Global: Cómo intensificar sus relaciones económicas', Bocconi University, Milan, 15–16 January 2003. The views expressed in this paper are the authors' alone.

Figure 1. Evolution of ACP exports by region since 1980 (1980 = 100)



Source: UNCTAD (2002)

Figure 2. Evolution of share of ACP exports in world total by region: 1950–2000 (%)



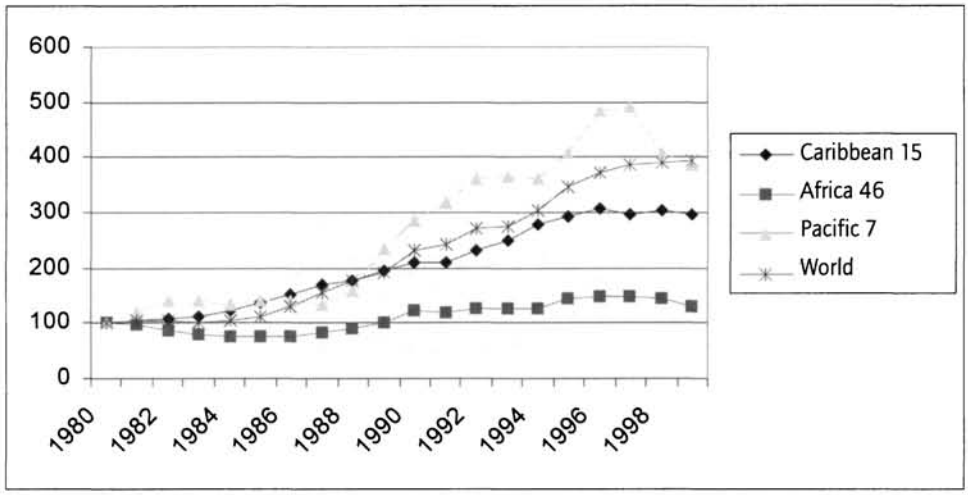
Source: UNCTAD (2002)

one-half over the last 20 years. In value terms, its merchandise exports have barely grown (by an annual rate of 0.05% on average). In comparison, exports grew by 1.6% over the same period in the Pacific ACP, and 3.4% in the African ACP, still far below the world average of 7.0% for that same period. So, while the Caribbean depends greatly on their external trade, they have not been able to take full advantage of the new opportunities offered by the global trend towards the liberalisation of international markets.

In contrast, the Caribbean region has fared rather well in expanding its service exports, which have about tripled during the 1980–99 period (see Figure 3). As a matter of fact, the Caribbean economies have become largely dominated by services. In 1999, services accounted for 46.3% of Caribbean exports. Travel and tourism services are the main contributors, although financial and insurance services are gaining in importance as well (see Figure 4).

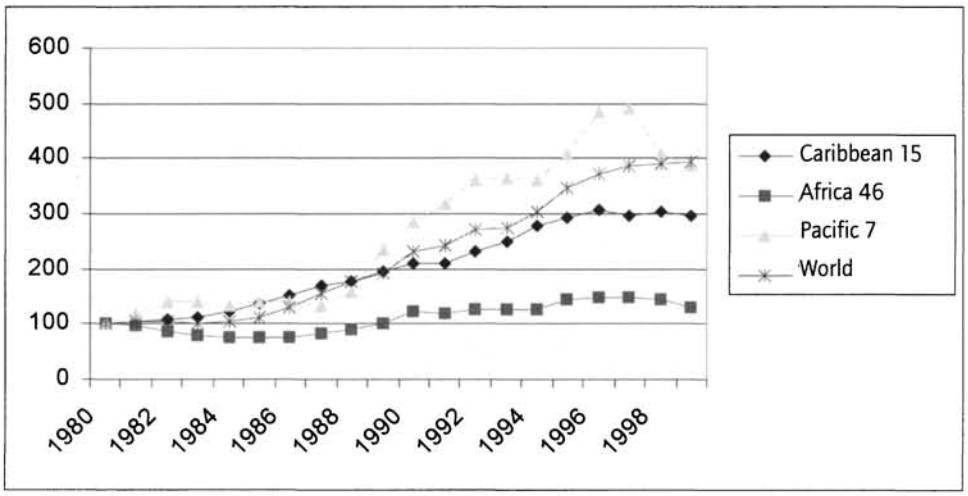
Yet, in spite of this relative good performance, the share of the Caribbean in world exports of

Figure 3. Evolution of service exports by region since 1980 (1980 = 100)



Source: UNCTAD (2002)

Figure 4. Composition of Caribbean (15) exports of services by sector



Source: UNCTAD (2002)

services has slightly declined, from 0.75% in 1980 to 0.6% in 1999 (see Figure 4), perhaps suggesting that the competitiveness of Caribbean services could be improved.

Overall, the trade balance of CARICOM is negative. The situation has considerably worsened during the last decade, from –US$713 million in 1990 to –$4,995 million in 1999. This represents, in terms of exports/imports ratio, a drop from 86% in 1990 to 51% in 1999.

The trade balance of the Caribbean has also worsened with its two main trading partners, the US and the EU. During the 1990s, the share of CARICOM imports from the EU fell from 16.8% in 1990 to 11.9% in 1999, while its share of exports to the EU fluctuated around 20%. Yet, from a trade surplus with the EU in 1990, with an export:import ratio of 104%, the CARICOM trade balance has become significantly negative in the 1990s, with a ratio of only 76% by 1999. In comparison, over the same period the dependence from the US market increased from 43.1% to 52.0% of the share of CARICOM imports, with a share of around 40% of its exports entering the US market. Hence, the

trade deficit towards the US was multiplied by 8.7, to reach over $3 billion in 1999, which corresponds to an exports:imports ratio of 41%, compared to 84% in 1990 (see Figures 5 and 6, and Davenport et al., 2002).

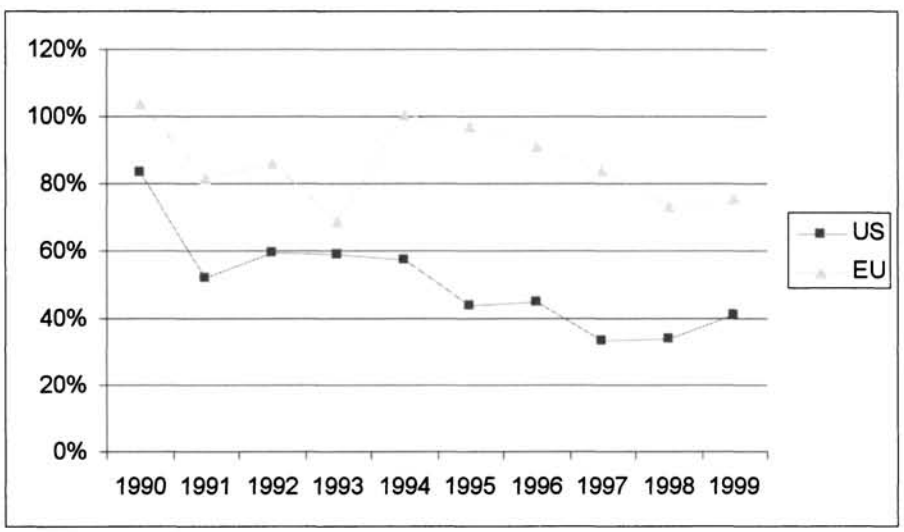
This overall picture helps to put the outcome of the ACP–EU partnership agreements somewhat in perspective for the Caribbean. It is often assessed that EU trade preferences have in general failed to boost trade and economic growth in the ACP or to promote diversification. There is no doubt that the Lomé Conventions, including Lomé IV, have led to rather disappointing overall trade performances by the ACP, including the Caribbean. Yet, the Caribbean region has performed poorly in general, and one could speculate whether the Lomé Conventions have not contributed, at least to some extent, to support Caribbean exports to the EU (see Figure 6).[1]

The impact of preferential access to EU markets has obviously been stronger for some sectors. For instance, Egoumé-Bossogo and Mendis (2002) find that the gradual decline of preferential access to the EU market for Caribbean bananas had a significantly negative impact on CARICOM bananas exports, while benefiting the so-called 'dollar bananas'. In general, the erosion of preferences can partly explain the decline of CARICOM agricultural products, from almost 60% of total EU imports from the region in 1991, to 32% in 2001. Yet, a major factor is probably the transformation of the economies of most Caribbean countries, whose dependence on agriculture has been reduced. The Caribbean is no longer an exporter of labour-intensive agricultural products, facing low and volatile prices. 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 EU in 2001. Only three agricultural products, rum, sugar and bananas – contributing to 25% of total exports – featured among the top ten Caribbean exports to the EU.

The statistics of decline in the relative trade performance of mature industries threatens to mask more than they reveal. In terms of exports of goods, for example, St. Kitts remains dependent on exports of sugar, St. Lucia, St. Vincent and Dominica on bananas, and Guyana on sugar, rice and rum. While Jamaican exports have diversified in the last decade, sugar and bananas still feature heavily. Agriculture's remaining importance to regional and national economic welfare is best illustrated by the fact that the sector generates one in every three jobs within the region.

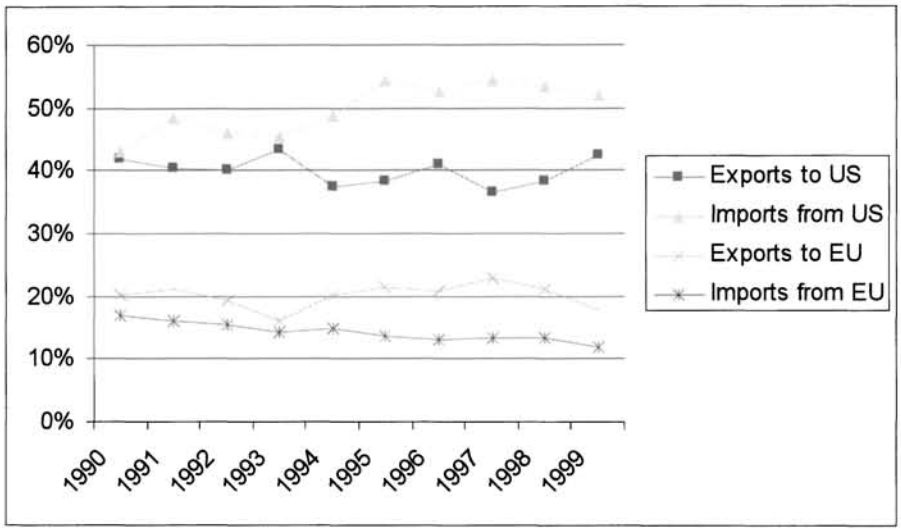
The regional market has also become increasingly important for Caribbean products, whose

Figure 5. Export:import ratio for CARICOM with the EU and the US



Source: Own calculations from ECLAC (2002), as reported by Davenport et al. (2002)

Figure 6. CARICOM share of trade with the EU and the US



Source: ECLAC (2002), as reported by Davenport et al. (2002)

intra-regional exports have jumped from 11.8% in 1990 to 19.3% in 1999 of CARICOM total exports (see Davenport et al., 2002). CARICOM membership seems to have been a significant factor in fostering regional trade (see Egoumé-Bossogo and Chandima Mendis, 2002). In this respect, any reform of the ACP–EU trade relations will have to take into account the regional integration process and its importance for the Caribbean economies.

The Caribbean experience of regional integration

In its experience of regional integration, the Caribbean has not escaped from the classic fault line of widening versus deepening. The region has embarked upon both paths at various times during the 35-year history of regional integration (see Gonzales, 2002). Economic integration has deepened in two ways. Firstly, via an increase in the number of countries that are members of CARICOM, to its present tally of fifteen. Since the formation of CARICOM in 1973, the original members have been joined by Suriname (1995) and Haiti (2002).[2]

Secondly, CARICOM has broadened the regional integration exercise by negotiating trade, investment and economic agreements with Colombia, Costa Rica, Cuba, the Dominican Republic and Venezuela. Notably, the Free Trade Agreement (FTA) concluded in August 1998 between CARICOM and the Dominican Republic provisionally entered into force in December 2001.[3] This Agreement contains provisions in the areas of market access for goods (including rules of origin (ROO), technical barriers to trade (TBT), sanitary and phytosanitary measures (SPS), customs procedures and trade promotion measures) and investment (reciprocal promotion and protection). It notably provides for the asymmetrical application of the reciprocity principle in favour of CARICOM less-developed countries that are signatories to the Treaty.[4] It also provides for future negotiations in the areas of trade in investment, services and government procurement. This FTA should have been reviewed in the course of 2004.

In addition, Caribbean countries are currently engaged in a series of external trade negotiations that should foster their integration into the world economy. This includes notably the ongoing WTO Doha Development Round (DDA), the Free Trade Area of Americas (FTAA) negotiations and the EPA negotiations with the EU as well as with Canada. Besides, CARICOM has also started discussions on deepening trade relations though the possible conclusion of an FTA with MERCOSUR.[5]

The widening of the regional integration exer-

cise has been complemented by graduating from a free trade area (CARIFTA) to the creation of a common market (CARICOM), to the current goal of developing the CARICOM Single Market and Economy (CSME). Given the fact that the region is predominantly an arch of small island developing states, it is rather unsurprising that the regional integration movement assumes that of concentric circles. The seven members of the Organisation of Eastern Caribbean States (OECS) represent the deepest form of regional integration as exhibited in their monetary union and common judiciary. Within the context of OECS members' review of the Treaty of Basseterre, the formation of an economic union is being considered.

CARICOM represents the next concentric circle in the regional integration movement. The legal framework for the goal of CSME is essentially in place. CARICOM member states agreed in February 2002 to conclude the formation of the CSME by 31 December, 2005.[6] This decision implies the elimination of all measures that either restrict or differentiate the conditions among CSME nationals as regards to (a) the right to establish businesses; (b) the right to provide services; and (c) the right to move capital and invest.

Almost 100 per cent of goods that satisfy the conditions for acceptance as produced within the CSME region are now traded free of either customs duties and equivalent charges or quantitative or other restrictions. Intra-CARICOM data attest to the increased liberalisation of barriers within the region. In 1993, intra-CARICOM exports amounted to $624 million while in 2003 the comparative figure was $1,467 million – an annual growth rate of 8.9%. As a result, as previously indicated, intra-CARICOM trade in 2003 represented 17.1% of total CARICOM exports, compared with 15.2% a decade ago (INTAL, 2005). Measured in value terms, CARICOM is presently the third-largest market for its own exports behind the United States and the European Union.

The CSME regime has intermediate targets in which each member state has identified measures that will be eliminated on 31 December, 2003 and 31 December, 2004. It builds on three important decisions, namely:

- the standstill introduced in 1998 halting member states from introducing any new measure that discriminates against CARICOM nationals;
- the removal by February 2002 of any discriminatory measure that was not negotiated into the programme; and
- the facilitation of the free movement of certain categories of skilled people, namely university graduates, sports people, media workers and artists as agreed by the member states in 1993.

The CSME poses a number of immediate challenges, with the following constituting the more severe:

1. **Implementation.** The region faces the challenge of accelerating the terms of implementation of decisions. Efforts must be accelerated in specific areas such as rights of establishment, provision of services and movement of capital, mutual recognition of educational certificates and qualifications, and the removal of restrictive practices. Here, there is a clear recognition that the problem is a reflection of resource-constrained public administrations rather that political will. The CARICOM Secretariat responds to this imperative by assisting member states to fulfil their obligations.

2. **Dispute settlement.** Nationals and other member states have the right of redress, where member states fail to act, through the dispute settlement mechanism that has been established under the Revised Treaty of Chaguaramas. The dispute settlement mechanism has at its apex the Caribbean Court of Justice (CCJ) – the final arbiter on the Treaty. The CCJ also acts as a court of arbitration in commercial disputes but here again the process of ratifying the legal instruments of the CCJ is mired in political controversy.

3. **Harmonisation.** There are also requirements in the revised Treaty for the harmonisation of legislation and policies in several areas. The CARICOM Secretariat is putting in place the legal capacity to develop model-harmonised legislation and provide advice in order to assist member

states in the process. This issue also extends to the full establishment of a common external tariff. This process has been hampered by a combination of variable speed and phasing schedules, and compounded by the region's reliance on border taxes.

4. **Free circulation of goods.** This relates to the issue of free circulation once a good or a service provider is inside the customs territory of the single market. This area has been recognised in the Revised Treaty for urgent technical analysis and for decision by way of a Protocol.

The third and final concentric circle of Caribbean regional integration is the CARICOM–Dominican Republic FTA. Signed in August 1998 and ratified in December 2001, the FTA provides for reciprocal market access in goods traded between the Dominican Republic and the CARICOM's more developed countries, i.e. Barbados, Guyana, Jamaica, Trinidad and Tobago and Suriname. CARICOM least-developed countries (LDCs) are given non-reciprocal access to the Dominican Republic market. The FTA further provides for the negotiation of services, investment, intellectual property and government procurement through a built-in agenda. Full implementation of the FTA has lagged behind with minimal progress secured on the built-in agenda. More recently, policymakers in the Dominican Republic[7] have publicly mooted the possibility of that country's accession to the CSME. The debate has placed on the agenda whether the current FTA constitutes an ambitious platform to govern the economic relations between CARICOM and the Dominican Republic.

In general terms, the nature of the Caribbean economic space is broadly defined by the three streams of regional integration. The same designation does not apply to the relationship between the CSME and both the Bahamas and Haiti. The Bahamas has full membership of the Caribbean Community yet also enjoys full exemption from CSME obligations. The Bahamas's consideration of its relationship with the CSME is driven by two major concerns, namely, (a) the structure of its tariffs with applied rates considerably higher than those of the CARICOM CET and (b) the ramification of full implementation of elements of Chapter III of the revised Treaty.

Haiti became a member of the Caribbean Community in 2002 with its terms and conditions conferring it with, *inter alia*, CARICOM LDC status. The country was granted a moratorium on implementation of CSME obligations. The status of the moratorium, which ended in December 2003, is mired in legal misinterpretation and compounded by the suspension of the country's CARICOM membership.

It is in this regional context that the relations with the EU must be envisaged.

From Lomé to Cotonou: Negotiating EPAs

From 1975 to 2000, four successive Lomé Conventions governed the development and trade relations between the African, Caribbean and Pacific (ACP) countries and the European Union (EU). Under this development framework, the EU has granted non-reciprocal trade preferences for ACP exports to its market. Most ACP products were allowed to enter duty free on the European market, with the exception of some 'sensitive' agricultural products covered by the Common Agricultural Policy (CAP) of the EU. Four commodity protocols, annexed to the Lomé Convention, provided free access for a specified quantity of exports from a selected group of traditional ACP providers of bananas, rum, sugar and beef, allowing these commodities to indirectly benefit from the CAP.

Despite receiving preferences for more than 25 years, ACP exports have in general performed poorly, including Caribbean exports, as discussed in Section 2. The share of ACP exports to the EU market has fallen by more than half, from 8% in 1975 to 2.8% in 2000. Judging from the composition of aggregate ACP exports, trade preferences have in general also failed to promote diversification. Besides the disappointing results of the Lomé Conventions, pressures have increased on the ACP–EU trade relations to be more consistent with the rules of the multilateral trading system, since the establishment of the World Trade Organization (WTO).

The Cotonou Partnership Agreement, signed in June 2000, contains the basic principles guiding

relations between the EU and the 77 ACP countries for the following twenty years. Both parties agreed to review the ACP–EU trade regime in order to make it compatible with WTO rules and with the main objective of promoting growth, sustainable development and poverty alleviation and helping the ACP countries integrate into the world economy. This new economic and trade co-operation is aimed at 'fostering the smooth and gradual integration of the ACP states into the world economy, with due regard for their political choices and development priorities' and enabling 'the ACP states to play a full part in international trade' (Articles 34.1 and 2 of the Cotonou Agreement). So, the ACP states and the EU undertook 'to conclude new WTO-compatible trading agreements, removing progressively barriers to trade between them and enhancing co-operation in all areas relevant to trade' (CA Art. 36.1). Such agreements will take the form of EPAs (CA Art. 37.1) or, if need be, 'all alternative possibilities, in order to provide these countries with a new framework for trade which is equivalent to their existing situation and in conformity with WTO rules' to be considered from 2004 (CA Art 37.6). The most likely alternative, although not the only one, for non-LDCs that do not want to take part in an EPA, is to take advantage of the EU Generalised System of Preferences (GSP), possibly improved (a GSP-plus). As for the LDCs, they have benefited since March 2001 from an almost-free access to the EU market through the 'Everything But Arms' (EBA) agreement, a unilateral EU initiative within its GSP which removes tariffs and quotas on all LDC products except for arms and, during transition periods, bananas (by 2006), and rice and sugar (by 2009).[8]

The EPAs, proposed by the European Commission, would be free trade areas (FTAs) between (regional) groups of ACP countries and the EU. They would cover not only trade in goods and agricultural products, but also in services, including technical barriers to trade. Other trade-related areas could also be covered, including by increased co-operation between the EU and ACP countries within the framework of EPAs. Such areas are competition, investment, protection of intellectual property rights, standardisation and certification, sanitary and phytosanitary (SPS) measures, trade and environment, trade and labour standards, consumer policy regulation and consumer health protection, food security, public procurement, etc. (Articles 45–54 of the Cotonou Agreement).

On 27 September, 2002, the ACP and the EU officially launched the negotiations on EPAs, to replace the non-reciprocal preferential access to the EU market by fully WTO-compatible reciprocal agreements, while providing for differential and asymmetric treatment. For the transition period, until the end of 2007, the current preferential trade regime is extended.

With the objectives of fostering sustainable development, integrating the ACP into the world economy and fully complying with WTO rules, the basic guiding principles of EPAs are:

- **Development:** The new trading arrangements have to be seen within the context of the overall objective of the Cotonou Agreement, ensuring sustainable development and economic growth in ACP countries that will contribute to poverty eradication.
- **Reciprocity:** The EPAs will be (enhanced) Free Trade Arrangements, which will be compatible with the multilateral rules of the WTO.[9]
- **Regional integration:** EPAs will build on and should reinforce the regional integration process of the ACP. Regional EPAs should contribute to foster the integration of the ACP in the world economy, stimulate investment and contribute to locking-in the necessary trade reforms.
- **Differentiation:** Considerable weight is given to differentiation and special and differential treatment. EPAs will take account of the different levels of development of the contracting parties, providing for sufficient scope for flexibility, special and differential treatment and asymmetry.
- **WTO-compatibility:** A corner stone of the Cotonou Agreement is the imperative requirement for future ACP–EU trading arrangements to fully comply with the principles of the WTO. The WTO-compatibility of EPAs, or any alternative trading arrangements, requires, according to

the European Commission, that no further waiver should be requested at the WTO for the arrangements governing ACP–EU relations.[10]

The EPA negotiations are structured around two phases. The first phase of the negotiations, extending until September 2003, takes place between the European Commission and the ACP group as a whole. The objectives are to define the format, structure and principles guiding the negotiations. While both the ACP and EC agreed on a number of issues – e.g. EPA supportive of ACP regional integration processes and acting as a tool for development, the disagreements were considerable. The major fault lines separating the groupings were (a) the nature of Phase I and the associated issue of the form with which the All-ACP Phase should be concluded; (b) the scope of issues to be discussed and in particular the treatment of Singapore Issues; (c) securing resources beyond those committed under the 9th EDF for EPA implementation, and (d) the treatment of development as a cross-cutting issue or deserving of its own negotiating group.[11]

Phase II, due to start in September 2003, will most likely involve ACP regional groupings that consider themselves willing to do so. Although no formal agreement has yet emerged, it is easily foreseeable that a certain degree of flexibility will allow Phases I and II to overlap. Beyond the geographical configuration and the structuring of these negotiations, a whole series of challenges remain in terms of preparing the countries and regions for this phase. It was also agreed to maintain an all-ACP co-ordination mechanism during the entire process of the negotiations so as to ensure *inter alia* the reviews of the negotiations.

The EPA negotiations: A Caribbean perspective

The negotiation of an EPA provides a number of serious challenges to the region. A first issue relates to the nature of the CARIFORUM economic space. The Caribbean Forum of ACP states (CARIFORUM) includes 14 members of a regional integration movement – the Caribbean Community (CARICOM) plus the Dominican Republic and Cuba. This political group was created in 1992 in order to interact with the European Commission (EC) as an interlocutor at the regional level, especially for co-ordinating European aid under the European Development Fund (EDF). The geographical configuration adopted for a Caribbean EPA with the EU coincides with CARIFORUM, except for Cuba.[12]

However, this configuration is not without problems. Although the Dominican Republic (DR) has signed an FTA with CARICOM, what is the economic logic of two constituent parties to an FTA (DR and CARICOM) granting the EU (a block of industrialised countries) a level of market access that they themselves do not grant each other? Of course, the same argument applies to the Bahamas – a member of CARICOM, but not party to either the CARICOM Single Market and Economy (CSME) or its Common External Tariff (CET).[13]

Another difficulty of configuration stems from by the status of Haiti. As an LDC, this CARICOM member automatically benefits from the duty- and quota-free provisions of the EU's EBA initiative. Haiti, therefore, has the choice of (a) opting out from negotiating a Caribbean-based EPA and therefore relying solely on unilateral market access provisions, or (b) joining CARIFORUM in EPA negotiations with the obvious price of granting the EC reciprocal and preferential access to its market.

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 $15,000 in 2000, compared with $510 for Haiti. Even if Haiti opts out of EPA negotiations, a non-LDC – Guyana – records the region's second lowest per capita income of $760. By any standard, national economies within the Caribbean are by definition small. But even here wide variance can be detected, with the Dominican Republic posting the region's highest GDP of $19.7 billion in 2000 while at the other pole of the gamut, St. Kitts' GDP stood at $310 million.

In fact, EPA negotiations challenge the Caribbean to formulate policy positions on a bundle of issues. By way of illustration, key subject areas include the adjustment costs of both granting the EC reciprocal-market access and re-aligning the

region's economies to capitalise on any enhanced market access EPA might deliver; synchronising EPA and DDA negotiations to address offensive interests such as EU domestic support on its agricultural exports, Mode IV and addressing preference erosion; approaches to market access liberalisation including the computation of substantially all trade and length of the transitional period; and securing EU support to advance the CARIFORUM regional integration process in the areas of regulatory capacity, private sector development via competitiveness and innovation schemes and access to low-cost investment capital.

The reform of the CAP initiated by Agenda 2000 involves a shift from price support to direct payment to farmers. This is consistent with the WTO Agreement on Agriculture demanding a decoupling of the link between state financial support and export volume. One of the results of this policy switch is a marked fall in the price of EU agricultural products. CAP reform dents the economic rationale for Caribbean farmers to export to the EU.

The marked erosion of preferences as a result of most-favoured nation (MFN) liberalisation compounds both the decline in prices and the plethora of trade agreements signed between the EU and other countries or groupings. This development is consistent with the trend of the marked decline in agricultural commodity prices over the last 25 years. The economic importance of agriculture extends far beyond trade concerns, it compels Caribbean trade negotiators to greet with caution any proposal that further erodes the value of preferences in major sectors of the regional economy. This consideration must be balanced by the fact that the presence of the CAP not only generates above-world-market prices, but also thanks to reciprocity, poses an even greater threat to the region's domestic producers. EU milk powder dumped in the Dominican Republic provides the most recent proof of the trade distortion impact of the CAP on ACP producers.

Another major issue thrown at the Caribbean by EPA negotiations is that of the cost of granting the EU enhanced access to the region's market (yet another euphemism – offering reciprocity). According to the *2001 Annual Report* of the Eastern Caribbean Central Bank, border taxes as a share of recurrent fiscal revenues in six OECS countries' area during that year of review were: Antigua (66.1%), Dominica (54.8%), Grenada (61.2%), St. Kitts (50.7%), St. Lucia (55.4%) and St. Vincent (50.2%). The policy options facing the loss of a source accounting for greater than one-half of all fiscal receipts are rather limited. Obviously, the value-added tax (VAT) is an option – either introducing it or hiking its rate. However, this potential course of action comes with a hefty political, economic and administrative price tag.

Admittedly, the granting of reciprocity is muted by the fact that the EU is not the major source of imports. However, the Caribbean is party to two other processes – one multilateral WTO and the other hemispheric FTAA – that threaten traditional sources of fiscal revenues. The cost of reciprocity goes far beyond the loss of fiscal revenue. Granting the EU 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, both retraining workers and instituting appropriate anti-dumping and safeguard measures, while required, 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.

The Cotonou Agreement, as well as the EU Negotiating Directive, foresees opportunities of SDTs in accordance to meet development concerns of the ACP economies. What are the elements of SDT that the region clamours for? The roster includes asymmetric obligations to trade liberalisation with respect to product coverage, length of the transitional period and definition of substantive trade. But in view of the special difficulties encountered by the Caribbean economies, which are all small islands, and their respective level of development, a flexible and comprehensive approach will be required.

To complete this brief review of some of the main issues under EPA negotiations, it is important to stress that the Caribbean has also to ensure the coherence of their approach to EPA with other trade negotiations. Progress on the development agenda of the Doha Round will obviously impact on

EPA negotiations. Agriculture, SDT, market access, services, trade-related (Singapore) issues, revision of WTO rules (in particular GATT Article XXIV on regional integration), all represent issues where the multilateral forum will have significant spillovers into the bilateral negotiations with the EU.

The FTAA process – in which the Caribbean has a major interest – has slid into a bout of protracted hibernation. Sequencing of the three theatres of negotiations forms yet another important challenge to the region. The MFN provision embedded in Article 5 Annex V of the Cotonou Agreement compels Caribbean countries to automatically grant to the EU market access concessions similar to those conferred on non-developing countries within the FTAA process – Canada and the US. The earnestness attached to this legal provision by the EC is borne out by a similar reference in its EU mandate (3.2), namely:

> *Notwithstanding the above, 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 provision compatible with WTO requirements.*

More work needs to be done on determining whether the wording in Cotonou makes it mandatory to automatically confer to the EU MFN treatment granted to other developed countries beyond market access concessions. What remains clear, however, is that the importance of the FTAA negotiations assumes even greater relevance to the Caribbean. The sequencing of negotiations does not assist in allying some of the fears within the region. With the current stalemate in the FTAA talks, the issue of MFN provision of both the FTAA and CA has created even further uncertainty.

The CARIFORUM–EC EPA negotiation process[14]

CARIFORUM–EC EPA negotiation principles

The CARIFORUM–EC negotiations for an EPA shall be based on the following principles, which are enshrined in a plan and schedule agreed on April 16, 2004.

Above all, the CARIFORUM–EC EPA shall be conceived as an instrument for development which is forged within the broader context of the ACP–EU Partnership and which is to be consistent and complementary with the Cotonou Agreement's goals and principles. It means that the EPA shall be mutually reinforcing and supportive of the Cotonou' political dimensions and development cooperation strategies, and so contribute to the global objectives of sustainable development, smooth and gradual integration into the world economy, and poverty eradication in the Caribbean countries. The EPA shall promote sustained growth, increase production and supply capacities, foster economic structural transformation and diversification, and support regional integration in a way that is consistent with CARIFORUM countries and regional groupings' development policy objectives and strategies.

In order to achieve these goals, due consideration shall be given to the economic, social, environmental and structural constraints of the Caribbean country or region concerned as well as to their capacity to adapt their economies to the EPA process. During the preparatory period of the negotiations, capacity-building measures will be implemented, notably to enhance competitiveness, modernise infrastructures, foster supply capacity and strengthen regional integration processes in the CARIFORUM region.

A fundamental negotiation principle is that the CARIFORUM–EC EPA shall build upon and support the Caribbean regional integration process. It concerns mainly the completion of the CSME scheduled for 2005 but also the accelerated implementation of the CARICOM and the Dominican Republic FTA. This emphasis on regional integration and market consolidation shall precede the bilateral trade liberalisation aspects of the negotiations.

Another crucial negotiation principle is the need for differentiation, flexibility and asymmetry among individual Caribbean countries. Special and Differential Treatment (SDT) which is not limited to longer transitional periods and technical assis-

tance and which may go beyond WTO rules shall be granted according to the differences in size, vulnerability and levels of development among the various Caribbean economies. The CARIFORUM–EC EPA shall be flexible enough to allow individual countries to calibrate the pattern and schedule of implementation considering their national circumstances and constraints. In that respect, special attention shall be paid to the case of Haiti, which is the only United Nations-recognised least-developed country in the region.

Among other principles of the negotiations figure the need for WTO compatibility, the move from a preferential to a reciprocal trade regime, and the incorporation and improvement of the Lomé/ Cotonou *acquis* regarding the access to the EU market for the Caribbean countries.

CARIFORUM negotiation structure

In preparing for the first negotiating session encounter with the European Commission, CARIFORUM ministers earlier agreed to both the region's negotiating structure and the phasing of EPA negotiations. Three tiers of negotiations were identified – ministerial, principal negotiator, and subject-specific technical experts. At the ministerial level, Dame Billie Miller of Barbados is the region's lead ministerial spokesperson. Supporting senior minister Miller is a troika comprised of ministers from the Dominican Republic, Saint Lucia and Belize. The director-general of the Caribbean Regional Negotiating Machinery (CRNM) assumes the role of the region's principal negotiator (see Box 1), while the technical experts will negotiate at the third and subject-specific tier.

Box 1. The Caribbean Regional Negotiating Machinery

Facing a continuously expanding agenda of trade negotiations, the CARICOM members states set the Regional Negotiating Machinery (RNM) in 1997. The RNM was mandated to enhance both co-ordination and execution of external trade negotiations, with a view to fostering a coherent regional standpoint in the various talks. It provides services that include research, consultancy, negotiations, training, communications and the mobilisation of technical assistance.

Structure and funding: The core budgetary resources of RNM are funded by the CARICOM members' states, but programme funding comes from bilateral donors (mainly CIDA, CDB, IDB, DFID and USAID). Operating from offices in Jamaica and Barbados, the RNM is a small organisation, currently working with 10 professional staff members, which are supported by call-down experts and at times voluntarily by specialists from the member states. Overseas, the RNM has representation in Brussels. Offices in Washington, Geneva and London have closed down thanks to a combination of a lack of funding and organisational restructuring.

Mode of operation: In principle, the RNM is responsible for international negotiations (FTAA, WTO, EPAs), whereas the CARICOM Secretariat (CS) manages the internal aspects of economic regional integration. In the preparatory phase for negotiations, the RNM is to engage in continuous consultation with the member states' ministers by means of developing strategies, position papers, reports and briefs. With the private sector and civil society, a communication structure has been set up, facilitating general briefing reports as well as specialised consultation meetings with sectoral interest groups.

Strengths and weaknesses: The strengths of the RNM primarily lie in its cost-effectiveness. It generates various opportunities to pool resources in terms of financial means and expertise. Member states benefit from the RNM by a reduction of their own workload, financial savings and access to data, documentation and expertise. A current weakness is that its status within CARICOM, in particular its relation to the CS and the national ministers, is unclear. A private sector advisor is now on board with plans to form a Private Sector Advisory Council.

Source: Solignac Lecompte (2001)

At first glance, the CARIFORUM negotiating structure mirrors that applied in the FTAA. Both negotiating arenas embrace three tiers of negotiations, with a lead ministerial spokesperson, the CRNM as the principal negotiator, and a 'college of negotiators' grouping the technical experts. However, the structure for EPAs differs from the FTAA in a number of respects. First, the inclusion of the Dominican Republic reflects the CARIFORUM configuration, as opposed to the FTAA where CARICOM negotiates on its own accord. Second, the EPA's accent on supporting the regional integration process is reflected in the central role of the regional integration secretariats (from the CARICOM and the Organisation of Eastern Caribbean States (OECS)) are expected to play in negotiations with the EC. Third, the formal negotiating structure will be shadowed by the Regional Preparatory Task Force (RPTF). This body, manned by national and regional authorizing officers (NAOs and RAOs) along with representatives of regional secretariats, non-state actors (NSAs) and universities, will act as a nexus between the EPA negotiations and the development support component of Cotonou. Fourthly, the complementarity of the three pillars (trade, development and political dimensions) of the Cotonou Agreement is signalled by the appointment of the Barbadian Ambassador in Brussels as the vice-dean of the EPA college of negotiators.

Assigning the post of the principal negotiator to the CRNM is fuelled by the recognition of two facts, (a) the highly technical nature of these negotiations (not only in terms of the scope and complexity of modern trade negotiations, but also the incorporation of trade liberalisation commitments on the part of the Caribbean) and (b) the imperative of achieving coherence in all spheres of the region's trade negotiations. The same rationale applies to the formation of the EPA college of negotiators whose members should stem mainly from CARICOM technical experts drawn heavily from the FTAA process and complemented by their counterparts from the Dominican Republic. This group of technical experts, headed by the principal negotiator, will be mandated to provide the technical oversight of horizontal issues emerging during the EPA negotiations. It would have been incongruent if the region did not avail itself of services of technical experts who have worked on 'new generation' trade agreements such as the FTAA. The institutional mechanism of the EPA college allows the Caribbean to draw on the most technically competent and tested negotiators while facilitating coherence across negotiating arenas.

Participation by CARIFORUM member states

CARIFORUM countries members were understandably and correctly insistent on the imperative of maintaining all elements of the negotiating structure open to all member states. For example, although a cluster of entities has been identified as the core members of the RPTF, all CARIFORUM countries are open to participate in all deliberations, if they deem so necessary. Caribbean member states are bent on exercising their sovereign right to participate in all tiers of the regional negotiating structure mainly in recognition of the gravity of the upcoming negotiations with the EC. Concerns about the loss of fiscal revenue, erosion of tariff preferences and the impact of enhanced access to European exporters on domestic production and employment exercise the minds of policymakers. Adding to the zeal of member states to participate in the negotiations at the front seat is the fact that CARIFORUM is not a customs union with delegated supranational secretariat. All member states assume the legal responsibilities of any agreement negotiated with the EU.

In terms of co-ordination of policy mandates and signing off on agreements, CARIFORUM has developed a regional structure with clear reporting mechanisms. The lead ministerial spokesperson on EPA will report regularly to the Prime Ministerial Sub-Committee (PMSC) on External Negotiations and the Conference on Heads of Governments – the body with final political oversight for the negotiations. Ministers meeting regularly at the Council on Trade and Economic Development (COTED) can issue recommendations to negotiators. The principal negotiator is also required to provide regular reports on the state of negotiations to both the PMSC on External Negotiations and COTED. The region's technical positions in the negotiations are

defined at meetings of the Technical Working Groups (TWGs). These TWGs comprise officials and experts from all CARIFORUM member states, regional secretariats, non-state actors and the RNM. In addition to the EPA specific TWG, the region has benefited from subject-specific TWGs, e.g. on market access, agriculture, services and intellectual property.

The CRNM has committed itself to actively support the formation of a CARIFORUM NSA Forum on EPAs. The emergence of such a body could provide a platform for the region's stakeholders to both consult and channel their views into the negotiations. The consultative process with NSAs would not be limited to the establishment of the Forum. Private sector groupings, trade unions and NGOs also actively participate in the meetings of the various TWGs along with the appropriate bodies of CARICOM. In Kingston, both CARIFORUM and the EC agreed to further channel NSAs input into the negotiations via the Sustainable Impact Assessment (SIA) studies. The legitimacy of EPAs would be undermined if the region's stakeholders were robbed of an opportunity to voice their legitimate concerns and bring their considerable experience to bear on the negotiations. In addition, Caribbean NSAs have amassed considerable experience in trade negotiations and are therefore well placed to contribute to the negotiation exercise.

Negotiations in four phases

At the first ministerial working session, both CARIFORUM and the EC agreed on four distinct phases of negotiations:

1. Initial phase: Establishing the priorities of the EPA negotiations (from April to September 2004)
2. Second phase: Convergence on strategic approach to CARIFORUM regional integration (from September 2004 to September 2005)
3. Third phase: Structuring and consolidating of EPA negotiations (from September 2005 to December 2006)
4. Final phase: Finalisation (from December 2006 to December 2007)

The four phases can be collapsed into two distinct periods, that is (a) a period of identifying the priorities of CARIFORUM regional integration and the requisite support measures and (b) the trade liberalisation period. From the perspective of the Caribbean, the phasing of the negotiations into these two distinct clusters is both logical and commonsensical. The form of CARIFORUM regional integration remains undefined and must be implemented before market access concessions can be granted. Furthermore, the WTO defines the base arrangements on preferences, RTAs, subsidies and services. CARIFORUM member states remain cognisant of the imperative of first establishing the institutional architecture of the multilateral trading system before assuming market access commitments within the ambit of EPA negotiations. All CARIFORUM members with the notable exception of the Dominican Republic are members of the CARICOM. The Caribbean's premier project in terms of regional integration remains the completion of the CARICOM Single Market and Economy (CSME) by 2005. Once fully implemented, CSME will facilitate the emergence of a contiguous and single economic space facilitating the free movement of goods services, capital, and – with notable exceptions – of people.

Both parties to EPA negotiations agree that EPAs should support the regional integration process as defined by CARIFORUM. The orientation of the CSME has been well defined and its full implementation is being accelerated, even if the schedule date of completion might be delayed. The negotiation of an EPA gives the region its own internal platform of addressing the derogations granted to the Bahamas (permanent) and Haiti (temporary). The Caribbean project of regional integration transcends the CSME. The nature of regional integration between CARICOM and the Dominican Republic remains a political and technical challenge. In addressing this issue, the region can be guided by the CARIFORUM Regional Integration Development Strategy, Annex IV of the 9th Caribbean Regional Indicative Programme (RIP). The CARICOM– Dominican Republic FTA is yet another policy plank on which CARIFORUM can build. The review of the agreement, slated to be

conducted later this year, provides an opportunity for the economic relations between the two sides to be upgraded (for example, negotiating the provisions on services) or superseded by an EPA.

All ACP dimension

The start of CARIFORUM– EC negotiations of an EPA does not obviate the need to retain an all–ACP structure. To the contrary, the launch of regional negotiations in the four ACP regions strengthens the case for increased intra-ACP collaboration. In pursuit of this objective, the Caribbean has championed a proposal aimed at developing the ACP Follow-Up Group (FUG). At its inaugural meeting in January 2004, the Caribbean tabled proposals to show how this entity could become a vehicle for the articulation of common ACP positions. The Caribbean anticipates that after a period of reflection, ACP member states with understandable reservations will recognise that the FUG is an advisory body and therefore acts in manner that would not seek to undermine the sovereign decision of any ACP region.

In terms of the continuation of the all-ACP process, the Troika of ACP ambassadors and a senior European Commission official have held initial discussions on dispute-settlement mechanisms and non-execution clauses. On both issues, all ACP member states and regions have voiced their concern about the EU stance. Take the example of the EU insistence that a non-execution clause not only forms an indelible element of an EPA but in case of an infringement by a member state of an ACP region, the sanctions apply to all members of that region. The ACP has firm reservations about the need to insert such a clause in a trade agreement. Furthermore, even if an agreement could be struck on inserting a non-execution clause into an EPA, why should the entire ACP region be punished for the actions of one of its members? The strength of the ACP position attests to the need to retain mechanisms through which the solidarity and unity of the group can be manifestly expressed.

A final testimony of the vibrancy of intra-ACP collaboration has been the informal exchange among ACP regional organisations and member states. The Caribbean has benefited tremendously from the technical and strategic work of other ACP regions. The pooling and sharing of technical studies and policy considerations among ACP regions has greatly contributed to CARIFORUM's willingness to assume the challenges of EPA negotiations.

Conclusion: In search of complementarity and consistency

In light of the vulnerability of the Caribbean region, one of the myriad of challenges posed by the EPA negotiations will be how to ensure that the EU delivers its commitment that these new trading arrangements will enhance market access conditions currently provided under the Cotonou Agreement.[15] A further challenge is to convince the EU that consistent with the provisions of the Cotonou Agreement Article 39(2), both parties must work within the World Trade Organization (WTO) on a common set of objectives. Major concerns relate to whether the provision on regional trade agreements (GATT Article XXIV) affords sufficient flexibility for development concerns such as special and differential treatment mechanisms, in particular to small and vulnerable states, and the grandfathering of existing trade preferences.

Another of the stern challenges facing the Caribbean during EPA negotiations is how to effect the complementarity of trade, development support and political dimensions that define the Cotonou process. In numerous and recent policy documents, the EU has underscored the need for trade and development co-operation to be viewed as complementary to each other, consistent with Article 18 of the Cotonou Agreement. The Europeans have even gone so far as recognising that trade measures must be supported by adequate development support measures if ACP countries are to experience sustainable development.[16] Although EPAs and the discussions on a successor arrangement to the 9th European Development Funds (EDF) represent two distinct institutional settings, it remains a strategic imperative that these two processes are twinned. EPAs might be a trade agreement but they must be viewed from the Caribbean's developmental prism. The region's negotiating structure attempts to take

cognisance of this strategic link between trade and development co-operation via a negotiation structure that embraces both trade negotiators and development finance experts.

Endnotes

1. Whether or not this was done at the expense of other trading partners is another question.
2. The 15 CARICOM members are Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago. The Bahamas acceded to the Treaty of Chaguaramas in 1983 at a time when there was a marked distinction between membership of the Community and the Common Market. The revised Treaty of Chaguaramas has removed that distinction. Haiti's obligations under the CSME are presently the subject of a review.
3. The Agreement was signed on 22 August, 1998 and a Protocol to implement the Agreement was agreed in the middle of 2000.
4. The CARICOM least-developed countries signatories to the Treaty are defined in Article 4 of the Agreement and are: Antigua and Barbuda, Belize, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines.
5. The member states of MERCOSUR are Argentina, Brazil, Paraguay and Uruguay. Chile and Bolivia are associate members.
6. Here, CARICOM member states were heavily influenced by the scheduled completion of the FTAA on the same date. This is one primary example of the need for coherence and consistency both with varying international trade obligations and negotiations, but also between the imperatives of regional integration on the one hand, and international trade policy dimensions on the other.
7. See for example the speech of Carlos Manuel Troncoso, Minister of Foreign Affairs at the 14th CARIFORUM-EC Annual Ministerial Consultations on EDF, Santo Domingo, July 14, 2005.
8. Official information on EBA can be found on the website of the European Commission (DG Trade), http://europa.eu.int/comm/trade/miti/devel/eba.htm. For a discussion, see Hewitt (2001), Ianchovichina et al. (2001), Page and Hewitt (2002), and Stevens and Kennan (2001).
9. See Scollay (2002) for an exposition on the theoretical and operational background of the requirements of reciprocity for compliance with WTO Article XXIV on Regional Trade Arrangements.
10. For a discussion of the WTO-compatibility issue, see Bilal (2002), Davenport (2002), Onguglo and Ito (2002), and Scollay (2002).
11. See the Joint Report of the ACP–EC Second Ministerial on EPAs, October 2, 2003, ACP-EC/NG/NP/43
12. Cuba, although a member of the ACP, is not a signatory to the Cotonou Agreement and as a result not a direct participant in EPA negotiations.
13. The CET provides for CARICOM member states to both operate at differing points within the agreed schedule of tariff reduction, but also apply varying levels of CET based on four product listings. See INTAL (2005), for a survey of the varying applied CET rates for the same product lines and Caribbean Export (2001) and WTO (2000).
14. See Lodge (2004).
15. Para 3.2 of Annex I on EC Directives for the negotiations of EPA with ACP countries and regions, June 17, 2002. www.epawatch.net/ documents/doc71_1.doc
16. 'Trade and Development-Assisting Developing Countries to Benefit from Trade' COM (2002) 513, p. 17. http://europa.eu.int/comm/trade/issues/ global/development/pr180902.htm

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A Development Agenda for the Economic Partnership Agreement between the EU and the Pacific ACP (PACP): A Concept Paper

Roman Grynberg and Bonapas Onguglo

Background

Under the trade provisions of the Cotonou agreement the EU and the ACP have agreed to enter into negotiations on a WTO-compatible trade regime no later than September 2002.[1] The precise configuration of the partnership agreement remains to be determined. There remains within the ACP group a strong view that the partnership or at least significant elements of the trade agreements should be negotiated on an ACP-wide basis. The preferred position of the EU has been for the negotiation of regional economic partnership agreements in the various sub-regions of the ACP where members feel they wish to proceed with a GATT Article-XXIV-compatible free trade agreement. In 1999, at a seminar on the future of the ACP–EU trade relationship in Suva the EU indicated its willingness to enter into a regional economic partnership agreement with the Pacific ACP states.[2] The Pacific ACP states have, at ministerial level, indicated their willingness to consider such an approach.[3] No substantive decision to negotiate has been made by either parties.

This chapter begins from the premise that the EU and the Pacific ACP countries, in whole or in part, will opt to negotiate an economic partnership agreement that includes, among other things, a free trade area agreement as broadly envisaged by the EU in its most recent pronouncement on the subject. Thus the paper begins having assumed that the process between the present and the decisions that will ultimately be made by September 2002. This paper focuses upon additional modalities within the context of the partnership agreement and already specified in the Cotonou Agreement that can be employed to further enhance the development process in the Pacific islands region while simultaneously being advantageous to the trading interests of the European Union.

The chapter begins by considering several issues pertaining to the technical feasibility and economic desirability of an FTA between the EU and the Pacific ACP countries. The second section considers the salient features of the Pacific ACP economies and how WTO-compatible trade agreements may help overcome barriers to investment in sectors where the Pacific ACP states have an actual or potential commercial advantage.

The technical feasibility of an FTA between the EU and the PACP

At present GATT 1994 Article XXIV(8) remains vague as to the definition of what constitutes 'substantially all trade'.[4] Despite negotiations to clarify such matters during the Uruguay Round, contracting parties were at the time unable to reach a consensus on the precise definition of what constitutes 'substantially all trade,[5] although they have established a maximum ten-year transition period for interim arrangements. Despite the agreement by WTO members at Doha[6] to negotiate further disciplines in the area there is no reason to believe that there will be a greater consensus in the present round than there was during the Uruguay Round. However the decision to negotiate such disciplines creates further uncertainty as to the WTO compatibility of such a trading arrangement. These negotiations, despite their hypothetical time limits, will extend throughout much of the decade and create an atmosphere of uncertainty around the EU–ACP partnership negotiations. Without appropriate 'grandfathering' or special and differential provi-

sions for North–South FTAs the WTO Article XXIV negotiations may undermine the efforts of the parties to the Cotonou Agreement to negotiate with the WTO.

The EU has proposed in its intervention what has commonly become known as the 'South African Formula' to assure WTO compatibility of an FTA, that is 90% of bilateral trade.[7] Such a formula is of questionable technical viability as, of the 14 Pacific ACP states, five are least developed and, given the implementation of the EU's 'Everything But Arms' proposal for LDCs, would gain no economic benefit in liberalising towards the European Union as duty-free and quota-free access to that market is already guaranteed.[8] The six new PACP countries[9] that joined the ACP group in 2001 have virtually no trading relationship with the EU, and hence it would be impossible to define a stable and consistent schedule of concessions based on the South African formula. Only three developing PACP countries, PNG, Fiji and Tonga could benefit from an FTA and have a trading relationship where a schedule of concessions could technically be defined. In the case of Tonga the trading relationship is characterised by very small volumes of imports and volatile annual shifts in the composition of imports from the EU, which is typical of an immature trading relationship and hence not normally conducive to a free trade agreement, which is normally the end product of a mature and highly developed trading relationship. This leaves only PNG and Fiji as two economies that could technically define a schedule of concessions though even in these relatively mature economies this technically remains problematic.[10]

Thus far the paper has not considered the economic desirability of such a WTO trading arrangement between the EU and the ACP. Unlike any of the other ACP regions the Pacific has a far more complex series of historical links with the former metropolitan powers than either Africa or the Caribbean, and as a result a series of explicit and implicit MFN trading obligations exist between the PACP and Australia and New Zealand and between the former US Trust territories and the USA under the Compact of Free Association.[11] This would mean that even should an FTA with the EU be deemed to be economically or politically beneficial to Pacific island countries, the economic cost of the adjustment, induced by a *de jure* extension of tariff preferences to other and much more significant trading partners than the EU, would necessitate a wholesale reform of the taxation system. In Melanesia, where significant import-substituting industries exist this would also involve wholesale economic reform. Thus agreeing to an FTA with the EU will invoke a series of legal obligations that will ultimately result in the complete abandonment of tariffs as a source of revenue and industry protection.

It remains the subject of further analysis and investigation but it would not be imprudent to suggest that there may be some PACP countries that have a strong defensive trade interest in their existing market-access arrangements into the EU. This is certainly true of Fiji and PNG where canned tuna exports remain dependent upon the 24% nominal margin of trade preference into the EU market.[12] Also Fiji has a very substantial interest in its sugar quota under the Sugar Protocol. However, while an FTA with the EU will constitute a defence against an GATT Article I violation, it will not constitute a defence against an Article XI or Articled XIII.2 violation,[13] which is the most likely point of attack on the EU quota regime. Moreover, the introduction of the EU's Everything But Arms proposal will mean an elimination of much of the benefits of the Sugar Protocol by 2009.

The Cotonou Agreement and the Pacific ACP economies

One of the greatest strengths of the Cotonou agreement and its Lomé predecessor has been its explicit recognition of the breadth of the constraints to the development faced by ACP states. It was this strength that was simultaneously one of its greatest weaknesses because it rendered the resources of the European Development Fund available under the Lomé Convention subject to capture by a wide range of domestic interests in ACP countries as well as within the EU. These interests were often wholly legitimate as they addressed one of the many pressing development problems confronting the ACP states. However, what this meant was that the

scarce resources of the European Development Fund were frequently dissipated in addressing development problems that could never be addressed in a sustainable and long-term manner without economic growth. The Cotonou Agreement constitutes a quantitative shift in thinking in that it attempts to focus on the twin problems of the establishment of an appropriate environment for investing in and assisting the private sector.[14] Regrettably, Cotonou is stronger on the former than it is on the latter. Implicitly the problematic raised by the EU in the lead up to Cotonou recognised that without economic growth stimulated by private investment Cotonou, or even government-funded projects which address legitimate and pressing social concerns, would ultimately prove unsustainable.

The Cotonou agreement contains numerous improvements over the Lomé Convention and attempts to sharpen the focus on economic governance and the development of the private sector. These efforts are wholly commendable. Unfortunately the new agreement has not closed the possibility of once again dissipating the scarce EDF resources on the multiplicity of legitimate and simultaneously 'aid- efficient' projects that have been the hallmark of funding until the 8th EDF. Using the 9th EDF to build more hospitals, roads and bridges cannot possibly be opposed as they invariably address burning social needs but this will not resolve the issue at the heart of the 'Cotonou problematic', which is addressing the question of private sector development. As we shall argue, this was unnecessary in the minds of the architects of Cotonou because private investment would respond to an appropriate environment, so little further intervention was necessary. While the Lomé instruments of private sector assistance were reformed in Cotonou, e.g. through the creation of the Centre for the Development of Enterprise (CDE), others such as the EIB interventions will, at least nominally, provide even less direct assistance to the private sector.[15] The implicit logic of Cotonou is that beyond technical assistance in creating the right economic and political environment, the use of scarce development resources for promoting private investment in ACP countries is largely unnecessary. 'Build a stable and economically well-governed and market-friendly environment and the investors will come' is the implied logic behind Cotonou interventions in the development of the private sector, as it was behind much of the thinking of the architects of the global post-cold war economic context.

The authors do not dispute the need for the creation of an environment that is well governed and politically stable with market-friendly institutions. This is undoubtedly a necessary condition for attracting investment. However, what can be disputed is the implication that this a sufficient condition to attract foreign or even domestic investment in the PACP countries, which are characterised by small isolated and physically dispersed islands with their inherently high cost structure. In a globalised economy with greatly diminished trade barriers the international investor has a world of possible locations for their investments. The Pacific islands regrettably do not rank high on the list of possible locations for most investors. This is true even in cases like Samoa or Kiribati where the international community recognises that economic management has been excellent.

The economic partnership agreement should therefore be seen by the PACP as an opportunity to focus the instruments already in the Cotonou agreement on the particular problems of trade and private sector development of the PACP, which is one of the most challenging commercial environments. In the past the Pacific has suffered from marginalisation within the ACP, overshadowed by the larger concerns of Africa, which as the EU's immediate neighbour has been the principle focus of its concerns and interventions. Thus the upcoming negotiations should be seen as an opportunity to correct a historical imbalance in PACP–EU trade relations.

Elements of a mutually advantageous partnership agreement

Before commencing any analysis of a development agenda for a regional EPA (or REPA) in the Pacific it is useful to recall that partnership must necessarily be mutually advantageous and ask what could possibly be of trade and investment interest to the EU in the PACP states. Agriculture has in the past been the main trade interest of the EU in the ACP coun-

tries in general. However, it is of greatly diminished EU trade interest as its policy no longer focuses on sources of supply of raw materials as it did in the 1970s and early 1980s. It is only the capture fisheries that the EU continues to have an interest in ongoing access to natural resources. By and large the EU trade focus has shifted towards access for exports and EU investment. Thus there exist only two sectors where the Pacific could constitute a possible destination for EU investments, and this is in tourism and fisheries.

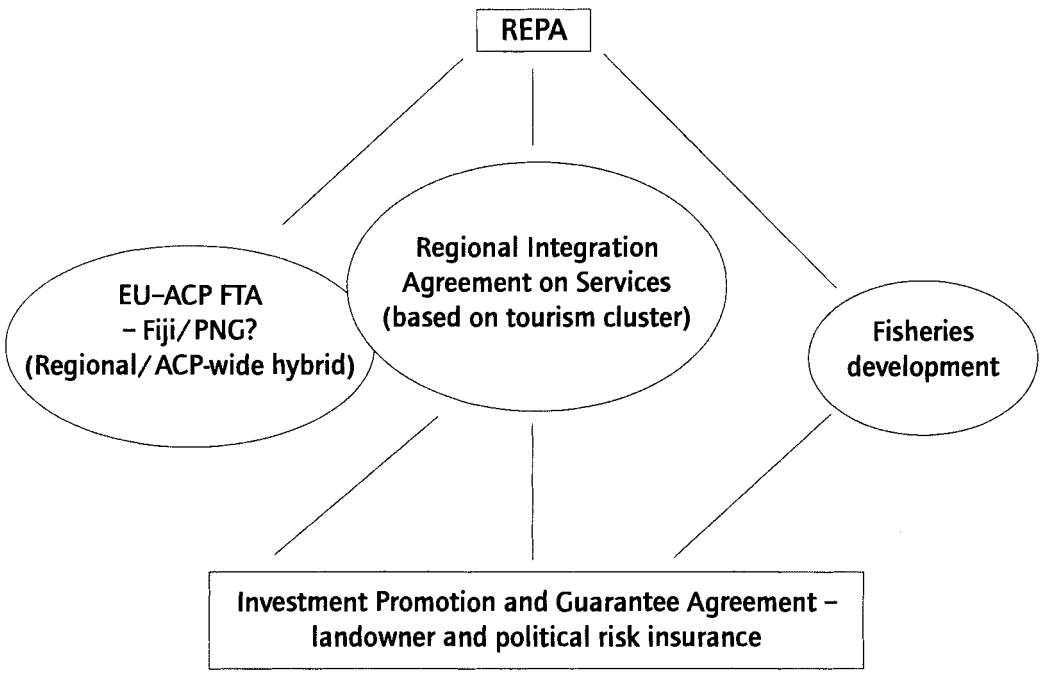
The Pacific remains one of the few regions where the tuna stocks are not in overall decline. Recently the EU distant-water fishing fleet increased its commercial presence in the region. Tourism also remains an area of potential interest where little service trade currently occurs between the EU and the PACP but there remains a considerable presence of EU firms in the sector in the French DOMs in the Pacific. Several PACP countries have attempted to induce EU tourism investors into the region with limited success. What follows explores instruments that would increase EU trade and investment interest in the region. Entering into a regional arrangement with the EU on services would provide a guarantee of openness in tourism and related services. Such a commitment would enhance the viability of EU investment in the tourism sector in the region as it would provide a guarantee of market access. Fisheries and tourism are the two sectors where the Pacific ACP either has a commercial advantage or could develop one with appropriate interventions. Fortunately both these sectors are of trade and commercial interest to virtually all PACP countries.

What is proposed in the organogram below is an architecture for a partnership agreement with the EU that focuses on key areas of mutual interest between the EU and the Pacific. It also develops a investment promotion and guarantee arrangement that focuses on the actual problems confronted by investors in the Pacific islands. The proposal is in line with various provisions already in the Cotonou Agreement and simply aims to operationalise the specific provisions that the Cotonou Agreement has for LDCs and small island states.[16]

The structure and rationale of the proposed PACP–EU Partnership

The REPA

If the PACP countries wish to negotiate trade arrangements on a range of issues, not just an FTA in goods, there will be a need for a much broader umbrella agreement that will guide the arrange-



ments in goods and in other areas. The umbrella agreement would by necessity be preambular in nature and set out the broad principles and parameters of the trade and development arrangement that would govern relations between the Pacific and the EU. An umbrella agreement could contain:

- commitments to the sustainable development of the region;
- broad developed-country MFN obligations;
- an agreement to review and extend the relationship in light of the emerging agreements between the PACP countries and the French DOMs in the region; and
- subsidiary agreements pursuant to the umbrella would be entered into when PACP felt that their economy was ready for such an arrangement.

FTA

The configuration of the FTA between the EU and ACP countries remains to be determined. However, for the moment ACP states in their preparation for negotiations with the EU have focused only on the trade in goods. Several ACP countries, especially in West Africa, have already expressed a preference, at least at official level, for a regional economic partnership arrangement, and this regional approach is supported by the EU. Mauritius has proposed an ACP-wide EPA with the EU. What appears possible is a hybrid architecture where several components of the agreement may be negotiated ACP-wide such as commodity agreements or perhaps rules of origin members The precise configuration of this FTA as it pertains to the PACP remains to be determined but it is evident that few, if any of the PACP countries will find the arrangement either technically or economically feasible. Only the trade relationship between PNG and Fiji and the EU appears developed enough that an FTA is technically feasible.

A regional integration agreement in services

The reality of the PACP economies is that tourism remains one of the main sectors of export-oriented economic activity in several countries including the Cook Islands, Fiji, Samoa, Federated States of Micronesia, Vanuatu and Palau. In the PACP region the service sector is relatively open. PACP WTO members will be asked to make market-access commitments in the sector in the current round of service negotiations, and hence PACP obligations may not be onerous and because there is no MFN obligation on services do not have to be extended to the USA or Australia and New Zealand. At present all three PACP states that are members of the WTO have made market-opening commitments in tourism services in the Uruguay Round. However, what is proposed in the draft annex on tourism currently before the WTO is market-opening commitments in a wide range of tourism-related services. What is being proposed is a 'cluster' approach to liberalisation.[17] What can be offered, following a thorough feasibility study, would be a WTO-plus commitment that would give strong commitments to market access for EU service providers and thereby decrease some of the perceived risks of investment in the Pacific tourism sector. Negotiations on services are also foreseen in the Cotonou agreement.[18]

A services agreement compatible with GATS Article V cannot simply be predicated upon PACP market-access commitments if it is to result in investment being attracted in a high-cost region such as the PACP. If such market-access commitments were all that were required to assure investment in the sector these no doubt would have been made already by the PACP. The development of tourism as a key sector of development of the region involves an agreement which focuses upon:

- what is needed is stimuli to investment for EU investors in the sector;
- commitments by the EU to strengthen training and experience of staff; and
- marketing of the region as well as 'product' and infrastructure development.

Thus a developmental component of the regional agreement is required that would act as a special and differential commitment. Funding of the development component will be discussed in the subsequent sections of the paper but funding will have to come from the regional indicative programme of the 9th EDF.

However an FTA consistent with Article V implies an exchange of reciprocal obligations, which raises the serious issue of what meaningful reciprocal obligations the EU would undertake in such an arrangement. The PACP only export tourism and financial services, but also relatively large quantities of unskilled and semi-skilled labour. Given that PACP services firms are highly unlikely to seek market access, EU commitments could be based on 'GATS MFN plus standstill on existing Mode 4'. In the case of Kiribati and Tuvalu, for example, the single greatest source of foreign exchange has been remittances from nationals working on EU vessels. This has been an ongoing and mutually advantageous arrangement which is offshore by nature and therefore raises few immigration concerns in the EU. Market-access commitments on Mode 4 that are outside the context of corporate intermediation would not be politically acceptable to the EU. However arrangements similar to those that operate in formal arrangements between German shipping companies and Kiribati and Tuvalu with only limited immigration concerns could be developed with EU fishing fleets and tourism plant operators in the EU and abroad. These provisions could be developed within an exchange of obligations in a services agreement.

As the PACP has an interest in the opening of tourism *per se*, this should be seen as a benefit and not a cost. However the following options could be considered in an EU offer:

- a standstill on existing market-access provisions in marine shipping; and
- commitments to further expansion of on-the-job training and work experience in other key sectors such as fisheries and tourism.

Such programmes could be developed and funded within the context of the regional indicative programme.

A fisheries development framework agreement

One vital component of the development of the trading relationship between the EU and the Pacific ACP region is the development of the region's abundant tuna resource. At present most PACP countries that lie in the tropical convergence zone where large quantities of tuna are to be found do not have the capacity to localise the capture fisheries within their EEZ. It is an objective of all these states but none have the experienced labour force, financial resources or entrepreneurial capacity for localisation, especially in the relatively capital-intensive purse-seine fisheries. There has been some localisation in the long line and pole-and-line tuna fisheries and the domestic prawn fisheries sector has been localised in PNG. For some time to come the principle economic benefit to the PACP region of their tuna resource will be the revenue gained from access fees. Over the last few years the EU distant-water fishing fleet has begun to enter the EEZ of the PACP. At present some 20 purse-seine vessels fish in the EEZ of the PACP region. Fisheries agreements are foreseen in the Cotonou Agreement[19] and have been negotiated on a bilateral basis with countries in the region.

Any agreement between the PACP countries and the EU on fisheries would have to recognise the imminent negotiations of fisheries subsidies disciplines at the WTO.[20] This will mean that much of the assistance provided as subsidies to domestic fleets will be phased out over time. However, in relevant WTO agreements' development assistance is not deemed to be a subsidy and it is assumed that this principle will extend to any future agreement on fisheries subsidies.[21] The formation of a strategic alliance with a resource-rich region such as the PACP that strives to localise fishing operations may assist the EU in facilitating the adjustment of its capture fisheries to a more liberalised trading environment.

The components of a fisheries development framework agreement with the PACP countries could focus on:

- training PACP nationals on EU vessels in the region and outside;
- provide assistance to facilitate the long-term localisation and effective joint ventures in the industry;
- environmental sustainability commitments;

- transparency in bilateral access agreements;
- commitments on the treatment of EU vessels in PACP countries;
- commitments to full compliance with all relevant PACP surveillance provisions including paid observers; and
- provision of concessional assistance to PACP entrepreneurs to assist in the localisation of distant-water purse-seine vessels.

Funding for such a proposal would be largely to national governments and hence a formula approach to the disbursement of resources from the agreement should be agreed. The disbursement should be on the basis of catch levels in the EEZ of particular PACP regions. However, as some of these activities are regional in nature a fixed percentage of the revenues associated with this agreement could be devoted to region-wide fisheries development. Funding could also come from a combination of the regional indicative programme and a levy linked to catch levels.

Investment promotion and protection agreement

The most significant component of the series of agreements that would go into making up a development-oriented partnership between the EU and the PACP would be an investment promotion and protection agreement. Such agreements are not unknown in the PACP[22] are also foreseen in the Cotonou agreement[23] though the form of such an arrangement would of necessity have to confront the specific challenges confronted by investors wishing to invest in the PACP that are quite different from that of any region. Two overarching barriers exist that need to be confronted:

- Perceived landowner risk of investment that stems from the absence of clearly defined freehold or leasehold title to land. While this risk is greatest in Melanesia the effects of the perceived risk have affected threshold rates throughout the PACP. An investment guarantee agreement could also cover issues of sovereign risk associated with the region.
- The PACP, by virtue of its inherent characteristics, has a high cost structure and has witnessed an erosion of the commercial value of trade preferences due to trade liberalisation. In the past trade preferences compensated investors for the inherently high costs. The region has also witnessed the loss of concessional funding for the private sector because development banks, including the EIB, have moved to more and more market orientation.[24] As a result several of the funds that invest in the region such the Kula fund require rates of return greater than 25%. These thresholds are often 10% higher than for similar projects in larger and less isolated economies and reflect the market's perception of those risks.

Thus two separate financial instruments that address the risks of investment and the barriers to promoting investment need to be fully considered and investigated. The first is a fund for covering landowner risk, especially in tourism and agriculture where such risks are major barriers to new investment. Such insurance already exists on the commercial market and its necessity stems from an externality created by the absence of land as a commercial factor and therefore the governments of Melanesia in particular may wish to consider offering such protection to new investors using RIP resources.

There is a need for a second instrument to focus more carefully the new investment facility of the EIB on the needs of the private sector in the region. An analysis of the problems confronting trade and investment in the Pacific must commence from the peculiar predicament that the private investor in the region does not, by and large, face a shortage of loanable funds. Indeed many of the PACP commercial banks in the smaller countries export their surplus loanable funds on a regular basis to their head offices in Australia. What is in short supply in the region is bankable projects at the market rate of interest, gestation, and terms and conditions. The absence of significant concessional funding will mean that the EIB market-based revolving funds will replicate the results of already available commercial funds and may simply act to crowd out private financial institutions. The Kula fund, which takes equity positions, because of the high threshold

rate of returns has invested virtually its entire portfolio in mining projects in PNG and some large projects in Fiji. If the new EIB facility is going to be based solely on market criteria with a revolving fund based on a maximum 3% concession it will likely to replicate the geographic and sectoral concentration of the investment portfolio found in the Kula fund.

To address the real handicaps faced by investors in the region a fund, administered by the EIB and that provides significantly more concessional funds the greater the inherent disadvantage faced by the country is required. Countries such as Kiribati and Tuvalu, which face particular disadvantages stemming from size and location would have access to very highly concessional funding and less concessional funds would be available to larger countries such as PNG and Fiji. Moreover, the value of the concessional component must be passed to the investor and not to the intermediary institution, as was the case under the Lomé Convention. This fund should be administered through local commercial banks as partners (to avoid moral hazard) whose overheads for the administration of such investments would be subsidised by the fund. Without a much more significant concessional component from the EDF than is found in Cotonou, the EIB portfolio in the PACP will almost certainly be concentrated in resource sectors, with a likely crowding out of private sector funds. As the EU is unlikely to reform the EIB facility in any way the PACP themselves may wish to consider the use of their regional indicative programmes to create a fund that would stimulate such investments.

Funding a development agenda

This paper is principally concerned with devising trade and development instruments that will facilitate the development of the private sector of the region. However, while trade agreements can be helpful in providing an appropriate legal and economic environment they are insufficient to ensure the successful stimuli of the private sector in such challenging commercial environments as found in the PACP region. Much of what is proposed above rests upon mobilising the resources of the RIP. Only the fisheries programme is envisaged as having Cotonou-plus resources. The necessity to divert resources from other development projects into directly supporting the private sector must stem from an explicit recognition of two underlying facts by the political leaders in the PACP region. First, the largesse of the EU and even the region's other donors will continue for a finite period and will eventually taper off. Second, that a growing private sector is vital to the long-term development of the region but will not develop without market-friendly assistance from governments and the international community.

Hence without a vibrant private sector development efforts will not be sustainable in the PACP region. The region needs to face the realities constraining investment. Without political and economic stability all interventions by government or the international community are doomed to failure. Here the advice being offered by the international community is, in our opinion, fundamentally correct. However, the presumption underlying this advice is that the economic and political stability is in itself sufficient to attract investment. Outside the resource extraction sectors this assumption is probably incorrect throughout most of the ACP, but is particularly flawed in the Pacific where the combination of smallness, geographic isolation and dispersion of population creates overarching barriers to private investment. Unless instruments are devised to provide incentives to private-sector investment to overcome the inherent cost disadvantages of locating in the Pacific then the Pacific ACP region faces a future of stagnant or declining real per capita incomes.

Using the resources of the RIP to attract investment into sectors where the region has a comparative advantage is the most sustainable use of those resources in the long term as it will ensure the growth of income that sustains the region's development effort. Moreover, using those resources in this way would constitute a powerful signal to the international community that the Pacific itself is willing to devote scarce resources over which it has some say to solving its long-term development problems. There is a need to address the highly political issue of ensuring that there is an adequate balance of interests in such an arrangement or, like so many

past decisions on the allocation of the RIP, there will be a division of benefits by countries such that the potential economic benefits will be dissipated in a shopping list approach to the allocation of these resources. Given that the two focal sectors of such a programme are based on fisheries and tourism there is the possibility of an appropriate balance of benefits to all countries in the region. Whether the financial resources available from the RIP would be sufficient to cover the costs of a proactive private-sector development programme in fisheries in tourism remains the subject of a future feasibility study should the concepts be accepted.

Conclusion

This paper has attempted to map out an alternative approach to the economic partnership agreement between the PACP countries and the EU. The suggested structure offers, on an á la carte basis a series of trade agreements that the PACP may wish to consider as a basis for the development of the trading relationship with the EU. These agreements focus on the sectors in which the PACP has a comparative advantage while incorporating the original EU proposal for an FTA based on the trade in goods. It is recognised that the FTA with the EU is of the most doubtful technical viability at this point in time for most of the fourteen PACP countries. For Fiji and PNG an FTA with the EU may be technically feasible though is also of doubtful economic viability given the low benefits and very high adjustments induced by MFN obligations to other development partners. Nevertheless the FTA should remain open to future ratification by the PACP region as and when their economies and trading relationships with the EU evolve to a level of a maturity that renders such an arrangement feasible.

A services agreement based on a 'tourism plus' cluster with a development component has been proposed. The development component could involve standstill arrangements and on the job training for PACP nationals in existing arrangements plus new arrangements with EU tourism plant operators. Two other agreements, including fisheries and investment protection and promotion, have also been mooted. The success of the package in attracting export-oriented investment into the PACP will depend in part upon the funding of the proposal, which would largely be funded from the RIP of the 9th EDF. However part of the funding for the fisheries agreement could be based on Cotonou-plus resources as this would be part of the broader commercial arrangement.

Endnotes

1. Cotonou Agreement, Article 37.1
2. Workshop on post-Lomé Trade issues for Pacific ACP countries held in Suva in March 1999. The EU delegate to the Pacific stated:
   'There has been some speculation as to how the Pacific region would be represented in a Regional Economic Partnership Arrangement with the EU.....The negotiation of a REPA will be completely voluntary: the EU will negotiare with those regions, sub-regions or countries "which express an interest".'
3. Report of the Meeting of Pacific ACP trade ministers, May 1999.
4. In the GATT/WTO there is extensive jurisprudence on the quantitative definition of what constitutes an FTA. In 1957 a working party reviewed the consistency of the EEC treaty arrangements with those of Article XXIV. The EEC position at the time was that: 'a free trade area should be considered as having been achieved for substantially all trade when the volume of liberalized trade reached 80% of the total' (GATT Document, L/778, adopted on 29 November, 6S/70, 99 para. 30). This definition has never been accepted and increasingly the more common quantitative measure that has been employed has been based upon 90% of total bilateral trade. However, neither the 80%, nor 90% figures have any legal foundation. Moreover, countries such as Australia have suggested that the definition of substantially all trade should be based on the concept of 95% of tariff lines.
5. *Understanding on the Interpretation of Article XXIV of the GATT 1994.*
6. See Ministerial Declaration, Fourth Session, Doha, 9–14 November, para.29 WT/MIN(01)/DEC/W/1.
7. European Commission Staff Working Paper. Workshop on post-Lomé IV Trade Arrangements, 2 June 1999, p. 18.
   'Therefore, in view of the extent to which the EU has already liberalised vis-a-vis the ACP and of the structure of trade between the parties, the ACP may not have to liberalise to the extent assumed by the studies to fulfil the requirement of 90% coverage of global trade.
   For the Pacific ACP countries and on the basis of present trade data and excluding sugar, only 77% of the imports from the region enter the Community market duty free. If sugar were included in the EU liberalisation plan, moving from a transitional quota to complete liberalisation after a transition period, WTO compatibility would be easy to achieve. Under this assumption, the Pacific countries would have to liberalise only 45% of their imports to the EU'
8. UNCTAD & Commonwealth Secretariat 'Duty Free and Quota Free Market Access for LDCs: An Analysis of Quad Initiatives', Geneva 2001.
9. These include Cook Islands, Marshall Islands, Micronesia, Nauru, Niue and Palau.

10. R. Grynberg 'Asymmetric Reciprocity in the Post-Lomé Framework – Implications for Trade Relations in the Pacific', Pacific Islands Forum Discussion Paper, 2000.
11. While a multiplicity of trading arrangements also exist in the Caribbean, only the US arrangement, the Caribbean basin initiative, contains explicit MFN provisions. No similarly explicit provisions exist in AGOA.
12. Until the recent closure of the Taiyo facility in the Solomon Islands it also had a strategic trade interest in tuna fish exports to the EU, but as it is an LDC it is covered by the EBA market-access provisions.
13. The US and the EU had agreed to an Article XIII waiver for bananas in April 2001. This was in recognition of the apparent violations of those provisions in the EU's banana regime. While sugar quota arrangements are quite different the quota allocation mechanism could be deemed to violate the chapeau of Article XIII.2. When the WTO waiver was finally granted at Doha it was only for Article I and did not include an Article XIII waiver for bananas.
14. While private-sector development has been greatly increased in importance in the new agreement it is by no means the only shift in development policy found in the new ACP–EU agreement. The inclusion of new actors such as NGOs and the private sector as well as an improved functioning of development assistance have also been pivotal changes in the Cotonou Agreement from the previous Lomé Convention arrangements.
15. Under the Cotonou Agreement the EIB bears the exchange risk of its interventions in the ACP region, thus avoiding the need for state loan guarantees. However while the new investment facility avoids the need for state intervention, a major flaw of the Lomé arrangements is that it creates a minimal concessional component. Under Lomé there were much larger concessional components but the state was the principle intermediary and it frequently absorbed the concessional component as state revenue to compensate for the risk taken. Alternatively the concession was passed on to the intermediary DFI and was absorded. Interest rate concessions in EIB actions were rarely passed on to the private sector investor under the Lomé Convention.
16. Cotonou Agreement, Article 85 and Article 89.
17. See '2nd Draft Annex on Tourism', Working Group on Liberalization, Third meeting, Madrid, November, 2000.
18. Cotonou Agreement, Article 41.4.
19. Cotonou Agreement, Article 53.1.
20. Ministerial Declaration, Fourth Session, Doha, 9–14 November, para.28, WT/MIN(01)/DEC/W/1.
21. Given the very vocal opposition from the environmental NGO lobby on this issue it cannot be assumed that ODA will be excluded from the definition of subsidy.
22. PNG has signed five investment protection agreements with trade and investment partners.
23. Cotonou Agreement, Article 78 and Annex II, Article 15.
24. Cotonou Agreement, Article 31 and 32.

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The Private Sector's Perspective, Priorities and Role in Regional Integration and Implications for Regional Trade Arrangements

Nick Charalambides

Private-sector perspectives and priorities in regional integration

Several of the main companies operating at the regional level were consulted in the course of this study, as well as leading national firms and private-sector representatives in Tanzania, Kenya and South Africa. The study also draws on research carried out in Namibia and Rwanda and during the mid-term review of the SADC Trade Protocol. Companies operating at the regional level provided a particularly useful perspective, as they enabled a direct comparison of experiences across different countries.[1]

Tariffs are an important concern of companies outside of South Africa, as is underlined by the 20% per annum increase in intra-COMESA trade since the introduction of the free trade area. However, according to many companies agreements exist 'on paper' only in the sense that their implementation is often poor and their provisions cannot be enforced. Also, in some cases non-tariff barriers have taken the place of tariffs. This was confirmed by several companies, which reported finding it easier to trade with countries with which there are no regional or bilateral trade agreements than with countries belonging to the same regional integration initiative.

Companies also indicated the extent to which constraints to competitiveness relate primarily to the domestic situation. In a survey of Tanzanian businesses carried out by the Confederation of Tanzanian Industry (CTI), 36% of respondents indicated that high taxes made them uncompetitive in the East African market, and 29% cited high energy costs as a key problem; no companies included trade policy measures among their major concerns (CTI 2002).

Problems of overlapping membership

Businesses and private-sector representatives mention as the main problems of overlapping membership the proper administration of tariffs, enforcement of rules of origin at borders (which may also breed corruption), and confusion due to lack of co-ordination amongst regional integration initiatives. The poor articulation of tariff liberalisation under the different agreements, where for instance Kenya under the EAC transition arrangements may face higher tariff barriers in Uganda and Tanzania than COMESA and SADC members, respectively, was also raised as a concern, as was the possible infiltration of duty-free EU goods from SACU into SADC and via Tanzania into the EAC.

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Barriers to regional trade

For firms outside of South Africa, tariffs are a significant issue. Businesses in Namibia report having been hard hit in regional markets by the withdrawal from COMESA while SADC partner tariff reduction schedules are being phased in. Particularly affected have been low-value high-volume goods such as salt. In Tanzania discussions with the private sector revealed a strong preference to rejoin COMESA to regain preferential access, a position which is now supported by the East Africa Business Council. This view was also noted by researchers at Tanzania's Economic and Social Research Foundation:

> *Tanzanian business community strongly opposed Tanzania's withdrawal from COMESA [...] the feeling we got from the interview with the private sector umbrella organizations is that the private sector benefited much more from COMESA than is the case with SADC* (Kweka and Leyaro 2004).

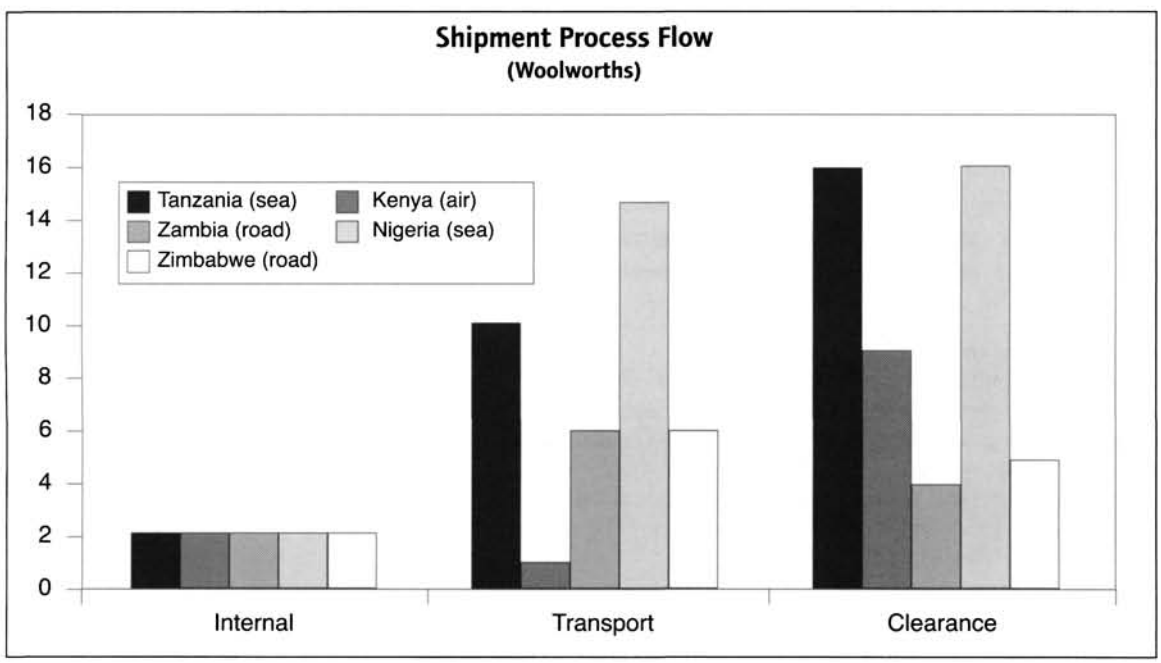
Many companies throughout the region, excluding South Africa, cited protection from tariffs in domestic markets and tariff preferences in regional markets as mitigating domestic constraints to competitiveness. However, the importance of domestic factors was underscored during consultations. For example, a leading Kenyan business representative cited the reduced cost and improved reliability of electricity supply as the single change in the business and trade environment that would most improve the day-to-day operations of his company – a view shared by many in East Africa, including in Rwanda.

The main barriers mentioned to regional trade are customs procedures, red tape and corruption, differences in standards and requirements in the various markets of the region, high transport costs and non-tariff barriers in the form of import bans, suspended duties and the like. According to several companies, the harmonisation of requirements, or 'one set of rules' for entering markets in the region, was the single most beneficial change that regional integration could deliver, both in terms of documentation and of technical requirements and standards. Other barriers related to the business environment, difficulties in resolving late or non-payments, and availability of finance.

Customs procedures

The experience of Woolworths in moving goods throughout Sub-Saharan Africa offers a perspective. Figure 1 indicates the shipping process flow. Here,

Figure 1. Shipment process flow (number of days taken)



Box 1. Pre-shipment inspection in Tanzania

Companies mention Tanzania's pre-shipment inspection requirement as a significant barrier to trade. The experience of a major South African retailer operating in Tanzania reveals the following:

- For seafreight shipments requiring pre-shipment inspection, the clearing process takes an average of two weeks, a minimum of four days and a maximum of 30 days.
- For airfreight shipments requiring pre-shipment inspection, the clearing process takes seven to ten days, and for shipments not requiring inspection (those under US$5,000) a minimum of three days is needed.

Pre-shipment inspection adds 1.2% to the f.o.b. price.

two points are worth noting. First, experiences differ widely across SADC. For example, the clearing process normally takes two to four days in Zambia, while in Tanzania it takes an average of two weeks, though goods are often held there for more than a month. The delay in Tanzania is mainly due to the country's pre-shipment inspection requirement.

Second, the existence of trade agreements does not seem to have a noticeable impact on the shipping flow. Clearance times for Tanzania and Nigeria from South Africa are the same. The fact that the easiest countries, logistically speaking, for Woolworths to operate in are Ghana and Uganda underscores this point.

The form of transport also matters a great deal. For example, the clearance process for airfreight in Kenya takes between six and eight days, including pre-shipment inspection, while the clearing time for sea freight is the same as for Tanzania. Reasons given for this disparity are differences in customs infrastructure, procedures and quality of personnel. This offers some indication of the performance improvements that could be gained by upgrading customs capacity.

Other problems relate more to the performance of customs than to the regulations as such. Many companies mentioned the inconsistent application of customs legislation and procedures, including within SACU. Also, personnel changes are often accompanied by border problems. An example is the misapplication of immigration laws. In one instance a Namibian driver in Zambia was informed that he required a new permit, but after significant delay and further inspection, the driver's permit proved valid for another 27 days.

Several traders in Namibia said that even the tariff rates applied can vary, though it is impossible to ascertain whether this is simply a classification problem (for example, computer equipment is subject to a different tariff rate if it is classified for use in telecommunications).

Red tape, technical regulations and corruption

As mentioned, several companies consider the harmonisation of requirements or 'one set of rules' for entering markets in the region to be the single most beneficial change that regional integration could deliver. Table 1 indicates the divergence of requirements, even within SACU.

In the consultations no company indicated that standards or technical regulations were being used deliberately as a protectionist tool. But they did consistently point to differences in regulations and slow procedures as barriers to trade. To deal with the different requirements, some companies operating across the region employed specialists for each country. Examples of problems encountered are a shipment of condensed milk being accepted in some countries but rejected in others, differences in the quality of imports permitted, with Kenya refusing 'Tiger Head'-brand batteries and Uganda accepting them and light bulbs being accepted in Uganda and Tanzania but rejected by Kenya due to their standards legislation being out of print and unavailable.

However, the potential cost of not harmonising and expediting regulation is most clearly illustrated by seed policies and registration requirements, in this case related to SPS regulations.[2] The current situation requires every new seed variety to be tested by a national authority and listed on a national variety register before it can be marketed commercially

Table 1. Documentation requirements

	Namibia	Botswana	Swaziland	Mozambique	Zimbabwe
Tax invoice			X		
SDN		X	X		
CCA1	X	X	X	X	X
Commercial invoice	X				
BW 500		X			
Health certificates	X	X	X	X	X
Permits	X	X	X	X	X
BOE				X	X
SARS export certificate	X	X	X		

All require bank clearance F178 if the value of the invoice is more than R50,000.
Source: Information provided by Woolworths Ltd, cited in Trade Specialist Group/USAID (2004) at www.satradehub.org.

in any SADC country. The testing can take up to three years after which a variety release committee considers the results. This is irrespective of whether the variety has already been released in another country, as the rules on variety testing and release differ between countries. This unnecessarily duplicates activities and slows the release of new varieties to farmers.

Consultations also confirmed the role of corruption. Some companies estimate that corruption adds 3% to 7% to operating costs; and not paying bribes could delay a shipment for weeks.[3]

Transport costs

For landlocked countries in particular, transport costs are a main constraint to competitiveness. Table 2 provides estimates of the cost of importing a key input, indicating the landed price of inputs is between 25% and 43% higher relative to regional competitors. This is in line with several earlier studies in Southern and Eastern Africa which suggest that companies in landlocked countries face 50% higher transport costs than their water-accessible counterparts.

As Table 2 shows, a large part of the higher costs result from physical infrastructure constraints coupled with the need to travel longer distances. However, the breakdown also indicates a significant direct cost of a 'second round' of customs clearance, between 5% and 10% of the f.o.b. price.

In addition, companies bear the cost of delays at borders. For one Kenyan company it was not uncommon to pay up to $3,000 demurrage/waiting fees on a lorry-borne container worth an average of $35,000;

Table 2. Import of raw materials, palm oil (in bulk), cost comparisons per tonne

	Rwanda (US$)	Uganda (US$)	Kenya (US$)
FOB	440	440	440
Sea freight to Mombasa	45	45	45
Clearing, storage charges (Mombasa)	29	29	9
Road/rail transport	180	90	35
Insurance	3	3	2
CIF	697	607	531
Import duty	35 (5%)	0 (0%)	0 (0%)
Clearing, storage charges (Kigali)	28		
Bank charges	3.5	3	2.7
Landed cost per tonne	764	610	534
Increase vis Uganda	25%		
Increase vis Kenya	43%		

Source: SULFO Rwanda Industries

that is, 5% to 10% of the value of the shipment.

Transport costs are being driven higher by laws restricting the operations of transport companies in the region. Cabotage laws segment and distort the market for transport services by preventing transporters from operating outside the country in which they are registered. Hence, a Namibian registered truck with a shipment for Gaborone (Botswana) cannot pick up a load in Gaborone to take to Durban (South Africa), for instance. Similarly, a South African truck delivering goods to Oshkati (Namibia), for instance, cannot accept a consignment for delivery in Windhoek (Namibia).[4] However, COMESA has a common carriers license which registers transporters in all COMESA countries, allowing carriers to carry backloads and thus significantly reducing the costs of transport.

The form of transport and the ratio of value to volume plus weight of cargo also matters. Table 3 sets out the different costing, provided once again by Woolworths, for shipping required stock from Cape Town to Nairobi. The conclusion that airfreight is cheaper than shipping by sea or by road is initially hard to believe, but it is the consequence of the specific goods moved. Airfreight becomes viable for high-value goods that are low in weight and volume. To illustrate, $700 will buy up to a tonne of airfreight with a fixed unit space. This allows a lot of, for example, shirts to be transported. $750 will buy around 27 tonnes in a sea container, which is beyond the requirement for high value, low weight and volume products. Another example is the cost of moving a car from Durban to Nairobi, which is $800 dollars by air, while by sea Durban to Mombasa alone would cost $700.

This illustrates the extent to which transport costs are higher for low value-added, high-volume goods, exactly the type of goods most likely to be produced by the agricultural sector and the poor.

Non-tariff barriers

Non-tariff barriers take various forms within Southern and Eastern Africa. For example, in Zambia, though tariff and quota restrictions have been removed, import licences are required for agricultural imports and these licenses are often not granted. In addition, as tariffs fall under COMESA, Zambia has implemented temporary bans on Zimbabwean products (most of them agricultural).[5] Import licences for meat, poultry, salt and sugar are still required for Malawi. In Tanzania there are several cases in which excise duties are highly discriminatory. To illustrate, if the tobacco used in cigarettes is 75% or more Tanzanian, the excise duty is TSh3,500 per 1,000 sticks; if cigarettes are imported or use less than 75% Tanzanian tobacco, the excise duty is TSh17,000 per 1,000 sticks. Exporters to Tanzania also face an increasing use of suspended duties to protect local industry. Suspended duties on batteries are between 25% and 35%.

The proliferation of non-tariff barriers[6] risks nullifying any increases in regional trade resulting from the phasing out of tariffs and quota reductions. To make this point, one business representative in Kenya remarked that the implementation of the EAC customs union would have little impact on export opportunities in Tanzania since exports are 'always being hit by suspended duties'.

Intra-SACU trade in agricultural products appears as affected by these non-tariff barriers, despite the customs union agreement which precludes such measures.[7] Botswana imposes periodic

Table 3. Freight (high value-added products): Cape Town to Nairobi

Options	Rates	Frequency/transit times
Airfreight: Cape Town to Nairobi	R 15,055	day 1, 3 , 5 & 7
Road: Jhb & airfreight to Nairobi	R 10,633	Monday and Friday
Rail: Jhb & airfreight to Nairobi	R 17,143	daily ex Jhb.
Sea: Cpt to Mombasa and road to Nairobi	R 27,279	weekly 12–13 days
Sea: Cpt to Mombasa and rail to Nairobi	R 21,413§	weekly 12–13 days
+ Mombasa to Nairobi		20 days

Source: Woolworth Plc. See text for explanation.

bread bans. Swaziland imposes levies of between 4% and 25% on selected agricultural products ranging from maize and wheat to fruits and vegetables to poultry (see Table 4). Namibia controls maize imports and effectively bans wheat imports for human consumption through licensing permits, while Lesotho controls imports of bread, fruits and vegetables, pulses and dairy and meat products through the use of an import permit system.

Perspective of formal sector SMEs (South Africa)

In general, it is the larger companies that operate at a regional level. Small and medium-sized enterprises in the region tend not to export, at least not directly. Most of their products are sold on local markets, and if they are traded across borders it is generally done through the informal sector. The informal sector is not included in this study, not because it is unimportant, but because the decision to remain in the informal sector and the sector's operations are generally unrelated to trade policy (except in the case of smuggling, which is touched upon later in this paper).

The only small and medium-sized enterprises that are significant exporters in the region and operate within the regulation of regional agreements are in South Africa.

To gain a perspective on the challenges and opportunities facing small and medium-sized enterprises a survey was carried out in Johannesburg in co-operation with the NAFCOC/JCCI.[8] The survey included formal-sector enterprises that were already exporting, aware of the importance of representation and able to articulate their requirements. In other words, it was not a random sample of the sector as a whole but rather an attempt to gain a glimpse of the relative importance of different barriers to different markets, often for the same firm (many of the companies exported to more than one destination). Some 79 firms, ranging in size from sole proprietors to 30 employees, responded to a questionnaire by the NAFCOC/JCCI to their members on regional trade and support to small and medium-sized enterprises.[9] Manufacturing was the main activity amongst respondents (46%). Some 20% of the firms were service providers (e.g. crane hire and media) and 20% included in their activities wholesaling, retailing and agency work, while 18% of firms were engaged in more than one activity.

Of the responding firms, 73 do business outside of South Africa, 57 firms (80%) trade within Southern Africa, 45 firms trade with the European Union, 33 with the Far East and 32 with Central Africa. Respondents clearly indicated the EU as the easiest region to do business with. The picture for Southern Africa is less clear, but more firms see it as the easiest

Table 4. Swaziland scheduled agricultural products and levies

Product	Levy (%)
Whole white maize grain	1–4.5
Maize meal and other products	7.5
Rice	3.5
Fresh fruits, excluding apples, pears, peaches, grapes and bananas	7
Apples, pears, peaches and grapes	4.5
Bananas	6.5–25
Fresh vegetables, excluding cabbages, tomatoes, potatoes and sweet potatoes	1–10
Cabbages, tomatoes, potatoes and sweet potatoes	
Poultry and poultry products (excluding turkey)	13.5
Turkey and turkey products	20–25
Whole wheat	3–5
Wheat products	7–18.5
Frozen vegetables	7.5

Source: Namboard Annual Report (2002), National Agricultural Marketing Board Act (1985) and Amendment Notice (2002), WTO Trade Policy Review (2003), *A Comprehensive Agricultural Sector Policy for Swaziland* (2004), Ministry of Agriculture and Cooperatives, Trade Specialist Group/USAID (2004).

region (47%) than see it as the most difficult (39%). Within Southern Africa, 11 firms listed SACU countries as the easiest to do business with. Views on Zimbabwe and Mozambique were mixed, though on balance more firms placed them amongst the most difficult than amongst the easiest countries. Angola, Tanzania, Democratic Republic of Congo, Ethiopia and Kenya are all unambiguously 'difficult' countries.

What makes a region or country easy to do business with?

Firms were asked to explain their choice of easiest region to do business with.[10] Figure 2 summarises the responses. The most important factors are strong business ethics and culture (27 firms), followed by language and proximity (16). A strong business framework, in terms of financial and legal systems and political stability, is key, as are good customs procedures, transport logistics and communications, minimal red tape and low trade barriers (primarily low tariffs).

Proximity and strong business practice are the most important reasons for respondents that included Sub-Saharan Africa and North Africa amongst the easiest regions to do business with.

Barriers to doing business in Sub-Saharan Africa

Firms were asked to list the three main barriers they faced in doing business in Sub-Saharan Africa. Figure 3 summarises their responses. Half of the firms (37) cite poor business ethics and culture as a key constraint. Non-payment and corruption are the most prevalent problems in this category. However, the failure of suppliers to meet requirements in terms of quality, price and volume were also significant issues. Twenty-four firms cited transport, logistics and communications as important barriers, particularly the high cost and infrequency of shipping, poor communications and the high cost of airfares. High airfares and poor communications can be very damaging to small and medium-sized enterprises' efforts to develop new markets, which, in the words of one respondent, requires local knowledge and 'a lot of travel'.

A poor business framework, mainly with regard to foreign exchange controls and constraints on finance, but also resulting from economic instability and the strength and volatility of the South African rand, was an important constraint for 22 firms. Poor customs procedures, in particular the heterogeneity of procedures and required documentation and red tape, were considered a main barrier by nine respondents. Finding a reliable local partner in Sub-Saharan Africa is also a challenge (six firms). One firm pointed out the difficulty of finding local partners to provide after-sale service.

Only one firm cited tariffs as a major barrier to trade.[11]

Figure 2. Reason for choosing a region as easiest to do business with

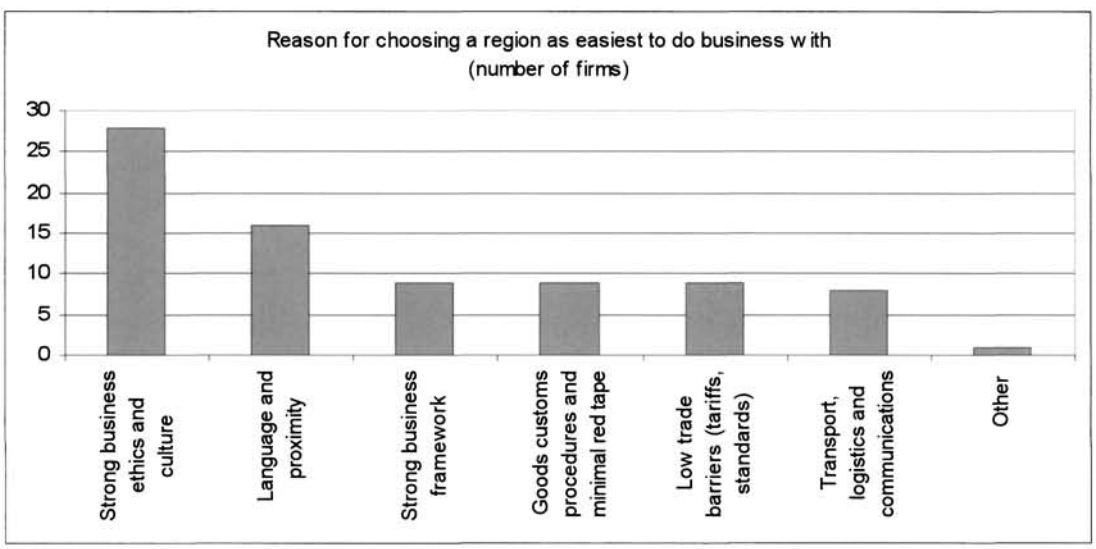
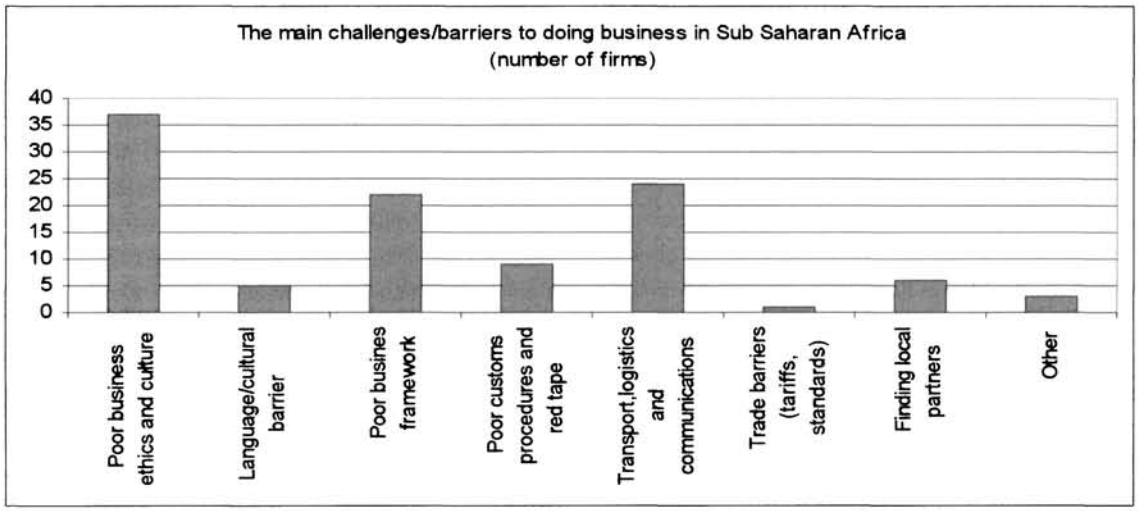


Figure 3. Main challenges/barriers to doing business in Sub-Saharan Africa



Challenges in other markets

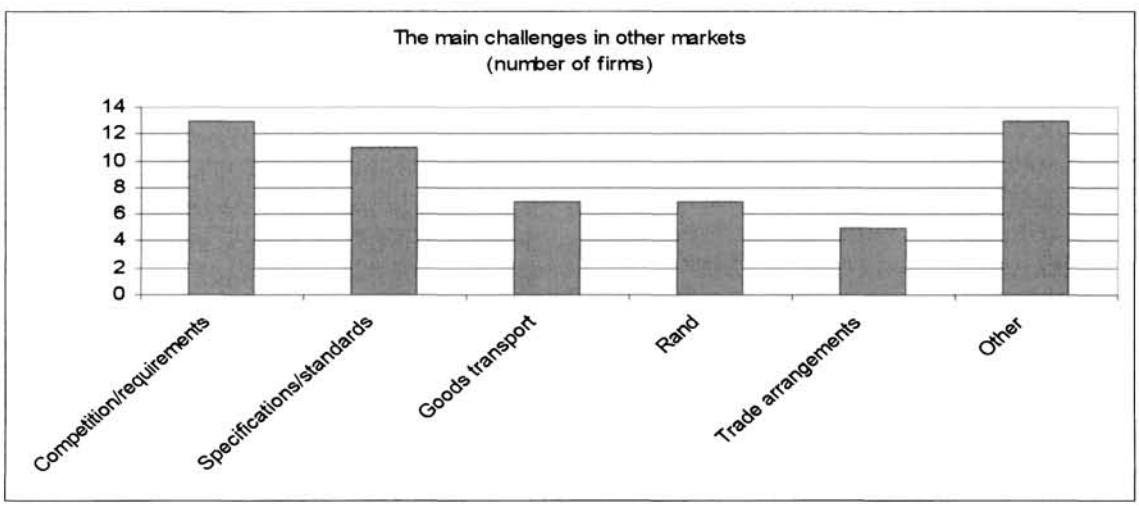
Some 13 firms cited strong competition and strict requirements as major challenges in other markets (see Figure 4). Specifications and standards are barriers for 11 firms, while the high cost of goods transport and the rand's strength and volatility were problems for seven firms. Five firms considered trade arrangements to be a barrier, with some pointing to tariff barriers and others citing preferences enjoyed by third countries as a problem.

Potential role of the private sector

The last decade has witnessed rapid growth in companies, mainly South African, operating at the regional level. Indeed, the growth of South African retail chains throughout Southern and Eastern Africa is the most visible sign of regional integration. This expansion of South African industry and commerce is politically sensitive. As one executive put it, 'We do not want to become South Africa's car park'.

However, the ability of these larger companies to absorb risks, their distribution network and their technical capacity offer real opportunities for countries in the region to enhance production for local, regional and international markets.

Figure 4. Main challenges in other markets



In a few cases we have seen companies exporting to regional partner countries, building markets that have since become competitively supplied locally. In 1995 Unilever South Africa began exporting to Mozambique, building the local market and developing brand awareness. In 2001/02 it invested in local production, with a turnover of R130–140 million, creating 65 jobs. Zambia has also witnessed regional exporters developing local markets which were then exploited by local companies (e.g. producing pannettes for horticultural exports).

Sourcing locally is the most direct way that retail chains can benefit local producers, though this is counterbalanced by the need to ensure no adverse effects on the price and quality of goods available to consumers. While there has been no overall evaluation of the extent of local sourcing, information from Shoprite (PTY) Ltd provides some indications (see Table 5). Information is also available from Metcash, which reports local sourcing at 95% in Zimbabwe, 75% in Malawi and 10% in Angola. The degree to which local producers supply local stores thus varies widely. Country size, natural resources and climate drive the differences to some extent, but are unlikely to explain the large range in outcomes (between 5% and 95%). This suggests significant opportunities for expansion.

Several companies indicated strong incentives for them to source locally, as a result of high transport costs and political sensitivity. As mentioned, the main constraints they face relate to quality and reliability of supply. One premium brand company reported that its ability to source outside of South Africa in some instances is constrained by the ability of producers to get higher prices in EU markets to which they also have duty-free access.

Note that the degree of local sourcing is largely unrelated to preferential trade agreements – at least as they are currently implemented. SACU members appear both at the top and at the bottom of Table 5. The same is true for countries with no formal trade arrangements with South Africa – witness Ghana and Uganda's positions.

There are also opportunities for upgrading standards. In Zambia, Freshmark, the fresh produce buying arm of Shoprite, is working integrally with growers, offering them technical assistance in the application of chemicals and providing chemical spraying equipment. Nandos sources some 60% of its products locally, the categories being poultry, bakery goods and vegetables.[12] Nandos assists local producers such as chicken farmers and bakeries to

Table 5. Local sourcing: Shoprite (PTY)

	Number of stores (incl. Shoprite, Checkers, OK, OK Furniture, Megasave, U-Save and Hungry Lion)	Percentage of goods sourced locally
Zimbabwe	1	95%
Namibia	15	90%
Ghana	3 (U-Save only)	90%
Zambia	25	70%
Mauritius	1	70%
Mozambique	3	60%
Madagascar	6	60%
Average		**52%**
Uganda	3	50%
Tanzania	7	50%
Swaziland	2	35%
Malawi	8	35%
Botswana	6	10%
Lesotho	4	5%
Angola	3	5%

Source: Shoprite PTY

raise their skill level and added-value processes to meet their specifications. A compliance director provides training to help suppliers meet requirements, and suppliers are assisted in becoming HACCP compliant, which is a pre-requisite for supplying poultry to the brand. HACCP compliance opens more opportunities, enabling producers to overcome SPS and technical barriers in some key markets.

Market opportunities also exist in South Africa for certain niche products. For example, some fresh produce is seasonal in South Africa, whereas the climate in Zambia allows year-round production. To ease the burden of transportation costs, retail chains could potentially provide what is effectively subsidised transport for exporters to South Africa. Many trucks return empty, implying low marginal costs for return shipments.

Regional integration policy: Priorities and impact of overlap

Having gained some insight into the perspectives of the private sector with regard to trade in goods, we can now assess the potential impact of regional integration policies and the extent to which overlapping membership constrains the necessary policy measures. We draw on the experience of the EU to shed light on what is, and what is not, achievable, at different levels of integration.

Integration can be characterised in four stages:

1. **Free-trade agreements** involve reciprocal opening of markets for 'substantially' all trade, generally going beyond tariffs and quotas and increasingly covering standards (including mutual recognition agreements) and regulation, trade facilitation, services, investment and competition and in some instances public procurement. Countries maintain sovereignty over their tariff and trade policy with regard to third parties. Fiscal frontiers and rules of origin also remain.
2. **Tariff unions** imply a free-trade agreement plus a common external tariff, though with no common trade policy beyond the common external tariff and no customs pool.
3. **A customs union** implies a common external tariff, a customs pool and generally a common trade policy. If all trade arrangements with third parties are harmonised then rules of origin no longer apply. Fiscal borders remain, as well as border controls, for instance, for goods for which safety standards differ.
4. A single market allows for the free circulation of goods. It requires a common trade policy, harmonisation of standards and common policies on competition, as well as on trade and in areas where there is substantial intervention in the market (see Figure 5).

Overlapping membership prevents the establishment of a common external tariff unless all of the concerned integration initiatives harmonise their common external tariffs. However, it is important to note that the stages as described above are simplified. Advances, for instance, in harmonisation of standards can be achieved with a free-trade agreement independent of the establishment of a common external tariff.

Customs unions and border transaction costs

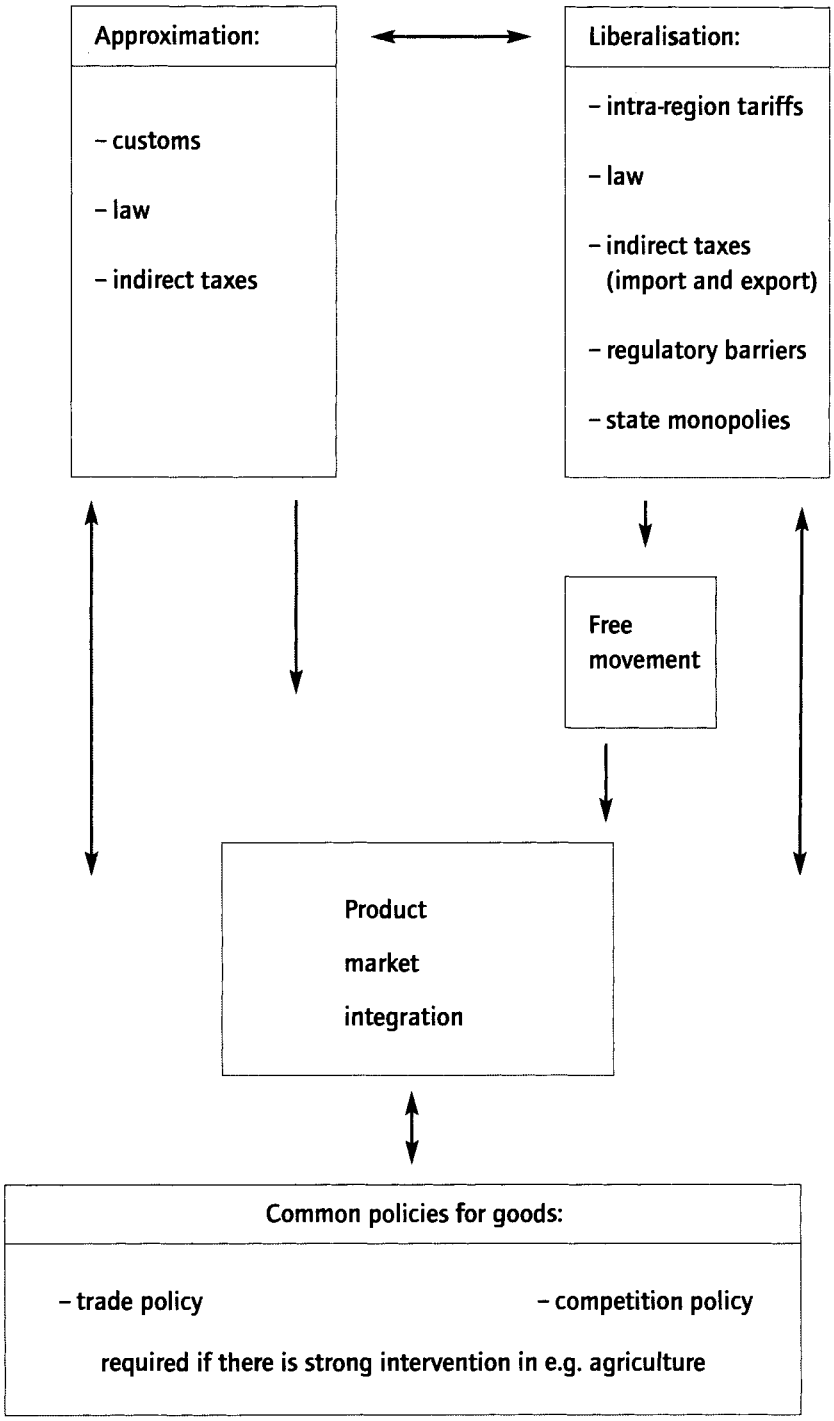
An important reason for forming a customs union is to do away with the transaction costs involved in border formalities, including rules of origin. Addressing customs procedures and red tape have also been identified as a priority.

However, in terms of reducing red tape at borders, the impact of a common external tariff may be limited unless a customs pool system is developed, fiscal frontiers removed, technical regulations harmonised and individual customs authorities given sufficient confidence in the institutional capacity of other member states to implement. Here, the European Union's experience is informative:

> *Despite the absence of customs duties in trade between member states, in fact, there was little difference in administrative burden or appearances between intra-Community trade and trade with non-member countries ... Customs clearance at the Community's internal frontiers was elaborate and time consuming (European Commission 1999).*

Only with the establishment of the single market

Figure 5. Framework for single market in goods



did free circulation of goods within the Community become a reality.

Doing away with the need for rules of origin may have the largest potential impact. However, even this requires not only a common external tariff, but also a raft of measures harmonising non-tariff barriers. This is a demanding process that took the European Union 30 years to achieve. In the initial stages member states were allowed to maintain their own quotas on certain third-country imports and use border controls to prevent their circulation (Winters 1993). The EU–Turkey customs union (for industrial products only) allows either party to impose anti-dumping duties on the other, automatically requiring rules of origin in order to define partner goods.

Therefore, while establishing a customs union can be an important step towards reducing transaction costs, in the short run transaction costs may be addressed by focusing on trade facilitation and infrastructure development under NEPAD or with spatial development initiatives and transport corridors. Furthermore, the experience of the European Free Trade Association (EFTA) reveals that, in principle and given sufficient resources, the free movement of goods can be achieved within a free trade area and does not require a customs union. Similarly, according to the EFTA secretariat, Norway is considering applying the same technology that has accommodated the differences in excise and value-added taxes within the European Economic Area (EEA) to take account of different tariffs applied by parties to the EEA (i.e. the EU and most of the members of EFTA).[13] However, the resources involved are significant.

Bans, suspended duties, discriminatory taxes and the like

Bans, restrictive import permits, discriminatory taxes and suspended duties are major challenges to the private sector. These problems, however, are unrelated to the absence of a common external tariff. Indeed, many of the barriers mentioned in the consultations were intra-SACU.

In view of the concern expressed by several companies about these measures, it seems likely that addressing these barriers would have a bigger impact on regional trade than the establishment of a common external tariff as such. Addressing these issues effectively and efficiently, however, requires a well-financed and well-resourced regional organisation or regional structure, working under a rules-based system and backed by an enforcement system and a dispute resolution mechanism.

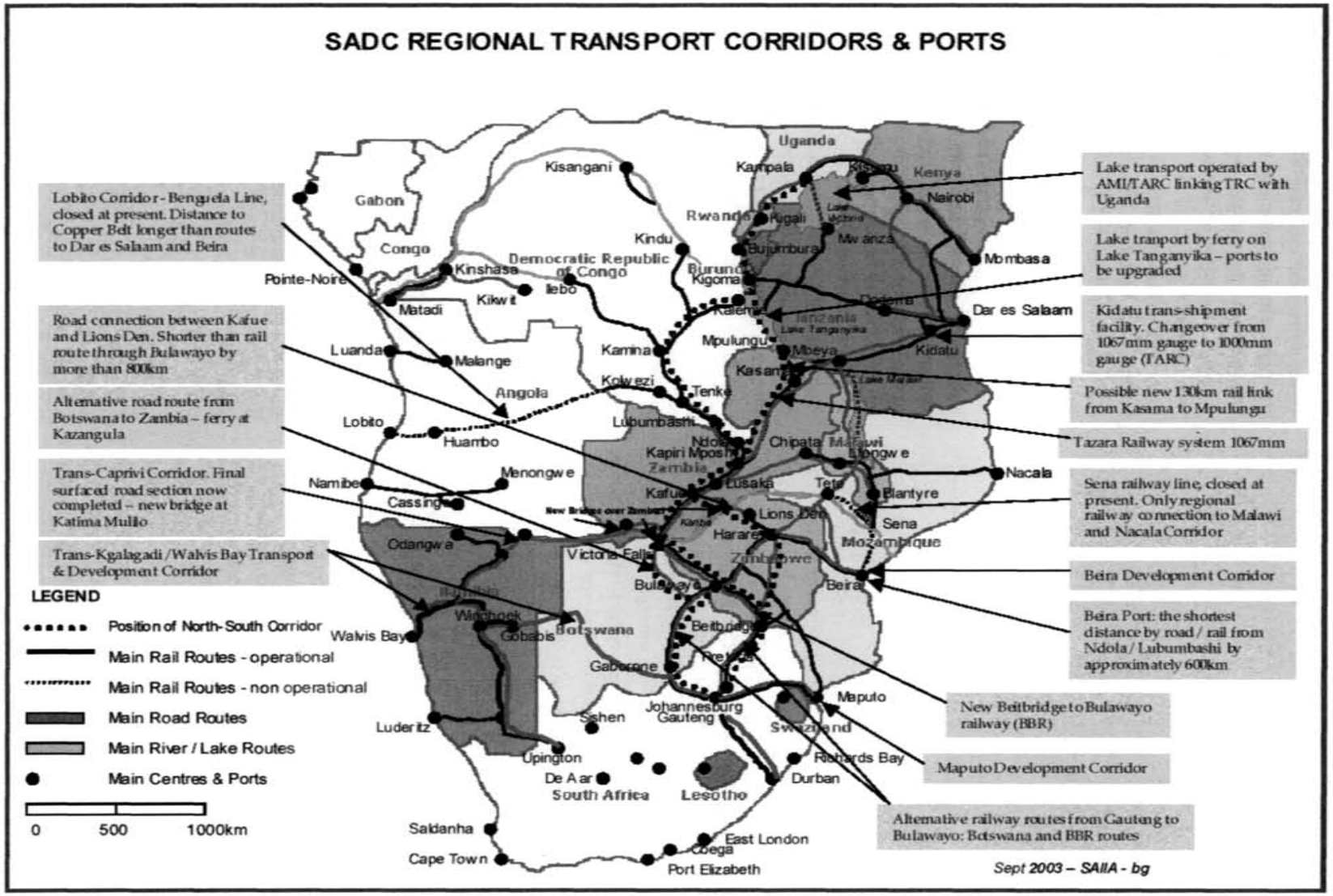
Technical regulation, standards and overlapping membership

With regard to technical barriers to trade and SPS measures, overlapping membership becomes important when different regions develop divergent regulations and standards. Company interviews revealed some instances of divergences in standards, particularly between Kenya and South Africa which may have implications for Tanzania if EAC standards converge with those of Kenya. However, there was little evidence to suggest technical regulations and standards are being used as a trade protection measure.

More importantly, given that the main markets for countries in Southern and Eastern Africa lie outside of the region, the focus for the development of regulations, standards and compliance should be to access those markets by adopting international standards as opposed to establishing regional ones. This, however, is not always easy given that standards applicable in, for example, the European Union and the United States, sometimes differ. Indeed, the problems of overlapping membership could potentially be most significant where regional integration initiatives are negotiating agreements with trading partners that strongly diverge in their approach, as in the case of EU and US food safety standards.

Interviews with European Commission experts suggest that while in the short term the divergence between American and European food safety standards may present a dilemma for some countries, over the longer term, for each country to maintain access to the EU market in certain agricultural products for instance, they will have to develop an institutional framework and capacity to manage both systems. This is inevitable given the presence of genetically modified crops in the region, the fact

Figure 6. SADC regional transport corridors and ports



that countries share the same rivers and the knowledge that winds carrying seeds do not respect national boundaries.[14]

Transport costs

Transport costs are driven largely by poor and fragmented infrastructure in the region. The map in Figure 6 taken from the SADC Barometer 2003 provides an indication of the discontinuities of the transport system and also the potential of some of the NEPAD supported infrastructure projects.

Co-operation on transport corridors can be developed independent of a common trade policy, and unilateral liberalisation can address some of the factors keeping transport costs high – such as cabotage laws. But the impact will be far greater if the liberalisation of such laws can be negotiated at the regional level.

Other measures

Given the extent to which late payments or non-payments can constrain particularly small and medium-sized formal-sector enterprises, establishing credit bureaus and enabling information sharing on credit histories across the region could enhance intra-regional trade. This would serve to compliment the development of a regional payments and settlement system and a trade insurance system.

Conclusions

Consultations and interviews with Southern and Eastern African companies and private-sector representatives underline three main concerns related to the overlapping membership of countries in regional integration initiatives: confusion over which regime and rules of origin apply at borders, limited co-ordination between COMESA and SADC, and the potential for infiltration of duty-free goods through partner countries with differing trade arrangement with third parties. These concerns are in part information problems, reflecting the poor state of awareness on trade arrangements and poor implementation of rules of origin.

Priorities expressed by the private sector relate mostly to customs procedures and red tape, bans and non-tariff duties, transport infrastructure and the business environment. Many of these issues can be addressed by measures that do not require the establishment of a customs union. Indeed, many of the barriers were cited for intra-SACU trade. Moreover, several of the companies interviewed found it easier to trade with countries with which there are no regional or bilateral trade agreements than with countries belonging to the same regional integration initiative.

Regional free trade seems to be held back by problems in implementation and an apparently equivocal government commitment to achieving regional integration, as evidenced by the proliferation of non-tariff barriers to take the place of tariffs. Less ambitious but properly implemented plans for regional integration would therefore better serve the needs of the private sector.

The problem of overlapping membership which so occupies policy circles need not prevent resolving many of the priority needs of the private sector. That said, strong implementation mechanisms are needed to address non-tariff barriers and other trade restrictions within the region. This will generally involve some transfer of sovereignty to regional institutions. Sovereignty cannot be effectively transferred to, for instance, both SADC and COMESA, while each retains a mandate in economic integration, unless there is convergence in arrangements and implementation. It may be that the biggest impact of overlapping membership, in terms of addressing the needs of the private sector, is the extent to which it impedes this transfer of sovereignty in some areas of trade policy to regional institutions.

Endnotes

1. The analysis was only able to capture formal trade. While recognising the importance of informal trade, the direct impact of most trade policy is largely on the formal sector.
2. This example is taken from ESRF (2003).
3. The private sector shares some responsibility for this problem, as it is often the case that the private sector circumvents procedures by either lobbying the government or paying officials to fast-track an import. This undermines national capacity and sets a precedent which others in the private sector must then follow.
4. See TSG/USAID (2004).
5. According to the ESRF (2003), 14 six-month bans were imposed in 2002 alone.
6. See Trade Specialist Group/USAID (2004).
7. SACU has an infant industry clause which legitimately allows members to shelter an industry from competition with other SACU partners for a period of up to eight years. The only measures currently covered by this clause relate to three products in Namibia – pasta, broilers and UHT milk.
8. Special thanks to Nada Reyneka and Tisch Schute.
9. 800 firms were invited to respond to a faxed questionnaire.
10. Firms were not presented with a checklist but allowed to identify key issues themselves. For details of the classification of responses in different categories contact nada@nafcocjcci.co.za or nickcharalambides@yahoo.com.
11. However, this may reflect an approach to business whereby small and medium-sized enterprises take tariffs as given.
12. On establishment in a country, it initially imports 80% of products.
13. For more information visit www.efta.int.
14. These issues are being addressed. The EU–East and Southern Africa (ESA) EPA negotiations are to include an audit of SPS requirements and design a programme to address deficiencies. According to the COMESA secretariat, good progress is being made in harmonising standards. The process followed is the same as that used by other international bodies such as CODEX.

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IX
ACP Capacity Development and EPAs

37

Coercion or Engagement? Economics and Institutions in ACP–EU Trade Negotiations

Stefan Szepesi

Introduction

In September 2002, the European Union (EU) and 76 African, Caribbean and Pacific (ACP) countries launched their negotiations on Economic Partnership Agreements (EPAs). This marked the start of the EU and the ACP group's implementation of the radical changes to trade relations agreed in the Cotonou Partnership Agreement of June 2000. This agreement defines EPAs as comprehensive free trade agreements that will replace three decades of generous non-reciprocal trade preferences with reciprocal and WTO-compatible arrangements, at the latest by 2008. A key element of the EPA concept is that, in principle, the agreements should be concluded with ACP regions rather than with single countries, implying that the ACP's own regional integration needs to be enhanced as well.

Though EPAs are not the only possibility that 'Cotonou' provides on future trade relations, it is the most likely option for the majority of ACP countries to choose.[1] ACP countries that are not least-developed countries (LDCs) cannot benefit from the tariff- and quota-free 'Everything but Arms' (EBA) initiative, and will lose some market access if they are 'graduated' to the Generalised System of Preferences (GSP). For the LDCs, the EBA alternative seems only a theoretical option if their non-LDC neighbours opt for EPAs: not to join EPA negotiations would isolate an LDC and almost certainly fracture trade relations with non-LDC regional counterparts. In addition, reciprocal negotiations might offer better opportunities to defend the specific benefits of the commodity protocol preferences that are currently enjoyed by certain ACP countries.[2]

To date, no ACP country has opted out of EPA negotiations.[3] Yet, progress has been fairly limited during the first 20 months of negotiations. EPA negotiations have been divided in two phases: Phase I at the all-ACP level and, since October 2003, Phase II at the respective ACP regional levels. The talks in Phase I concerned mere consultations between the parties on the framework and principles of EPA negotiations. Whereas the ACP group wanted a formal agreement to conclude Phase I, the European Commission rejected this, emphasising that the purpose of the talks was to clarify issues rather than to reach formal agreement. The most substantial disagreement of Phase I concerned the so-called additionality of resources. Whereas the Commission finds that the funds agreed in the 9th European Development Fund (EDF) should suffice to address EPA-related concerns, the ACP pressed for extra commitments so as to safeguard the original allocation of the EDF to non-trade-related areas.[4]

In practice, Phase I and Phase II talks are likely to proceed simultaneously during the remainder of the negotiations as some of the issues on the table touch upon all members of the ACP group. Currently, four ACP regions (ECOWAS, CEMAC, the Caribbean and ESA) have already launched Phase II negotiations with the EU, and two other regions are likely to follow soon.[5]

The aim of this chapter is twofold. First, it seeks to structure the discussion on the economic implications of EPAs for the ACP countries. Though, *a priori*, the economic impact of EPAs is ambiguous, both experience and economic theory suggest that the quality of certain institutions in ACP countries and regions will be a key (if not decisive) factor in deter-

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mining that impact. Therefore, this chapter also seeks to discuss whether the current process towards EPAs is likely to yield the necessary institutional improvements in time. The second section sketches some unique features of EPA negotiations, followed by an exploration of the variety of economic effects that EPAs might have on ACP countries. The next section deals with the question of institutions and trade capacity building, and the way these will be addressed in EPA negotiations, followed by two scenarios towards EPAs: coercion or engagement.

What is special about EPAs?

Since the mid-1990s, bilateral trade negotiations with third parties have been the rule rather than the exception in EU external trade policy. Various types of bilateral trade agreements have been negotiated with countries such as Chile, Mexico, South Africa, various countries in Central and Eastern Europe, and a host of Mediterranean states. Besides EPAs, the EU is currently negotiating new agreements with the Mercosur region and the Arab states united in the Gulf Cooperation Council (GCC). Against this background, it is no surprise that in its 1996 Green Paper, the European Commission proposed to replace the Lomé trade regime of non-reciprocal preferences by a set of free trade agreements between the EU and ACP regions.

Yet despite the proliferation of bilateral trade agreements, there is no real precedent for EPAs. Apart from the fact that the ACP group has economies that are very different from the other EU trade partners, the broad coverage of EPAs as set out in the Cotonou Agreement is reflected in only a minority of EU trade agreements.[6]

First of all, one of the central principles of EPAs is regionalism. The agreements should thus strengthen the various processes of ACP regional integration. This means that besides the common challenges that trade negotiations pose, the configuration and integration of ACP regions add an additional dimension of complexity to EPAs.

Second, the EPA principles of special and differential treatment on the one hand and WTO-compatibility on the other further complicate matters. Other EU external trade agreements have been designed to comply with GATT Article XXIV, but depending on the outcome of the Doha Round, this compliance is a moving target for EPAs.

Third, the economic and social impact of trade liberalisation on the EU trade partner is likely to be larger through EPAs than through any of the previous free trade areas (FTAs) concluded by the EU. Many ACP countries trade primarily with the EU. In contrast to other countries that have more developed and diversified economies (e.g. Mexico and Chile), the majority of ACP countries are still dependent on a handful of export products to Europe. As for imports from the EU, the average level of ACP protection is still relatively high, thus magnifying the overall impact that liberalisation will have on ACP domestic economies, which we will now discuss further.

The economic impact of EPAs

Economic theory leaves little doubt over the question of whether, in principle, economic integration – and trade liberalisation in particular – generates overall positive welfare effects. Once barriers to cross-border economic activity are lifted, this will usually result in a dynamic combination of efficiency gains (better allocation of production factors), increased competition, lower prices, knowledge transfers and ultimately higher economic growth. The success story of European integration is a textbook example in this respect. In addition, some observers claim that Europe's ever-closer economic integration has led to a peace dividend: additional economic growth derived from political and social stability.

Yet economic integration is not a cost-free process. Even in Europe, this is the prime reason why the complete elimination of all internal (technical and non-technical) barriers to trade in goods took as much as four decades. Moreover, to yield the benefits of integration certain basic institutional requirements need to be fulfilled. Whereas in theory 'winners' from a fast move towards integration could directly compensate 'losers', this proves difficult in practice, and requires sophisticated institutions to be developed.

Indeed, it is difficult to liken the economic

effects of EPAs between the EU and the ACP to the standard example of European integration. While textbook analyses are extremely useful tools for understanding the various effects of integration, one should not overlook the specificities of so-called North–South integration. With respect to ACP–EU trade liberalisation, the following sections look into some of these specificities.

Static trade effects

Though it is widely recognised that world-wide (multilateral) trade liberalisation is welfare enhancing, the same conclusion does not necessarily apply to liberalisation between a selective group of countries. **'Trade creation'** and **'trade diversion'** are the classic concepts used to explain so-called static welfare effects of regional trade integration. Upon trade liberalisation between an ACP region and the EU, trade diversion is the (negative) welfare change caused by ACP consumers and producers replacing lower cost imports from third countries (the US or Asian countries for example) by higher cost imports from the EU. This substitution can arise if the new tariff-free prices of EU goods are below those of the taxed goods imported from the rest of the world. Though ACP consumers gain from lower prices, economy-wide welfare is negatively affected because the tariff revenue that was previously yielded from third-country imports is now lost. Trade creation, on the other hand, is the welfare improvement that arises because high-cost domestic production in an ACP country is replaced by lower cost production in a regional ACP partner or the EU. Trade creation thus allows partner countries to better exploit their comparative advantage. As markets are opened, both the ACP region and the EU further specialise their production, thereby serving the markets of partner countries with products at lower prices.

Whether overall a net static welfare gain in an ACP region will be the result of an EPA thus depends on whether trade creation outweighs trade diversion or vice versa. The overall welfare effect is more likely to be positive if before EPA formation:

- the ACP region already traded relatively intensively with the EU;
- trade liberalisation towards third countries moves in parallel to EPA liberalisation; and
- both consumers and producers in the ACP region are largely responsive to price changes under an EPA.[7]

Since the Commission initially proposed EPAs, various impact studies have estimated the size of the static effects. The results differed substantially among ACP regions, with trade creation outweighing trade diversion in most cases, but not in all, and with static welfare effects ranging from negligible to substantial.[8]

Competition and economies of scale

Analysing the welfare implications of EPAs solely along static lines, however, has serious drawbacks. Trade reform directly alters the parameters under which domestic markets function: not only does the size of these markets change, also the level of competition is likely to increase because foreign competitors gain enhanced access. More competition, in turn, can lead to positive welfare effects by means of lower prices, more innovation, higher product variability and increased productivity.

As other developing countries, most ACP countries face a lack of competition in many of their domestic markets. Industries tend to have substantially higher concentration ratios than their counterparts in industrialised countries. Administrative barriers, such as establishment requirements and licensing, tend to be high and effectively constrain newcomers from entering the market. Red tape or excessive taxation can impede businesses from stepping from the informal sector into the formal sector. Imperfect financial markets also impede outsiders from obtaining the necessary financial resources to start new competitive businesses. With most developing countries lacking an effectively competition policy, all these factors tend to give excessive market power to incumbent monopolists and oligopolists.

Clearly, trade reform by means of EPAs could constitute an important step in improving levels of competitiveness in ACP economies. In sectors where domestic conditions are as described above,

the mere threat of competition from EU exports might be sufficient to improve the situation. However, removing tariffs is by no means a substitute for a good competition policy. Neither will EPAs as such result in less red tape, a business-friendly fiscal system or well-functioning credit markets. Hence, liberalised trade with the EU can help, but competition levels are ultimately determined by domestic policies. Conversely, should EPAs be introduced while upholding many domestic constraints, competition in some sectors might well decrease as large EU firms, unaffected by local market constraints, corner ACP markets by means of exports or commercial presence.[9]

Economies of scale that can arise as a consequence of liberalised trade are undeniably intertwined with the above. As long as business is conducted in a competitive environment, scale effects provide a net gain to the economy: by means of increased production, average production costs are lowered and consumer prices fall. However, small and relatively closed economies such as those of many ACP countries, might currently be too small to (fully) exploit scale production, for example, because local or regional demand is insufficient or because supply is fragmented over too many small producers. Enlarging markets by means of an FTA might then be a remedy to bring so-called 'unexploited scale economies' to the surface. In theory, EPAs would do exactly that.

Yet, whether enlarged markets can really bring about scale economies for developing countries is still hotly contested.[10] In terms of scale effects related to market access for exports, ACP countries have long enjoyed tariff-free access to EU markets for nearly all of their products. In this respect, if there are still unexploited scale economies, they could only be brought about by enhanced market *entry*, a point taken up in more detail below. In contrast to ACP trade with the EU, the regional dimension of EPAs *does* foresee enlarged markets, as intra-ACP trade is still relatively well protected in the regions.[11] However, the extent to which scale-derived benefits really come about in these markets remains to be seen. In the African regions, for instance, many exports are characterised by non-complementarity towards the exports of regional partners.[12] As export markets lie predominantly outside of Africa, this means that few scale benefits can be expected from liberalised intra-regional trade.

Who benefits? The issue of economic agglomeration

Even if the overall impact of integration is positive, the benefits of integration could be distributed unequally. Scale economies, for instance, are much more likely to be reaped in the larger, more competitive and advanced ACP economies. As differences between individual ACP economies are large, it is not unrealistic to expect **agglomeration effects** – that is, changes in the geographic location of economic activities – to take place when EPAs are implemented. Once intra-regional trade barriers are eliminated under EPAs, strategic considerations could convince businesses in the region as well as foreign investors to establish their production facilities and main offices in one or only a few locations, from which they can serve the entire regional market.[13] Clearly, within ACP regions, qualitative differences in the infrastructure of key business-facilitating areas, such as transport, financial services and telecommunications, can be huge. Consequently, both regional and foreign investors in, for instance, manufacturing, may tend to locate near each other at locations where facilities are best. For an ACP region, internal integration could thus imply that parts of the manufacturing sector will concentrate in the best-developed member state, leading to de-industrialisation of less-developed partner countries.[14]

Because economic agglomeration can benefit some members of an FTA at the direct expense of others, it has the potential to undermine the entire agreement. Where an EPA is implemented there is only one remedy to mitigate the agglomeration effect, and that is to structurally improve the economic infrastructure of the least-developed ACP countries in the region, ranging from enhancing the macroeconomic and legal environment to upgrading transport and communication systems. Hence, once again, mitigating potential costs arising from EPAs depends foremost on the degree to which complementary policies can be successfully pursued by the administrations within ACP countries.

Box 1. Divergence in economic performance – some examples

Whereas the best known case of North–North integration, that of the EU, is a clear example of how integration can lead to economic convergence, there are some examples of South–South integration where the opposite has occurred. The collapse of the Eastern African Community (EAC) in 1977 was partly caused by the dissatisfaction of Tanzania and Uganda over the fact that Kenya reaped a disproportionate share of the gains because it attracted the far greater majority of manufacturing industries and thus expanded its position as the industrial centre of the common market at the expense of the others. In the Central American Common Market (CACM), a similar trend is discerned: Guatemala and El Salvador produced 69% of the region's manufacturing value-added in 1965. This figure rose to 82% by 1996, possibly at the expense of the less-industrialised CACM members Nicaragua and Honduras, whose combined share declined from 31 to 18%. In West Africa, Ivory Coast and Senegal increased their manufactured value added from 55% of the Union Economique et Monétaire Ouest Africaine (UEMOA) in 1972 to 71% in 1997.

Source: World Bank (2000)

Investment and technology transfer effects

But withstanding the above, trade and economic integration aspire to more than changes in trade patterns, the size of businesses and economic geography. **Knowledge spillovers and technology transfer** are considered to bring the most crucial benefits from trade and economic integration, enabling faster economic growth through the accumulation of new knowledge, modern technologies and job-specific skills.

According to a review by the World Bank (2000), the empirical evidence available so far is indeed supportive of the role of trade in stimulating international knowledge spillovers between industrialised and developing countries. It appears that particularly in knowledge-intensive industries, trade between industrialised and developing countries significantly increases productivity in the latter.[15]

In the EPA context, an increase in imports from Europe to the ACP could boost the productivity (and thus global competitiveness) of ACP industries. Whereas currently certain ACP processing firms cannot access the latest, most cost-efficient technologies because of tariffs or strict investment regulations, EPAs could offer new opportunities. Yet to absorb knowledge spillovers, the state of domestic human capital must be constantly improving. In other words, trade-related knowledge spillovers make little sense if education and training are insufficient to enable a country to capture these benefits.

Both trade openness and the transfer of knowledge are often associated with **foreign direct investment** (FDI). Whereas in theory, FDI can be a substitute for exports, the two are often complementary. Because rules on investment are also on the negotiation agenda, EPAs could be assumed to boost FDI. However, as yet, there is no evidence that investment agreements as such boost FDI inflows. Neither is there much clarity on whether regional integration amongst developing countries will affect the inflow of investment. Rather, it is the quality of the national or regional investment environment that seems crucial. Issues such as macroeconomic stability, reliability of public authorities, rule of law and security of property rights form the essential elements of this environment.[16] Hence, also in the area of FDI and technology and knowledge transfers, domestic policies are again crucial for EPAs to have the desired effects.

The fiscal dimesion of EPAs

Though the implications differ widely between ACP countries and regions, the fiscal dimension of EPAs is another issue that cannot be ignored. Trade liberalisation within ACP regions and with the EU implies that fiscal revenues currently obtained from tariffs and duties on imports will disappear over time.[17] In particular, the fiscal revenues of the smaller countries and the LDCs in the ACP group, whose economies are more dependent on trade-

related taxation, will be seriously affected – up to 30% in some cases – as demonstrated by estimates made in different impact studies (see Table 1).

It should be noted that for many countries, the impact is likely to be even larger when the ACP's own regional integration processes and liberalisa-

Table 1. Estimates of fiscal effects of EPAs

ACP country	% fiscal revenue loss	% customs revenue loss
SADC		
Angola	3.7	n.a.
Botswana	1.0	6.0
Lesotho	0.4	0.8
Malawi	1.4	6.3
Mauritius	9.3	27.9
Mozambique	5.2	23.0
Namibia	0.8	2.5
Seychelles	29.7	70.0
Swaziland	0.4	0.8
United Republic of Tanzania	8.2	30.0
Zambia	2.0	22.0
Zimbabwe	3.1	18.0
EAC		
Kenya	12.0	82.0
Uganda	16.0	69.0
United Republic of Tanzania	20.0	73.0
CEMAC		
Cameroon	8.2	81.9
Central African Republic	14.9	79.2
Congo	14.1	71.3
Gabon	6.5	51.0
Guinea	5.0	67.0
Chad	18.2	76.7
Pacific		
Papua New Guinea	0.6	2.8
Fiji	0.3	1.4
Solomon Islands	1.4	2.5
Vanuatu	1.4	2.7
CARICOM/Dominican Republic		
Antigua Barbuda	9.5	14.0
Bahamas	n.a.	n.a.
Barbados	0.6	17.0
Belize	1.0	16.0
Dominica	1.4	6.0
Dominican Republic	1.9	19.0
Grenada	2.1	13.0
Guyana	2.6	12.0
Haiti	n.a.	n.a.
Jamaica	0.9	11.0
Montserrat	4.6	10.0
St Kitts and Nevis	2.0	10.0
St Lucia	2.5	15.0
St Vincent and the Grenadines	7.1	17.0
Suriname	n.a.	17.0
Trinidad and Tobago	0.4	16.0

Source: Bilal (2002)

tion towards third countries are taken into account.

There is no doubt that without flanking measures, these large decreases in fiscal revenue will substantially harm ACP countries' budgetary capacities to finance key expenditures in focal development areas, such as education, health and poverty alleviation. Alternative sources of revenue will therefore need to be created. A standard recipe is to replace the taxes levied on imports with an (increased) tax on consumption, labour or capital. Overall, consumers and firms should find such a tax (increase) bearable, as prices of imports would decrease simultaneously.[18]

Yet however large the rationale for fiscal reform, the issue is likely to remain among the more controversial aspects of EPAs. Experience suggests that radically altering the fiscal system is a cumbersome exercise for developing countries because (a) a large part of economic activity takes place outside the realm of the official economy; (b) many developing countries rely heavily on taxation of imports because it is relatively easier and less costly to administer; and (c) some government agencies are considered not strong enough to enforce modern types of taxation.

The issue of fiscal revenue is one of the prime examples where EPAs would need to take into account the serious institutional implications of regional integration.

Deep integration

According to the Cotonou Agreement, EPAs aim to go beyond traditional free trade agreements to tackle trade-related regulatory issues such as **sanitary and phytosanitary standards (SPS), technical standards, rules of origin and customs procedures**. These elements will be of crucial importance to ACP exporters as their effective inclusion in EPAs can make the difference between so-called 'shallow' and 'deep' integration.[19]

There is increasing evidence that while direct taxes on trade have been significantly reduced over the past decades, alternative forms of effective protection, mainly through increased regulation, have become the most significant barriers to trade with developed countries. However, compared to tariffs and quotas, this issue is much more difficult to tackle in a systematic way. It is, for instance, difficult to ascertain where trade rules stop being 'fair' and hidden protectionism (whether purposeful or not) emerges.[20]

To address issues of technical barriers to trade (TBTs), standards, and rules of origin, particularly close collaboration and consultation is needed with the relevant private sector actors, because these issues require input of a highly detailed and often very technical nature. In many ACP countries, however, constructive platforms bringing together public and private sector actors are still lacking. Hence, in order to move from free market access to effective free market entry, a lot remains to be done at the domestic policymaking levels of the ACP countries and regions.

Should EPAs turn out to be shallow agreements in practice, the lack of deep integration is likely to seriously restrict any beneficial effects. ACP regional markets are already shallowly integrated. While constraining many of the benefits, unfortunately, a shallow EPA does not necessarily mitigate the costs that integration might bring. The erosion of tariff revenues and the potentially harmful penetration of low-cost EU producers (possibly with monopoly power) will also occur under EPAs that are formed solely around the reduction of tariff barriers. In this respect, the depth of EPAs will be of much greater importance to the ACP region than to the EU.

Trade reform and poverty

In its very first article, the Cotonou Agreement states that it 'shall be centred on the objective of reducing and eventually eradicating poverty'. The first article of the Economic and Trade Cooperation chapter reiterates this principle, but subsequently the term 'poverty' goes unmentioned in any of the more detailed provisions on EPAs. Of course, one could argue that the mere successful implementation of EPAs – that is, agreements that ultimately contribute to ACP economic growth and ACP integration into the world economy – implies a positive impact on poverty alleviation. Yet such an approach surpasses some of the basic insights from economic theory and disregards practical experiences of the effects of trade reform on the poor in developing countries.

Though a few paragraphs certainly cannot suffice to cover the relation between trade reform and poverty, some basic insights can be mentioned.[21] As put forward by Winters (1999), the functioning of markets is the most critical issue determining the impact of trade liberalisation on the poor. The welfare effects of trade liberalisation can be distributed along four major channels: the prices of goods, the prices of production factors (capital, labour), the effects on technology and growth, and the effects on the fiscal balance.

First, trade reform sets off price changes. In general, trade liberalisation increases export prices and decreases import prices. The existence of functional distribution channels (wholesalers, transporters, retailers) determines the degree to which price changes at the border actually filter through to the rest of a country or region. Further, if the diversity and substitutability of the goods consumed is large (and markets function well), overall effects are likely to be positive because the poor can shift their consumption towards goods that have become cheaper.

Second, trade reform may change factor prices. Changes in employment and wages might have serious consequences for the poor. Whether the poor can mitigate costs (e.g. unemployment in import-competing industries) and subsequently benefit from opportunities (e.g. employment in expanding sectors) depends on the functionality of labour and capital markets, as well as the degree to which workers and smallholders can adapt their skills to the new economic environment.

As discussed before, a liberalised trade policy can stimulate economic growth through the import of new technologies and the inflow of knowledge, either via trade in goods, the attraction of FDI, or both. Though there are exceptions, empirical evidence strongly suggests that economic growth tends to benefit the poor proportionally.[22] However, as also mentioned earlier, trade liberalisation can adversely impact the fiscal balance. Whether this affects poor households – and to what extent – ultimately depends on the budgetary and fiscal decisions made by government. Though the poor constitute the largest proportion of the population in nearly all ACP countries, a key question is to what extent the poor can form an effective interest group in the tax-reform process. In developing countries where a small elite dominates the political agenda and the reform process, there is a real danger that the burden of budget cuts or new taxes will be disproportionately shifted towards the poor.

Clearly, the functioning of markets, flanking measures and democracy are the key elements that determine the overall effect of trade liberalisation on the poor. If the markets for goods, labour and credit function adequately, poorer groups will ultimately be better off by means of a generally lower price level and jobs or businesses that earn better wages and higher profits than before. Similarly, the quality of public services in combination with the effectiveness of democracy ultimately determines whether the benefits and costs will be spread equally over society.

Three factors affecting the impact of EPAs

From the above, it is still impossible to discern the impact that an EPA might have on an ACP region. To do so would require detailed analyses at both ACP regional and country levels. Overall, three factors can be said to determine the final outcome of EPAs, should they be concluded:

- the economic characteristics of the ACP region;
- the provisions of the final agreement; and
- the development and enhancement of key institutions in the ACP countries before, during and after EPA negotiations.

As for the first factor, *the economic characteristics of the ACP region*, it is evident that the ACP group is much too diverse to generalise on the overall directions of the aforementioned economic effects. Crude economic characteristics, such as GDP per capita, macroeconomic stability, main income sources and trade patterns with the EU, differ substantially between but also within ACP regions. Inevitably, some countries will be more prone to gain from EPAs whereas for others, the costs, at least in the short run, are likely to be larger.

In contrast to the first factor, which comprises a given set of characteristics that each region has to live with, the second factor, *that of EPA provisions*, is

Table 2. An institutional 'wish list' for EPAs

A	B	C	D	E
Economic impact*	**Positive effect +**	**Negative effect – (maximise B, minimise C)**	**Welfare stimulators**	**Key institutional and organisational requirements**
static effects	• trade creation	• trade diversion	• trade liberalisation towards third countries	• strategic external trade policy
competition effects and scale effects	• lower prices for consumers and producers • job creation • efficiency gains • stimulation of domestic and foreign investment	• threat to previously protected industries • job losses • monopolies cornering regional markets • growth divergence between least and more developed countries in an ACP region	• competition policy • short adjustment processes for firms and workers • improved market access to EU for exporting (scale) industries • improved economic infrastructure and investment environment in least-developed ACP countries	• functional labour and capital markets • rule of law • functional judiciary • competition authority • national and regional infrastructure strategies • improved access to credit for SMEs
agglomeration effects	• centripetal forces: broad geographical distribution of benefits	• centrifugal forces: benefits accrue predominantly to centres of economic activity	• improvement of economic infrastructure	• national and regional infrastructure strategies (see WB on this) • improved private and public access to credit
FDI and technology transfer effects	• growth in FDI • knowledge accumulation • productivity increases	• hub and spoke (investment diversion effect towards EU hub)	• trade and investment liberalisation within ACP regions and towards third countries • improvement of investment environment	• rule of law • macroeconomic stability and reform • social stability • education
fiscal effects	• fiscal reform (trade policy no longer fiscal instrument)	• loss of fiscal revenue due to tariff elimination	• technical assistance for reform • fiscal compensation measures	• competent tax authorities • society conducive to change • rule of law
additional integration effects	• deep integration: from market access to market entry	• shallow integration: few measures beyond duty-free access	• upgrading of customs procedures, certification agencies and public and private sector know-how on trade facilitation • strong EU–ACP co-ordination and co-operation on (removal of) non-tariff barriers • improved rules of origin	• empowerment of business associations • dialogue and trust between public and private sector • competent trade bureaucracies • strong regional organisations

Table 2 (continued)

A	B	C	D	E
Economic impact*	**Positive effect +**	**Negative effect - (maximise B, minimise C)**	**Welfare stimulators**	**Key institutional and organisational requirements**
impact on poverty	dependant on dynamics of B and C		• functional markets for goods, credit and labour • poverty impact analyses by ACP and EU, including informal sector, urban, rural and gender dimensions	• effective democracy • education and training • mainstreaming trade policy into PRSPs and overall development policies

*This table provides a schematic – and necessarily artificial – representation of the variety of economic effects that EPAs could have and their enabling conditions. Genuine classification of effects and conditions is problematic because of strong interrelationships.

in constant flux. The precise details of an EPA will be discussed time and again over the next few years. The extent to which the principle of asymmetry is applied will probably be at the heart of these discussions. Transitional periods, sector exclusions and safeguards can all prevent or eliminate the economic effects discussed above. This can be positive in areas where large costs and only marginal benefits are involved for the ACP. However, excessive flexibility in the implementation of reforms can also evaporate all potential gains. Furthermore, there are important legal challenges to tackle. On issues such as investment rules, contingency protection, dispute settlement, trade-related areas and EU assistance, it is the legal and procedural details, rather than the inclusion of these areas as such, that will affect the impact of an EPA.

The third factor, *development and enhancement of ACP institutions*, is the most elusive but arguably the most important in determining the outcome of EPAs. In parallel to the EPA negotiations, ACP countries face the overriding challenge of preparing their relatively small economies for free trade with the world's largest economy. As previously argued, being prepared means that the necessary *enabling conditions* are in place once an EPA is implemented. To bring about these conditions, a wide set of institutional reforms is necessary, and sufficient capacity must be in place to adequately manage these reforms. Indeed, from the previous sections, an *institutional 'wish list'* could be compiled with respect to ACP preparations (see Table 2). Yet history shows that the emergence of institutions is anything but an automatic and inevitable process.[23] Moreover, various institutions that ACP countries currently lack have taken decades or more to develop and mature in developed countries.[24] In other words, acknowledging that many ACP countries at present lack the resources, the experience and often the necessary political leadership, the question springs to mind of whether the necessary 'eruption' of institutions and capacities can occur within the relatively short timeframe that EPA negotiations pose. The next section deals with this question.

An institutional race against the clock

From the previous section it is clear that the quality of institutions will be a crucial factor determining the impact of EPAs on ACP countries (Box 4.1). However, in many ACP countries and regions, the institutional framework is currently insufficient to adequately deal with all of the economic effects of EPAs. A key question is thus whether the process of EPA negotiations can sufficiently trigger the improvement of institutions in the ACP countries. That institutions matter for development is now widely acknowledged within the international community. The quality of developing countries' institutions is generally viewed as a crucial factor in realis-

Box 2. Institutions

In the literature, the term institutions is used by a wide range of academic disciplines and applied to a variety of contexts. For the purpose of this chapter it refers to:

formal and informal rules and their enforcement mechanisms that shape the behaviour of individuals and organizations in society.

(Burki and Perry, 1998).

Clearly, this is a broad concept. However, in light of column D in Table 2, it would be impossible to come up with a more narrow and concrete concept that would do justice to the range of conditions that will determine the impact of EPAs. Because both the form and the quality of institutions are dependent on a great variety of factors – (financial) resources being only a minor one – changing the institutional framework of a society is broadly recognised as an elusive and long-term process.

ing a horizon of objectives, whether they concern human rights, peace and security, health and education, the environment or economic prosperity and poverty alleviation.[25]

Institutions as the crux for trade and development

Many observers argue that understanding the conditions that shape institutions is central to explaining international differences in economic performance.[26] With respect to trade policy, an interesting empirical debate has emerged as to whether trade openness or institutional quality better explains a (developing) country's economic performance.[27] Recent work by Rodrik and others suggests that once institutional quality is accounted for, this factor trumps all others – including openness – in explaining international differences in prosperity.[28] In this light, the controversy regarding the proposition of Dollar and Kraay (that openness leads to significantly higher economic growth) is further increased. Rather, it appears not to be *what* a country does that is crucial, but *how* it does it.[29] The issue then moves away from the one-dimensional question of protectionism versus openness towards the multiple dimensions of the trade policymaking process and related institutions.[30]

If the process and institutions related to trade policymaking are indeed so crucial to economic growth and development, EPAs pose much more than just a strategic challenge to the ACP. Before, during and after liberalisation of trade with the EU, complex analyses must be undertaken and difficult decisions made with respect to the functioning of capital and labour markets, public investments in infrastructure, competition and other legislative settings, a new or improved fiscal system, social safety nets, a multilateral trade strategy, the structure, shape and programme of regional integration, and an upgrade of statistical services, customs procedures and technical facilities. Of course, for all of the areas mentioned, reforms are needed – regardless of whether trade is liberalised through EPAs. Yet the key question is whether the EPA process offers a good vehicle to achieve the reform objectives, and if so, whether the timeframe is sufficient to allow the appropriate institutions to develop.

To better concretise the case for institutions, the following sections deal specifically with the trade policymaking process and the related issue of trade capacity-building.

The trade policy process: Best practices from developing countries

If there is no standard formula for the best trade policy with respect to development, then certainly no standard policy process can exist. Each developing country has a unique political, social and economic environment in which the government operates to make trade policy and prepare for international trade negotiations. In this respect, of particular relevance for most developing countries are the financial and human resource constraints that impede the generation of all relevant information and hamper analyses for optimal preparation.

Though a range of literature addresses how trade

policy is conducted in developed countries, only in recent years have academics and policymakers from North and South started to give systematic attention to trade policy processes in developing countries.[31] In order to discuss these, it is first necessary to define what is meant by effective trade policymaking. Following Solignac Lecompte (2001a), it can be argued that this is a process that:

- identifies the country's *trade interests*, in the framework of its overall development strategy;
- translates these interests into *policies and negotiating goals*; and
- distributes *roles* – either explicitly or implicitly – and allocates *resources* to implement these policies and promote these interests, reactively or actively, in the various negotiating fora (at multilateral, bilateral and regional levels).

Reviewing the recent literature, the overall picture seems to be that despite impressive progress in certain countries, most developing countries remain unable to live up to the enormous challenges posed by current global trade rules and multiple negotiation fora. Though, naturally, financial and human resource constraints are the suspects most visible to observers, evidence also convincingly points towards a lack of several other elements as hampering trade policymaking.[32] Those that seem most critical to an effective trade policymaking process are leadership, capacity, and inclusiveness and transparency.

Leadership. Political leadership is a sine qua non for a good trade policymaking process. Only when a government clearly recognises the importance of its trade policy, it can prevent the trade agenda from being fully captured by wider political interests. Policymakers and trade officials require not only adequate resources but also sufficient political support in order to embed national trade policy in overall development policy. If a government is to take trade policy seriously, it must allow its officials to deal with vested interests, both within the government administration and in the private sector.

Capacity. To adequately deal with the international trading system, countries need basic capabilities, functioning organisations and competent people within those organisations. The scope of WTO rules and bilateral trade negotiations is so broad that both the development and implementation of trade policy will affect a wide range of government departments. Hence, there is an overriding need for adequate capacity, not only to understand international trade issues and their potential impacts, but also to co-ordinate between relevant departments within the government and to delegate authority amongst government actors.[33]

Inclusiveness and Transparency. The inclusion of non-state actors in formulating trade policy can widen the resources and information available to the policymaking process and channel information on policy implications to stakeholders. An effective consultation mechanism – involving the relevant government agencies, the business sector and civil society through unions, non-governmental organisations (NGOs), and academia – can lessen the burden on government to generate sufficient information. Inclusion can also create the necessary degree of *transparency* and *legitimacy* for trade reform.

Though easily adopted in principle, experience suggests that initiating genuine dialogue between government and non-state actors is difficult in practice. For example, private enterprises in developing countries are seldom aware of their stakes in trade agreements, and their relations with government authorities are often characterised by discontent and mistrust. Clearly, the development of a successful public–private consultation mechanism, in which government and non-state actors both recognise the potential value-added, can be achieved only with time.[34]

The donor dimension: TCB as a hype?

Donors and international organisations have increasingly recognised the capacity constraints facing developing countries in the field of international trade. Consequently, trade capacity-building (TCB) programmes aim to support trade-related institutions in those countries. Yet, it is only since the launching of the Doha Round in 2001 that TCB has been at the top of the international trade

Box 3. Trade capacity building

Although institutions (as defined in Box 2) are crucial to the impact of EPAs, the concept seems too broad and elusive to form a concrete target for development co-operation agendas.[a]

Instead, recipient government authorities and donors have narrowed their focus on those organisations that they perceive to be the most important through their direct impact on the wider institutional framework. Within the specific area of trade policy, we have clearly identified some of these organisations, such as government ministries, regulating and enforcement authorities, judicial bodies, regional organisations, private sector entities, universities, and civil society representatives. Obviously, the ultimate objective of co-operation and assistance is to build the capacities to research, debate, design, negotiate, implement and regulate trade and trade-related policies. In this respect the term *trade capacity building* is often used.[b] This paper defines trade capacity-building as:

'a process by which individuals, groups, and organisations enhance their abilities (individually and collectively) to perform tasks, solve problems and both set and achieve objectives in the field of trade and trade-related policymaking and implementation'.

[a]Over the past decade, some bilateral donors have incorporated *institutional development* as a cross-cutting objective in their co-operation and assistance programmes; however, there remains substantial ambiguity over what this means in practice.

[b]*Capacity development* or *capacity enhancement* are other terms often employed by international institutions and donors. Neither is necessarily more suitable than another. ECDPM is currently carrying out a study to shed light on the semantic confusion around and operational meaning of concepts such as capacity. This paper uses *trade capacity-building* because it occurs most frequently in the debate on ACP–EU trade negotiations.

agenda. The Doha Declaration clearly spells out that 'technical co-operation and capacity-building are core elements of the development dimension of the multilateral trading system' (Art. 42).

Table 3 shows that the increased attention for developing countries' trade institutions has led to substantial contributions from donors in TCB-related activities (see also Box 4).[35] Evidently, developed countries have a clear interest in devoting resources to these initiatives. Without the strong provisions for assistance to developing countries' trade institutions it is unlikely that the Doha Round could have been launched. For the WTO itself, TCB programmes are crucial because the non-participation of many developing countries constitutes a direct threat to the credibility and legitimacy of the organisation.

Moreover, TCB programmes seem important to ensure that developing countries stay involved in the trade liberalisation process and remain willing to enter into negotiations on issues that they originally perceive not to be in their interest. For instance, in 2002 one-third of the world total TCB activities concerned the so-called 'Singapore issues' (investment, competition, government procurement and trade facilitation).[36] Interestingly, it is exactly these issues that most developing countries are reluctant or unwilling to negotiate in the Doha Round, as was demonstrated by the breakdown of the WTO Ministerial Meeting in Cancun. Hence, TCB programmes can also serve as a buy-out to obtain concessions from developing countries in multilateral or bilateral trade negotiations.[37]

The European Commission has been among the main driving forces of TCB programmes. Though support in this area features throughout the EU's external relations agenda, EU support for TCB is most ambitious with respect to the ACP group. Since its initial 1996 Green Paper, which initially proposed reciprocity, the Commission has stressed that EPAs should go beyond just free trade. Consequently, provisions stressing capacity building for both regional and domestic ACP organisations recur throughout the Cotonou Agreement.[38] Yet the

Table 3. Trade-related technical assistance (TRTA) and capacity-building (CB) commitments in 2002 (US$ million)

Main donors	Trade policy and regulations[a]		Trade development[b]		Contributions to multilateral TRTA/CB providers or programmes[c]	
European Commission	292	41%	419	59%	0.8	0%
France	5.3	5%	112.8	93%	1.6	1%
Germany	9.0	12%	65.5	84%	1.2	2%
Japan	16.1	31%	34.8	67%	1.5	2%
Netherlands	2.6	10%	22.4	82%	2.3	8%
Switzerland	8.7	12%	55.7	79%	5.9	9%
United Kingdom	18.3	33%	35.2	63%	2.7	5%
United States	177.8	29%	437.7	71%	1.5	0%
World total	712	33%	1383.4	65%	34.6	1%

Source: WTO/OECD TRTA & CB Database (2003).

[a]Concerns programmes in areas such as trade education and training, regional integration, agriculture, services, competition policy, investment rules, SPS, TBTs, TRIPs, customs procedures and trade negotiations.

[b]Concerns programmes in areas such as business support services, public–private networks, trade finance, market analysis and trade promotion.

[c]WTO, Integrated Framework (IF), Joint Integrated Technical Assistance Programme (JITAP), and the International Trade Centre (ITC).

agreement did not go so far as to commit additional funds for countries negotiating EPAs. To date, the Commission has stressed that the 9th EDF already reserves a considerable sum for this purpose, mostly via its Regional Indicative Programmes (RIPs).[39] As an exception to the rule, a €20 million Programme Management Unit (PMU) was set up to facilitate preparatory work for EPA negotiations by ACP actors. This PMU is in addition to an earlier committed €10 million to support ACP participation in WTO negotiations.

Since the regional dimension constitutes an important element of EPAs, it receives special attention in the support programmes. In this light, the Commission introduced the so-called 'toolbox' into the negotiations. Under the toolbox heading 'the elements relevant for successful ACP regional economic integration' are to be discussed. The Commission stresses that discussions 'will not end up with a recipe for a 'one-size-fits-all' integration process but should reflect on the building blocks of regional economic integration and the relationship to regional negotiations of EPAs'.[40] To complement the discussions under the toolbox heading with concrete support measures, in July 2003 the Commission approved an all-ACP €50 million support programme called Trade.Com. During EPA negotiations, this programme is to support the ACP regions in their preparations both for the negotiations and for the implementation of EPAs (see Box 4).

TCB programmes and institutions

Whereas both attention and funding for TCB activities have increased, there is as yet no systematic evidence that TCB programmes actually result in the development of appropriate institutions and sustainable capacities for trade policymaking. Indeed, most initiatives are relatively new and their full impact remains to be assessed. Yet the literature on institutional development in general and some case studies on TCB in particular may already offer some preliminary insights.

Characteristics of institutional development

Many observers have asked the question of how institutions develop and, consequently, how such a process can be supported by outsiders – donors and international institutions. To what extent can these outsiders actually influence the development of institutions in the first place? To date, surprisingly little research has been done that systematically distinguishes between the impact of internal and external factors on institutions. With respect to the

Box 4. The EU and trade capacity-building

The apparent importance that the Commission attaches to trade-related assistance is certainly not to the ACP group. Over the past three years, some € 2 billion has been spent on TCB for developing countries.a In many national or regional assistance programmes, considerable funds have been explicitly reserved for this purpose. In addition to direct bilateral support, the EU has taken a lead role in various multilateral TCB initiatives aimed at developing countries.

EU funded trade capacity-building programmes*

Beneficiary	TCB fund/source[b]	EU trade-related funding (€ million)	EU trade-related funding as % of total (EU) funding
Multilateral initiatives			
LDCs	Integrated Framework	5.5	60%
Developing countries	Doha Development Trust Fund	12	63%
All ACP			
ACP group	Trade.Com (part of 9th EDF)	50	100%
ACP group	PMU	20	100%
ACP group	Doha Round	10	100%
ACP regions[c]			
Central Africa	RIP 2002–07	14–16	25–30%
West Africa	RIP 2002–07	118	50%
Eastern and Southern Africa and Indian Ocean	RIP 2002–07	100–120	45–55%
Southern Africa (SADC)	RIP 2002–07	35–45	35–45%
Pacific	RIP 2002–07	9	31%
Caribbean	RIP 2002–07	43–51	75–90%
Non-ACP countries[c]			
Paraguay	NIP 2000–06	21.7	42%
Uruguay	NIP 2002–06	5.4	29 %
Chile	NIP 2000–06	6.4	19%
Bangladesh	NIP 2002–06	49	9%
Vietnam	NIP 2002–06	6	6%
Thailand	NIP 2002–04	5	50%
Non-ACP regions[c]			
Andean Community	RIP 2002–06	0.7	5%
Central America	RIP 2002–06	44.7	60%
Mediterranean	RIP 2002–04	10	11%

*The table is illustrative and does not present all EU support in the TCB area. In the case of the ACP, National Indicative Programs (NIPs) may also include funding that is trade-related.

[a]EC (2003a)

[b]NIPs: National Indicative Programme; RIP: Regional Indicative Programme

[c]In some NIPs and RIPs, trade-related capacity-building support is included in allocations that serve a wider purpose; here only NIPs and RIPs that reserve funds explicitly for support to regional integration and/or trade-related capacity building are included.

Box 5. Trade.Com and EPAs

In July 2003, the European Commission approved the Trade.Com programme for ACP countries. According to the Commission, Trade.Com will focus on 'creating the necessary capacities in ACP countries to benefit from increased trading opportunities'. The programme comprises three main components:

- strengthening of local trade policymaking, research and training capacities in the ACP countries;
- establishing a network of ACP experts through a so-called 'Hub and Spokes' programme (in addition to regional senior trade advisers, funding will be provided for local and regional trade fellows); and
- pilot projects to address urgent institutional and supply-side constraints in the areas of technical standards and sanitary and phyto-sanitary (SPS) requirements.

Trade.Com will be financed from regular EDF funds. It will become operational in 2004 for a period of six years, thus covering the entire EPA negotiation period and beyond.

specific role of donors, however, several case studies suggest that they have often failed to incorporate institution-related issues successfully into their programmes.[41] Some would argue that in most cases it is mainly the context (the macroeconomic environment) that prevents external assistance from having a (sustainable) impact on institutions. However, here too concrete evidence is lacking.[42]

There is a large body of literature on the conditions that support or strengthen institutions.[43] Given the broad scope of the subject, it is not surprising that many of these conditions are interdependent and mutually reinforcing. In full acknowledgement of this, a non-exhaustive and necessarily artificial classification of some of the basic insights follows below.

A long-term and evolutionary process. Institutions cannot develop overnight or through one-shot initiatives or projects. One organisation cannot develop another. Rather, the development of institutions concerns an endogenous process that requires the stakeholders involved (e.g. public officials, non-state actors and donors) to continuously learn from each other, gain experience, and adapt their working methods along the way.

There is no magic bullet for creating or strengthening institutions. In particular in the area of trade, it has become abundantly clear that each case is *sui generis*. For instance, relatively successful institutions, such as those establishing European integration, are not easily copied by others. To be effective, institutions need to complement local conditions. Recent case studies on Latin America suggest that where trade institutions malfunction, building up new ones from scratch to eliminate past problems (so-called 'big-bang' reform) does not lead to improvements in practice.[44] Incremental change, by building on existing capacities and structures, however imperfect these may be, is more likely to yield benefits over time.

Political leadership. The willingness of leaders to use their political weight in support of change is crucial. Admittedly, the improvement of institutions is often a bottom-up process, originating from the roots of society. Politicians are sometimes late arrivals in such processes. Yet their role is crucial, since improvements in institutions can only be harnessed once the top has fully recognised their importance.

Ownership. Government and non-state actors are owners of a process when they feel it empowers them and serves their interests.[45] If organisations, laws or procedures are established only in response to pressures from outside, they are unlikely to survive or be implemented. Once actors feel they have a stake in the successful establishment of organisations or the effective implementation of rules and procedures, a basis for positive institutional change can emerge. The literature shows that when stakeholders come into policy processes with open minds, the final decisions are more appropriate and more likely to be implemented than if some stakeholders

adopt preconceived positions from the beginning. This suggests that policy conditionalities fixed *a priori* are likely to be counterproductive.

Inclusiveness. In many cases, institutional change is pursued in a context of policy reform. To prevent a (reformed) public sector organisation from operating in an isolated environment, it is important to involve non-state stakeholders in the reform process. In the area of trade reform for instance, developing countries that have been able to broaden their policymaking processes by engaging in open and inclusive consultations with the private sector have generally performed better than countries where such consultations have been absent.[46]

The involvement of donors

Though the concept remains elusive for many, building sustainable institutions has acquired a firm place on donors' lists of top priorities. Nonetheless, the donor community's record with respect to effective support for good institutions remains dismal. In a review of the literature, SIDA (1995) concluded, '[I]t is clear that aid agencies perform badly at institution building. They are bureaucratic institutions that are financially accountable to their own governments and taxpayers. They are outsiders to the country they are trying to help and their understanding of the local context is limited'.

The specific field of trade seems to be no exception in this respect: it has proven to be difficult to have a lasting impact as a donor. Moreover, the large number of TCB programmes have the additional disadvantage of possible double agendas and the risk of so-called 'biased aid'.[47] Except for this point (which applies specifically to the area of trade), the recent spurt of literature and case studies on donor involvement in institution building tends to confirm some general insights on how donors can stimulate or fracture the development of institutions.

Absorptive capacity. Unfortunately, the countries most in need of assistance in institution building have the most difficulties in using assistance effectively. Because the institutional bases in these countries are amongst the most fragile, it is all the more difficult to stimulate sustainable development from the outside. Additionally, in countries where the fewest government resources can be committed towards institution building, ownership and accountability are likely to remain low, and there is a serious chance that donor and recipient will enter into a downward spiral of aid dependency. LDCs constitute a particularly difficult case for donors. As UNDP put it, the LDCs' 'weakness also inhibits their ability and confidence to get into the driving seat, choose the direction in which to travel, and acquire and absorb appropriate resources that will be needed on the journey.'[48]

A demand-driven agenda. Where donors dominate the identification, design and implementation of programmes, recipients tend to adopt passive attitudes, resources are allocated inefficiently and aid-dependency increases. Although recipients are also often motivated by short-term interests, a donor-driven agenda tends to further bias the allocation of assistance towards activities that can, in a short time span, result in more tangible outputs. Without adequate needs assessments, programmes can divert capacities to areas of lesser local concern, decrease ownership and limit accountability on the recipients' side. Though the very involvement of donors will always complicate the intersection between demand and supply, by definition the genuine development of institutions is a process driven by local stakeholders.

Accountability. Donors can bias responsibility. The link between a government recipient and donor often takes precedence over the government's relationship with its citizens, which should be the cornerstone of a demand-driven process. Where actors are not very accountable to the actual stakeholders they serve, external assistance can undermine the opportunities for nationals to express their interests and priorities.

Flexibility. The circumstances under which institutions can be built or improved differ significantly by country and sector. 'One size fits all' programme designs tend to undermine flexibility, which is needed at the implementation level to adjust efforts to local circumstances.

Capacity depletion. Donors can attract competent personnel away from local organisations to the

detriment of sustainable institution-building. By directly or indirectly raising salaries and improving career prospects, donors can disturb the allocation of human resources in specific areas of policy-making, reducing continuity in the very institutions they are trying to assist. Personal skills are often upgraded through technical assistance and capacity-building programmes; but organisational learning is low because trained personnel switch to better-paid jobs. In particular, where projects are short-term, staff that benefited from training and education tend to leave organisations once projects are terminated.[49]

EPAs as drivers of institutions?

With respect to the impact that EU-funded TCB programmes might have on the relevant ACP institutions during EPA negotiations, the analysis above suggests some reservations.

Short-term. The timeframe in which EPAs are negotiated biases both donor and recipient priorities towards the short-term demands of trade negotiations: quick fixes and ad hoc solutions are required. For example, where there is a lack of local expertise, non-ACP consultants will likely be hired to provide various analyses and studies. Though these can be used directly as inputs in the negotiations, they seldom contribute to local policymaking capacities. Hence, there is an inherent danger that support programmes will quickly revert to backstopping of urgent capacity gaps, while ignoring their primary causes. Whereas the immediate negotiation process could run more smoothly with such direct support, a short-term approach could backfire once policymakers have to implement the agreement.

Supply-driven. Both the initial idea of EPAs as well as the current negotiation process have been predominantly driven by the European Commission. During negotiations on the Cotonou Agreement, many ACP countries responded to the idea of reciprocity with lukewarm enthusiasm.[50] Subsequently, the ACP group largely took a defensive and reactive stance during the first year of the negotiations. Though this cannot be generalised to every individual country, it is undeniable that many ACP countries have yet to fully endorse the ideas of reciprocity, domestic flanking measures and institutional reform.

Marginalisation of the national level? TCB support is likely to focus on the ACP regional levels, where bi-regional negotiations will take place. Yet it will be at the national levels that the bulk of policy reform will have to be done before and during the implementation of EPAs. As discussed, without significantly upgrading national trade policy institutions, ACP regions are unlikely to benefit from EPAs. Moreover, if national-level policymakers and politicians are marginalised in the EPA process, the negotiations are more likely to break down at critical stages.[51]

Lack of stability. Finally, in certain countries and regions, even the most basic enabling conditions for the development of trade-related institutions (or of institutions in general) are currently not in place. In various parts of West Africa and Eastern and Southern Africa, civil unrest, political instability and, in some areas, military conflict have eclipsed difficult but important policy issues such as trade reform on the policy agenda.[52] Some islands in the Pacific have also recently been contending with political turmoil. It is hard to imagine that their governments would currently be ready to fully engage themselves in reforming their trade institutions. Whereas other types of EU support might be most welcome, starting TCB programmes in countries where ownership and accountability is temporarily non-existent would be nothing short of a waste of resources.

Coercion or engagement: Two scenarios towards EPAs

An important aspect about EPAs is that the institutional 'wish list', as identified in section earlier, would hold true regardless of whether the ACP and the EU had agreed to reciprocity in the Cotonou Agreement. The current international trade environment demands substantial reforms from developing countries. Whether these reforms come about because of domestic, regional or multilateral factors is less relevant once it is acknowledged that trade policy and its related institutions *must* be improved, if only for the sole purpose of development and

poverty alleviation.[53] In this sense, it could be argued that the ACP can use EPAs and the accompanying EU assistance as a convenient vehicle to implement much-needed trade policy reforms.

On the other hand, it can also be questioned whether the concept of EPAs is suitable to deliver the required reforms. Arguably, trade-related institution building should basically be viewed as increasing ACP capacities to autonomously determine what policy direction is most suitable for their development. Yet the EPAs predetermine the direction of ACP trade policy (opening domestic markets *vis-à-vis* the EU). A related issue is that of sequencing. Whereas few disagree that trade policy reforms are necessary, a key question is whether up to 2008 and beyond the most pertinent needs will be addressed in the appropriate order and without skipping crucial steps in the process.

Taking into account the aforementioned insights on institution building and combining these with the experiences of other countries and regions that have been involved in trade negotiations with large trade partners, two different scenarios for EPAs can be envisaged.

Scenario I: A political economy of engagement

Recent case studies confirm that the mere involvement in trade negotiations can set off a range of positive externalities that affect policymakers and their institutions. In a case study of South Africa, Bilal and Laporte (2004) note that South Africa actively sought a new and progressive trade relationship with the EU, and it viewed trade negotiations as complementary to its overall development strategy in the post-Apartheid era (see Box 6). Under the influence of various regional and hemispheric negotiations, trade policy has also arisen on the agenda of the small countries in the Caribbean, pushing the pooling of resources at the regional level in order to deal with their considerable capacity constraints.[54] Hence, the urgent need to prepare input for trade negotiations can provide a necessary stimulus to organise policy processes more effectively, to better define economic and development policies, and ultimately to improve policy implementation. This also applies with respect to the intra-regional integration process. According to Bouzas (2004), the initial stages of Mercosur's integration process were characterised by the increased exposure of less experienced policymakers from the smaller member states (Uruguay and Paraguay) to their better equipped counterparts (Argentina and Brazil).

In this sense, (regional) trade negotiations can set off a political economy of engagement: domestic policymaking institutions improve as a consequence of the external policy agenda. As politicians and their policymakers become more exposed to the practices and policies of other countries, they will gain in their own leadership and policymaking capacities. Moreover, international negotiations provide an important incentive to review the strengths and weaknesses of domestic economic policy. Experience suggests that particularly in countries involved in democratisation processes with increasing participation of non-state actors (the business community, civil society and academia), policymaking institutions are likely to improve when exposed to external negotiations. Throughout Latin America, for example, democratisation and an increased demand for legitimate policymaking transformed trade policymaking processes throughout the 1990s. Opaque links between the public sector and a select group of large (import-competing) industries have been slowly replaced by more transparent and participatory policy processes.[55]

Seen in this light, EPAs could constitute an important stimulus to national and regional ACP institutions. This would affect not only trade policy *vis-à-vis* the EU, but also economic policy with respect to regional partners, important third-country markets, and multilateral partners. EPAs would then provide the often missing link between trade policy and ACP countries' integration into the world economy and, perhaps more importantly, between trade policy and their overall development policies.

Scenario II: EPAs through coercion

In the previous scenario, the EPA negotiation process would lock in an ACP's commitment to trade liberalisation, domestic flanking measures and institutional reform. Yet for this to happen, the

Box 6. South Africa: A precedent in institutional development?

Between 1995 and 1999, the EU negotiated its first comprehensive trade agreement with an African country, the Trade, Development and Cooperation Agreement (TDCA) with South Africa. A recent ECDPM case study (Bilal and Laporte, 2004) describes South Africa's preparatory process for these negotiations, highlighting a quite impressive performance of South African institutions (both state and non-state) at various levels. In the turbulent aftermath of the Apartheid era, the new South African government managed within a relatively short timeframe to define an overall development agenda for the country, integrate its external trade strategy into this agenda and identify its key strategic interests in the negotiations with the EU. After decades of sanctions, South Africa was a *de facto* newcomer in the international trade system. Devoid of any recent trade negotiation experience, the administration made use of its human resources to the fullest extent, as key administrators from the old regime worked together with the new ANC intelligentsia to prepare for trade talks with the EU. Other crucial elements supporting the administration were the functioning public–private sector platforms by which government, businesses, unions, farmers and civil society representatives critically followed the negotiations and distributed information to their constituencies. Various actors closely involved in the talks acknowledged that the negotiation process itself proved to be a valuable asset for South Africa's institutions.

The South African experience offers food for thought. If four years of experience in TDCA negotiations served to consolidate South African policymakers' trade and development strategies, wouldn't eight years of EPA negotiations provide similar stimuli to ACP countries and regions? Though the short story of the TDCA negotiations may give this impression, there are several reasons to remain sceptical.

First, after South Africa was initially declined access to the Lomé trade regime, the country consciously opted to negotiate a 'development friendly' free trade agreement with its most important trading partner. This deliberate approach was symbolised by the political leadership provided by presidents Nelson Mandela and Thabo Mbeki throughout the process. The South African administration was already engaged in a substantial trade-reform process before negotiations commenced, and in the government's view, an agreement with the EU would complement and harness these reforms. In contrast, many ACP countries have adopted a predominantly reluctant and defensive position the idea of reciprocity.

Second, prior to the negotiations South Africa's external trade policy already formed an instrument of an overarching development strategy, comprising a wide array of (reforming) institutions in the aftermath of Apartheid. In many ACP countries, however, trade and development have yet to be integrated into a mutually supportive framework.

Third, despite the radical changes that took place after the first democratic elections in South Africa, the old economic and institutional machinery was not destroyed by the new government. This meant that despite its inexperience on the international stage, the country was already endowed with a human capital stock and infrastructure quality beyond that of many ACP countries.

countries concerned would have to 'own' the concept of EPAs, like the way that South Africa actively sought new trade relations with the EU, or the Mercosur countries initially were highly committed to their internal integration process.

Yet, should ACP countries be engaged in EPA negotiations primarily for political reasons or because no suitable alternative is available, a different scenario is likely to develop. Instead of proactively engaging in trade policy analyses, consultations with non-state actors and the effective utilisation of TCB funds, countries and regions would adopt a wait-and-see approach, even as negotiations enter into the substance of trade liberalisation. Even

if the regional organisations may themselves grow stronger through the EPA process, their efforts to conclude beneficial agreements with the EU will be in vain if politicians and policymakers at the national levels do not get on board. In particular, if strong political leadership in favour of reciprocal trade agreements is lacking, national ACP actors are likely to act only defensively in response to EU proposals.

In consequence, there would be a serious danger that the ACP actors involved in the negotiations concentrate on the more superficial issues, such as additional resources from the EU.[56] Meanwhile, pertinent measures to upgrade domestic and regional trade institutions, both for the negotiations and for the eventual implementation of the agreements, would be omitted or implemented half-heartedly.

Of course, it cannot be ruled out that negotiations would simply break down if a certain ACP region proves insufficiently prepared to commit to an EPA. In particular, the regional dimension could frustrate the negotiations if members of an ACP regional grouping are unable to agree to enhance their own integration and their joint positions *vis-à-vis* the EU.[57] On the other hand, many ACP countries are highly dependent on access to the EU market. It is therefore questionable whether a country, under political pressure from its regional peers and the EU, would be willing to actually walk out of the negotiations at crucial moments.[58]

In this respect, there is a real possibility that even ACP countries that do not see the benefits of reciprocity would ultimately sign EPAs with the EU. In that case, trade relations with the EU are likely to be characterised by three features. First, the effective implementation of the agreements is likely to be cumbersome and restricted to the more superficial measures such as the elimination of tariffs on EU exports. Second, TCB funds available are unlikely to be used to effectively and sustainably improve trade policy institutions because the necessary reforms would not be owned by the recipient country. Third, and as a consequence, the largest benefits of trade liberalisation *vis-à-vis* the EU and its regional partners would not be captured by the ACP country concerned, though the most substantial costs will remain (see Box 7).

Box 7. The costs of non-engagement and superficial agreements

The largest economic benefits of integration are foregone when (regional) trade agreements are overly shallow; that is, devoid of provisions beyond the mere elimination of tariffs. Dynamic effects that are crucial to economic growth, such as increases in domestic and foreign investment, competition, economies of scale and technology transfers, are unlikely to accrue if regulatory issues such as customs procedures, rules of origin, standards and certification requirements are not adequately addressed in the negotiations and implemented afterwards. Because few tariffs and quotas are still in place on ACP exports to the EU, it is in these regulatory areas that most of the economic gains can be reaped. Yet, unlike calls for tariff elimination, addressing regulatory issues requires extremely detailed knowledge of product markets and the procedural constraints currently in place. In order to be sufficiently prepared, human and financial resources will have to be invested in the appropriate studies and in consultations with the private sector.

Within ACP regions, an equal amount of attention will have to be paid to the numerous non-tariff barriers that restrict intra-ACP trade. If instead only defensive positions are adopted within the region and *vis-à-vis* the EU, the result could well be that the gradual elimination of ACP tariffs on EU exports is exchanged for the status quo of (intra-)ACP market access. In that case, certain costs of trade liberalisation (e.g. increased competition from the EU for certain ACP industries and erosion of tariff revenues) will still be incurred, while crucial benefits are foregone.

EPAs as windows of opportunities and risks

If concluded, EPAs will constitute an unprecedented reciprocal free trade arrangement between the world's largest single market and some of the poorest economic regions. Obviously, the ACP group is far too large and diverse to generalise on the impact that such an arrangement would have on its members. Yet for all countries and regions concerned, a crucial question is whether the quality of trade policy institutions and other institutions suffices to optimise the benefits of free trade, while mitigating the costs. On the one hand, the very involvement in EPA negotiations could already have a positive effect on national and regional trade policymaking processes. EU funding to improve trade capacities in ACP countries could then make a further contribution.

On the other hand, if EPA negotiations and the use of TCB funds are driven by EU actors only, few positive externalities can be expected from the negotiation process. Indeed, should ACP countries finally conclude agreements solely because EPAs are considered the least bad of the alternatives, or in response to mere power politics, the costs of non-engagement during the negotiations are likely to be high. Moreover, most of the potential advantages of trade reform will be foregone if agreements and flanking measures are implemented half-heartedly, though the negative social and economic effects that accompany trade liberalisation will still be incurred.

In this respect, by introducing the concept of EPAs, the Cotonou Partnership Agreement offers a window of both opportunities and risks. The latter, however, are to be fully borne by the ACP countries.

Endnotes

1. For an overview of the key trade provisions in the Cotonou Partnership Agreement, see Bilal (2002).
2. In the WTO framework, the pressure on the EU to abolish or substantially alter the commodity protocols is likely to increase. Should ACP countries benefiting from the protocols decide not to open their markets to the EU and choose the non-contractual and non-reciprocal GSP or EBA schemes instead, this would substantially diminish their bargaining power to retain commodity protocol benefits.
3. Of course, countries can always withdraw from the negotiations and opt for an alternative at later stages. In this respect, it is no surprise that even those ACP countries most reluctant to negotiate reciprocity have remained on board so far. The Cotonou Agreement explicitly provides an alternative option for countries 'that decide they are not in a position' to negotiate EPAs (Article 37.6). This alternative is to be examined by the Commission in 2004.
4. See www.acp-eu-trade.org and the series of Trade Negotiations Insights (www.acp-eu-trade.org/tni.html) for the most recent updates and summaries on the ongoing negotiation process.
5. With SADC and the Pacific region, negotiations are planned to be launched in spring 2004 and in September 2004, respectively.
6. According to the Cotonou Agreement, in addition to market access in manufactured goods, agricultural products and services, EPAs will cover many trade-related areas, including competition policy (Art. 45), intellectual property rights (Art. 46), standardisation and certification (Art. 47), sanitary and phytosanitary measures (SPS, Art. 48), trade and environmental considerations (Art. 49), trade and labour standards (Art. 50), consumer protection (Art. 51), food security (Art. 54) and investment (Art.75). In terms of coverage, the recent agreements with Chile and Mexico best reflect the broad scope that EPAs are to have.
7. (i) If the majority of imports already came from the EU prior to an EPA, these imports simply become cheaper for ACP consumers and producers and trade diversion is likely to be small. (ii) Parallel liberalisation reduces the chance that low-cost imports from elsewhere will be replaced by more expensive goods from the EU. (iii) If domestic markets are not responsive to price changes, for example because of a lack of competition among suppliers, the benefits of tariff elimination are likely to be captured entirely by EU.
8. For a summary of the impact studies commissioned by the EC, see McQueen (1999). Gasiorek and Winters (2004) provide a recent assessment on the Caribbean.
9. It is sometimes argued that an open trade policy is the best implicit competition policy a country can adopt. Yet the creation of competition laws and a competition authority can be all the more important once trade and investments are actually liberalised. In particular, where trade patterns are mainly characterised by inter-industry trade (such as ACP–EU trade), liberalised trade can offer possibilities for large EU industries without counterparts in ACP countries to monopolise the latter's markets, and, consequently, abuse this position.
10. For a discussion, see Tybout (2000).
11. Not withstanding the fact that formally various ACP regions have already decided to move towards FTAs and customs unions, achievements so far have been limited. See e.g. Szepesi and Bilal (2003) on SADC.
12. See e.g. Yeats (1998).
13. In theories of economic geography, these strategic considerations are so-called 'centripetal forces': conditions that ensure economic activity are located in one central place. Renowned examples inspired from Porter's management literature (e.g. Porter, 1990, 1998) are *knowledge spillovers*, which make it attractive for firms to locate near each other; *labour market pooling effects*, which encourage firms to locate near the (most sophisticated) labour pool; and *buyer–seller linkages*, which induce firms to locate near the majority of their customers and suppliers. In addition, the quality of economic infrastructure and proximity to distribution hubs (such as seaports, main roads and airports) play a key role in the establishment strategies of businesses. See e.g. Krugman (1990), Puga and Venables (1998) and Venables (1999). Though other forces (so-called 'centrifugal forces) might counter these effects, both experience and theory suggest that for developing countries such as those in the ACP group, EPAs

might tip the balance towards a higher rather than a lower degree of economic agglomeration (see Box 1).

14. Except for arguments relaring to infrastructure, the geography of ACP regions could further stimulate agglomeration effects: within integrated ACP regions, economic activity might divert away from land-locked and small island economies towards their more strategically located counterparts.
15. See for instance Schiff, Wang and Olarreaga (2002).
16. See Hallward-Driemeier (2003)., Te Velde (2001) and Te Velde and Fahnbulleh (2003).
17. In the initial phases of EPAs the effect on tariff revenues is less clear. For some products, revenues might temporarily increase as lower tariffs may set off increased demand for imports.
18. Additional advantages of EPA-induced fiscal reform could be that tax revenues become more stable and the trade-distortive effect of import taxes would be eliminated. In the light of multilateral trade liberalisation or other regional arrangements, EPAs could well form a useful incentive to start reforms as soon as possible.
19. A case study that estimates large additional welfare effects of deep integration in a North–South (EU–Egypt) context is Hoekman and Konan (1998). As for rules of origin, some recent case studies of welfare-restricting effects are Brenton (2003) and Mattoo et al. (2002) for North–South trade and Flatters (2002) for South–South trade.
20. With rules of origin, this is slightly easier as quite a strong consensus now exists that when measured against their key objective – that is, preventing trade deflection – the rules are excessively restrictive and overly complicated in many cases. In its Green Paper on rules of origin, the European Commission explicitly acknowledged that at the request of its traders or its member states, ongoing 'maintenance' has been applied to the rules of origin, tailoring them to the needs of trade and industry and the common EU policies (EC, 2003b).
21. Winters (1999, 2002) offers a thorough analysis of the impact of trade reform on poverty. McKay, Winters and Kedir (2000) review case-study evidence.
22. Winters (2002).
23. See North (1991).
24. For a historical overview of the initiation, maturation and full establishment of economic institutions in now-developed countries, see Chang (2002).
25. Yet with respect to economic prosperity and poverty alleviation, notions such as 'institutional quality', 'institutional development' or simply 'institutions' have only recently been given the attention they deserve. Within the free market rhetoric of the Washington Consensus, for example, the pivotal role of institutions was more or less ignored. In the last few years, the World Bank has admitted the omission and radically changed its course. See e.g. Burki and Perry (1998) and the *World Development Report 2002*.
26. See e.g. Djankov et al. (2002). North (1991) offered an important early contribution to the debate on institutions and economic performance.
27. A country case study at the centre of this debate could be the one on Mauritius by Subramanian and Roy (2001) as it applies different theories explaining economic growth to the Mauritian growth miracle.
28. Rodrik, Subramanian and Trebbi (2002) use a model similar to the one by Frankel and Romer (1999) – one which attributes a key role to trade integration as a determinant of economic growth. Rodrik et al. (2002) use several proxies for 'institutional quality' and add these to the model. They find that institutions trump all other variables, rendering 'trade openness' and 'geography' insignificant in explaining growth.
29. In a recent contribution in response to Rodrik et al. (2002), Dollar and Kraay (2003) claim that on statistical grounds, Rodrik et al.'s cross-country variation is not very informative about the partial effects of institutions and trade on long-run growth.
30. In contrast to 'rule of thumb' economics on trade liberalisation, institutions and their accompanying policy processes are by definition context-specific. What works for some countries may well fail for others. See Rodrik (2003) for the wider debate on strategies for economic growth.
31. Recent case studies in which the trade policymaking process is at the centre of attention include Bouzas (2004), Dunlop, Szepesi and Van Hove (2004), Bilal and Laporte (2004), Jordana and Ramió (2002), IADB (2002), Bonaglia and Fukasaku (2002) and Solignac Lecomte (2000a/b and 2001a). The OECD has compiled theoretical and practical insights in OECD (2001).
32. See also Solignac Lecomte (2001a) and Szepesi (2003).
33. A good example of institutional malfunctioning is provided by the case of Argentina (e.g. IADB, 2002).
34. A frequently mentioned example is the Mauritius Joint Economic Council (e.g. Bonaglia and Fukasaku, 2002). On public–private sector dialogue, see e.g. Land (2002).
35. In March 2002, a TCB-pledging conference at the WTO resulted in US$17.5 million, twice as much as was targeted by the WTO Secretariat. From 1999 to 2003, the US has more than doubled its annual TCB funding from $369 million to $752 million (USAID, 2003). The UK has also committed to double its funding between 2001 and 2004 (DFID, 2001).
36. OECD/WTO TRTA & CB Database (2003).
37. See Solignac Lecomte (2003) for a discussion.
38. For instance, Article 44.2 states, 'The Community shall support the ACP States' efforts, in accordance with the provisions set out in this Agreement and the development strategies agreed between the Parties to strengthen their capacity to handle all areas related to trade, including, where necessary, improving and supporting the institutional framework.'
39. The 9th EDF reserves €1.3 billion for regional co-operation and integration, which equals 9.6% of the budget total. While these funds support the regional integration agenda, they are not specifically earmarked for EPAs and can thus be used independent of a region's decision to negotiate an EPA.
40. EC (2003b: p. 7).
41. See e.g. SIDA (1995).
42. In fact, one of the few studies which systematically compares externally steered programmes (by the World Bank) considering different variables – GNP, economic growth, inflation, government expenditure, relative importance of development assistance, population and urbanisation – concludes that the quality of programme design and the implementation process significantly trump the macroeconomic variables in explaining the impact on institutional development in the recipient countries (see Paul, 1990).
43. See, among others, Lopes and Theisohn (2003), Fukuda-Parr, Lopes and Malik (2002), World Bank (2002) and Land (2000). SIDA (1995) gives an annotated bibliography of 75 case studies on institution building in developing countries.
44. Jordana and Ramió (2002).
45. Van der Walle and Johnston (1996).
46. See the case studies as referred to in note 35.
47. Biased trade-related aid is usually seen in the bilateral context in which one party gives support to another party while simultaneously bargaining with that party at the negotiating table – see for instance Solignac Lecomte (2003). In a broader context, one can

argue that any trade-related support programme that is attached to a predetermined policy agenda concerns biased aid –a point advocated by Powell (2002) in relation to multilateral programmes on trade capacity building.

48. Fukuda-Parr, Lopes and Malik (2002).
49. For an insightful case study, see Godfrey et al. (2002) on Cambodia.
50. See e.g. Solignac Lecomte (2001b).
51. See e.g. the case study on trade policymaking in the Caribbean by Dunlop, Szepesi and Van Hove (2004).
52. Ironically, West Africa (ECOWAS) was the first region – together with Central Africa (CEMAC) – to formally launch EPA negotiations with the EU in October 2003.
53. This is only to say that from a development perspective, reform priorities concerning ACP trade policies have not changed because of EPAs. Whether the overall merits of bi-regional agreements such as EPAs outweigh those of reforms derived from multilateral commitments is another question.
54. See Dunlop, Szepesi and Van Hove (2004).
55. Yet the extent to which trade policymaking has changed differs much between the Latin American countries. For country case studies, see IADB (2002).
56. This is not to say that the issue of additional resources itself is not a legitimate one for the ACP to put on the agenda. Yet at the negotiation table, the key question of whether EPAs will ultimately be beneficial trade agreements for the ACP is not resolved by any compensatory funds as such, but by also discussing the substance of the agreement.
57. In this respect, the recent experiences of Mercosur offer useful insights. As long as the internal agenda concerned rather superficial measures, such as tariff elimination, there was a relatively high political commitment to the integration process. Yet after the mid-nineties, when the agenda deepened and negotiations with various external parties commenced, political commitment waned and regional institutions proved insufficiently strong to drive the process forward. See Bouzas and Soltz (2001) and Bouzas (2004).
58. This seems especially relevant for LDCs that in principle could opt for free-market access under the EBA initiative but by doing so would at least partially fracture their own integration with non-LDCs in the region.

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Talking Trade: Practical Insights on the Capacity to Conduct Trade Negotiations

Sanoussi Bilal, Geert Laporte and Stefan Szepesi

Introduction: The challenge of trade negotiations

International trade has grown at a seemingly exponential rate over the last decades and has been playing an increasingly important role in the development strategy of poor nations. For the developing countries that can develop their ability to integrate into global markets, and make effective use of the opportunities offered by new trade opportunities, the potential benefits, although difficult to quantify, are undeniably large, including for the poorer countries (e.g. Hertel and Winters, 2006; Polaski, 2006). However, trade liberalisation also entails significant adjustment costs and often necessitates profound policy and institutional changes (e.g. Bacchetta and Jansen, 2002). To effectively benefit from new trading arrangements, countries must be able to negotiate adequate provisions to their participation in the trading system (in terms of rules, institutions, technical and financial support) and appropriate conditions to ensure that the trade regime in place will contribute to their objectives of sustainable development and poverty alleviations. The way trade policy and accompanying measures are designed and negotiated plays in this respect a key role.

Countering marginalisation? International trade negotiations and developing countries

The problems faced by most developing countries in the international trade system are well documented. A large number of lesser advanced developing countries have experienced a serious decline of their share in world trade. Most of their exports are still very much dependent on a small range of commodities, which in turn suffer from worsening terms of trade and highly volatile world market prices. Increased market access alone will not solve these problems. Major supply-side constraints at the domestic level need to be addressed to enhance trade performance and stimulate diversification. These supply-side constraints are wide-ranging and fully intertwined with more generic constraints to economic development: macro-economic instability, inadequate transport and communication infrastructure, poorly functioning public administrations, lacking credit markets, etc. In addition, complex non-tariff barriers (NTBs) increasingly take a prominent place in international trade, further hampering the export performance of developing countries. Addressing these various challenges will require huge investments and profound strengthening of institutional capacities.

The difficulties preventing developing countries from effectively participating in trade negotiations have long been neglected.[1]

In the particular area of international trade negotiations, capacity problems are compounded by the limited time that is available to prepare and successfully conclude trade negotiations on various fronts, while simultaneously preparing for an effective implementation of the agreements and the accompanying reforms. Many developing countries, in particular the 50 least-developed countries (LDCs), are characterised by scarcity of human and financial resources, weak trade-related institutions, a fragile and unorganised private sector, and limited experience in the area of trade negotiations. Yet, over the past few years many of these countries have become involved in multiple trade negotiations at various levels. Besides negotiations with developed countries and the multilateral negotiations in the World

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Trade Organisation (WTO), bilateral and regional integration initiatives among developing countries themselves now feature prominently on the agenda.

The ACP and EPA negotiations

On 27 September, 2002, trade negotiations for Economic Partnership Agreements (EPAs) commenced between the African, Caribbean and Pacific countries (ACP) and the European Union (EU). EPAs aim to replace, at the latest by 2008, the current non-reciprocal preferences in ACP–EU trade relations by development-oriented free trade areas. For the ACP countries that are not in a position to participate in an EPA, alternative trade arrangements must be negotiated. While the prospects of EPAs or alternative trade arrangements could offer new opportunities to the ACP economies, they also generate numerous challenges for the ACP countries and their regions.

A general characteristic of the negotiations of North–South free trade agreements, such as EPAs, is the institutional imbalance between the Northern and Southern partners. While the EU benefits from a well-developed institutional apparatus and considerable experience in negotiating trade agreements, the ACP have scarce resources and much weaker institutions. They also face many competitive demands concerning their development policies, trade constituting only one component of their development strategies. On the trade front, their insufficient resources must also be stretched to cover parallel initiatives at the national, bilateral, regional and multilateral levels, EPAs representing only one of their potential objectives.

In the trade field, one of the key challenges for the ACP countries is to develop capacity at the national, regional and group level to negotiate new trade agreements with the EU. On the one hand, this requires plain input into the negotiations process: technical studies and strategic analyses are indispensable for effective preparation. Facing their constrained resources, ACP countries may want to draw on outside support to ensure this input is provided. On the other hand, the establishment and/or improvement of national and regional institutions is also crucial, not only for the purpose of streamlining (regional) co-ordination and consultation among the stakeholders in the negotiations, but also to ensure that a final agreement and the necessary flanking policies can be properly implemented in the future.

ACP countries and regions, however, have only limited or no experience in both building these national and regional institutions for trade negotiations and negotiating with such a powerful partner as the EU. In addition, they have not enhanced their regional integration agenda much; effective preparations are an enormous challenge. In part, the problem can be remedied by external support, such as was provided by the EU through the Programme Managing Unit (PMU) or by other international agencies. On the other hand, the complexity of present-day trade policy requires more than financial resources. Some developing countries can draw on a somewhat longer history of regional integration and/or experience in negotiations with Northern trade partners. Hence, in preparing for EPA negotiations, the ACP should not only draw on all kinds of support for direct inputs into the negotiations, but also capitalise on the experiences of others in building the necessary capacities for trade policymaking in general, and trade negotiations in particular.

It is in this light that ECDPM reviewed the trade capacity-building literature to date, and conducted three case studies on countries/regions whose experiences could be relevant for the ACP group.[2] The aim of this chapter is to synthesise the relevant insights in this respect. As the ACP is a very heterogeneous group of countries and regions, and there exists no single 'best practice' formula, it is not our objective to describe formal models in which preparations for EPA negotiations can best be structured. Rather, we aim to identify the main enabling conditions for effective preparation, and to suggest possible ways in which the question of capacity development can be addressed.

This chapter briefly reflects on the various dimensions of trade capacity-building and the role of donors therein. It then draws key insights from developing countries' recent experiences in strengthening their capacity to conduct trade negotiations, notably based on three case studies on South Africa, MERCOSUR and the Caribbean region.

Trade capacity-building: Donor rhetoric or a genuine answer?

In the past few years, international institutions as well as developed countries have increasingly acknowledged that most developing countries lack both the policymaking and the negotiating capacity to participate effectively in the global trading system. It is now well recognised that this lack of capacity constitutes a direct threat to both the credibility and the legitimacy of the international trading system. Capacity constraints not only jeopardise further trade liberalisation along the multilateral path (because developing countries are unable or unwilling to implement WTO provisions); they also hamper bilateral trade relations between North and South and among developing countries themselves.

Aware that further trade liberalisation could stall if these constraints are not addressed, international institutions,[3] as well as bilateral donors have responded with a high rise in support programmes that aim to bridge the capacity gap between North and South. The EU has been no exception in this respect: €10 million has been reserved for ACP preparations for the Doha Round; and €20 million, by means of the Programme Managing Unit (PMU), for EPA negotiations in particular. Recent academic research has centred around two questions: how can developing countries themselves strengthen their trade policymaking process? And what role can donors play in supporting such processes?[4] Overall, the growth in attention for the issue has given birth to the new jargon of *trade capacity-building*.

Box 1. Strengthening trade policy in developing countries

The OECD Development Assistance Committee (DAC) has been the institution most actively involved in discussions on trade capacity-building. Through its *Guidelines on Strengthening Trade Capacity for Development*, the DAC has been able to stimulate discussions among international institutions, bilateral donors and recipient on how trade policymaking processes can be strengthened in developing countries. According to the DAC *Guidelines*, the following elements are key in establishing an effective trade policy:

- a coherent trade strategy that is closely integrated with a country's overall development strategy;
- effective mechanisms for consultation among three key sets of stakeholders: government, the enterprise sector and civil society;
- effective mechanisms for intra-governmental policy co-ordination;
- a strategy for the enhanced collection, dissemination and analysis of trade-related information;
- trade policy networks, supported by indigenous research institutions;
- networks of trade support institutions;
- private sector linkages; and
- a commitment by all key trade stakeholders to outward-oriented regional strategies.

It is emphasised that for trade policymaking as such, a one-size-fits-all approach is unlikely to exist: different countries have different priorities and good practice in trade policymaking is likely to depend on the particular development strategy a country adopts. The DAC states that 'capacity development for trade today is about mobilising participatory approaches to deal with complex trade agendas'. Hence, building trade capacity involves building networks that go beyond government actors. Linkages between the public and the private sector, think tanks and universities, regional and national institutions are all conductive to improvements in policy making. Within government itself, co-operation and co-ordination among key ministries is an important factor fostering the formulation of strategies and the swift implementation of policy measures.

Source: OECD (2001)

An elusive term

Interestingly, there is no consensus either in the literature to date or among the assistance programmes that aim to improve trade policy capacity in developing countries on what exactly trade capacity-building entails – or should entail. Some might use it to refer to any activity that aims to boost a country's export performance by lifting so-called supply-side constraints (e.g. a weak infrastructure, lack of credit facilities, macroeconomic instability, etc.) or to assistance programmes that help developing countries to implement WTO provisions on issues such as customs procedures or the TRIPS Agreement. However, usually *trade capacity-building* does not refer to (assistance to) direct policy measures as such. Instead, it concerns programmes that address a country's *ability* to define and pursue its own interests through trade policy. This is an important distinction because the latter approach acknowledges that sustainable capacity is built endogenously and results can only be obtained in the long run. In the specific area of (preparation for) trade negotiations, genuine capacity-building programmes should thus target the respective human resources and institutions involved in these negotiations, improving their ability to conduct impact analyses, process information and develop negotiating strategies.

Support to the latter rather than the former type of projects have received increasing emphasis by academia and donors because it adheres more to the concept of sustainability. The relatively new notion of trade capacity-building is then lined up with an older one of capacity building in general: *the process by which individuals, organisations, institutions and societies develop abilities (individually and collectively) to perform functions, solve problems and set and achieve objectives* (Godfrey et al., 2002). Hence, the 'old-fashioned' planning of mere technical assistance from North to South (a top-down process) has made way for programmes that are supposed to be 'demand driven' and 'owned' by their beneficiaries.[5] As opposed to one-shot initiatives by means of foreign expertise or thematic training sessions, trade capacity-building stresses a longer term commitment by both donors and recipients. Table 1 sets out some of the key differences that separate the former from the latter.

Critique on trade capacity-building programmes

In practice, however, the distinction between these two approaches is often blurred: the same programmes that aim to address fundamental constraints also deal with the numerous short-term demands posed by the daily practice of international trade negotiations. Most initiatives thus try to do two things: finance the most pressing needs, e.g. externally conducted studies for trade negotiations, while simultaneously addressing the actual capacity deficit, e.g. by means of supporting domestic research institutions. As the multiple levels of trade negotiations are pressing both donors and policymakers to act, short-term objectives can dominate the agenda to the detriment of sustainable capacity-building.[6] Though there need not be a direct trade off between short and long-term objectives, in practice it is hard to avoid it. For example, hiring external expertise to prepare technical negotiation issues can prevent a developing country from entering negotiations empty handed. On the other hand, other negotiations will follow and many of the benefits of trade agreements

Table 1. Old-fashioned approach vs trade capacity-building

	Old-fashioned approach	Trade capacity-building
Approach	supply driven standardised consultancy and formal training	demand driven linking trade to overall development agenda
Focus	technical issues	process focus; endogenous learning
Expected output	upgrading facilities of trade ministry implementation of measures	strengthened human resources for policymaking and assessment
Duration	short term project basis	long term continuous

Box 2. A road map for donors

Increased concern for the capacity constraints developing countries face in the multilateral trade system has been paralleled by growing attention for donor activities in the trade field. On the basis of several country case studies, Solignac Lecomte sets out a road map, an invitation to donors to see trade policymaking as a dynamic process involving a diversity of actors and sectors. Some of the main recommendations include:

- Avoid biased aid: trade-related assistance can only have one ultimate objective: to empower developing countries in the multilateral trade system, and help their products penetrate world markets.
- Strengthen donor co-ordination.
- Adopt a comprehensive approach: link-up trade programmes with other development programmes.
- Include a wide range of stakeholders in the recipient country.
- Find new approaches towards the assessment of trade capacity building programmes.
- Trade should be neither neglected nor overemphasised: resources need to be balanced in relation to other development priorities.

Source: Solignac Lecomte (2001)

can only be reaped if its provisions are adequately implemented domestically.

Criticism of trade capacity-building programmes has increased as budgets have expanded. At the heart of this critique is the reality that donor interests can be seriously biased and that programmes are often not supportive to affect research and policymaking capacity in a truly sustainable fashion. The bias is most obvious when the donor is also the counterpart in trade negotiations (assistance may skew the choices made by the recipients in favour of the donors), but some observers see it more broadly: the increased attention for capacity building serves to lure developing countries into the ever-expanding agenda of bilateral and multilateral trade negotiations.[7] Content-wise, many programmes remain donor-driven and fail to link the issue of trade to the overall development agenda.[8] Programmes also frequently focus on directly visible results (backstopping the most urgent gaps) without addressing more fundamental weaknesses in recipient states and support tends to be temporary and based on short-term financing, which constrains the possibilities for building institutional knowledge, analytical skills and policymaking capacities.[9] Moreover, co-ordination among donors and recipients has been weak, although recently the WTO and the OECD have made considerable improvements.[10]

External support: Necessary but insufficient

As Solignac Lecomte (2001) argues, the case for trade capacity-building programmes still has to be made. The current high rise in donor assistance for trade need not be to the advantage of developing countries as the opportunity costs could well mean less funding for other, 'traditional', aid sectors such as education and health. It is yet too early to assess whether the current multilateral and bilateral programmes will achieve the desired result: the empowerment of developing countries in the global trading system. In any case, if external support can foster the development of policymaking capacity on a sustained basis, this result can only materialise in the long run. As ACP countries face trade negotiations, such as those for EPAs, in the short run it is inevitable that they turn to short-term assistance. A key challenge will be to use this assistance in such a way that it does not compromise the eventual objective of building indigenous trade capacity. In any case, while being able to facilitate ACP participation in the negotiations, short-term assistance, such as the PMU fund, will not ensure that countries come well-prepared to the negotiating table. As the various case studies discussed below point out, the essential conditions for being sufficiently prepared for trade negotiations cannot be created through external funding but only by the ACP countries themselves.

Practice provides the best learning: Three concrete case studies

Though the theory on capacity building for trade can provide some useful insights into 'good practices' for the preparation for trade negotiations, it is ultimately real-life experience from which the most practical lessons can be drawn. Many ACP states, however, have little to no experience in negotiating reciprocal trade agreements, let alone doing so with the EU. Therefore, one country (South Africa) and two regions (MERCOSUR and the Caribbean) were selected for in-depth case studies into their particular experiences in preparing for trade negotiations.[11]

The aim of the studies was to provide an insight into the political, institutional, and organisational challenges that developing and middle-income countries encounter once they enter into bilateral or bi-regional negotiations. South Africa is the only ACP country that has already concluded a reciprocal trade agreement with the EU by means of the Trade, Development and Cooperation Agreement (TDCA) signed in 1999. MERCOSUR has started negotiations with the EU in 1995, but little progress has been made since the region's own integration process stalled. MERCOSUR's experience in preparing for these and other negotiations is mainly instructive with respect to the challenges it encountered as both its internal and external negotiating agenda widened, something which is bound to happen to ACP countries that will negotiate regional EPAs. Finally, with CARICOM, the Caribbean can be considered one of the better integrated regions within the ACP. Though reciprocal negotiations with the EU are a primer for the Caribbean states too, they have been collectively involved in the Doha Round, the FTAA negotiations and various bilateral trade talks. Contrasting to the MERCOSUR case, the Caribbean experience offers a unique insight into the particular challenges that internal and extra-regional integration pose to small developing countries.

Capacity building for negotiations: Six key insights

The overriding principle: Negotiations as part of the development agenda

In the current global environment, entering into bilateral, regional and multilateral trade negotiations appears to be almost a routine response. Except for the problem this poses with respect to the resources needed to manage the various negotiation fora, there is an inherent danger that the decision to enter negotiations is not being born from economic and development considerations, but is solely motivated by political reasons. If this is the case, discussing new trade agreements is unlikely to bring about much merits; it may ultimately result in either a fractured negotiation processes, or worse, agreements that harm rather than benefit the country. It is therefore crucial that for each ACP country the participation in EPA negotiations is the result of a conscious and informed political decision, corresponding to well-identified strategic objectives within a coherent trade and development policy strategy. In the absence of such a strategy, decisions are bound to be taken by the better prepared ACP countries or regional bodies and by the EU, to the potential detriment of the other ACP countries. Countries that are not willing or able to undertake such commitments might be better advised to seriously consider opting out of an EPA process that would have been elaborated without their effective input.

South Africa's negotiations for the TDCA is an important example where a new trade regime was perceived as only one element (or rather instrument) of a broader strategy for the development of the country. Though negotiations with the EU have certainly not been exempt from policy challenges, these were integrated into a more comprehensive trade policy reform process. This explicit linkage between trade negotiations and overall development policy has played a determining role in the coherence of the South African approach, in the coordination mechanisms put in place and in determination of its policy objectives.

Political leadership

Without political leadership, it is impossible to conclude a beneficial agreement. The driving force for any attempt to develop a coherent strategy and effective mechanism to conduct international trade negotiations rests on the indispensable aspect of

political leadership. If the negotiation process does not benefit from sufficient political backing, resources devoted to the preparation and consultation are likely to be low and co-ordination among government actors at national and regional levels is likely to be weak. As a result, the outcome of the negotiations is likely to be driven, at the domestic level, by particular interest groups that seek to capture the potential benefits from any agreement, at the expense of the public interest of the whole country. In addition, the agenda, conduct and outcome of the negotiations are most likely to be dominated, if not fully determined, by the negotiating partner (that is the EU in the case of the EPA negotiations).

Again, the case of South Africa provides the clearest example of how political leadership can ensure a strong sense of shared values amongst state and non-state actors, providing the necessary alchemy to build a strong coherent policy and negotiating strategy. The decision to engage in trade negotiations with the EU was actively supported by the highest level, first and foremost by Nelson Mandela and Thabo Mbeki. This gave the negotiations an overall sense of priority to the whole government. As the post-apartheid regime was still engaged in determining a national trade and development strategy, negotiations with the EU provided further stimulus to identify core national interests; to clearly define negotiation objectives as part of the overall development strategy; and to establish the necessary co-ordination mechanisms for the conduct of negotiations.

The same conclusions can be drawn from the initial formation of MERCOSUR in 1991. MERCOSUR's establishment initially served as a catalyst for institutional change: in all four member states, the trade bureaucracy experienced a stimulus as a consequence of structured interaction in various policy areas, raising demand for expertise and co-ordination. However, the initial agenda points consisted of border issues where consensus was easy to find. As the agenda deepened, the fragility of common interests and the deficiency of common rule-making procedures became more evident. The lack of cohesion among its members is partly reflected in the fact that MERCOSUR has no permanent institutions at the regional level that can co-ordinate and/or conduct international negotiations. For collective negotiations with third parties, co-operation still builds on technical preparations done at the national level, and co-ordination and leadership is left to the rotating temporary presidency of MERCOSUR. The development of such a collective co-ordination mechanism will ultimately rest on the political will of regional leaders. It remains to be seen to what extent, in the absence of such a mechanism, MERCOSUR will be able to keep a united front and push its own (collective) interests during future negotiations.

Contrary to MERCOSUR, the recent experience of the Caribbean does feature a good degree of regional political leadership. In spite of the diversity of their economies and their development concerns, CARICOM and to some extent CARIFORUM countries have managed to set aside some of their differences to defend a common front on preferential trading agreements. This is the case for instance in the current FTAA negotiations, where the Caribbean often speaks with one voice, and a similar approach seems to be pursued in their relations with the EU. The establishment, in 1997, of a Caribbean Regional Negotiation Machinery (CRNM) is one of the most internationally recognised attempts by a regional grouping to jointly develop a cohesive and effective framework to co-ordinate and structure its preparation for and conduct of international negotiations. The CARICOM Secretariat is supposed to complement these efforts by ensuring the regional coherence and the achievement of regional objectives. By delegating some of their power to regional entities, closely supervised and monitored by Caribbean governments, Caribbean leaders have been able to increase their level of preparation to international negotiations and facilitate the co-ordination of their positions. This has helped to present a more cohesive front in international fora, which is ultimately conducive to the advance of the interests of the Caribbean region and its member states.

Political leadership has been a key factor in the effective functioning of these mechanisms for trade negotiations, as well in raising public awareness by actively participating in the public debate on these important negotiations with the EU. The South

African experience suggests that while high political involvement is no substitute for technical preparation, it is a necessary driving force to ensure cohesion and a strong sense of direction in the conduct of negotiations on a free trade agreement. Without such backing, the chances that an agreement will be both concluded and beneficial are slim. After all, trade negotiations have an inherent mercantilist bias and negotiators are weakened by an ambiguous political agenda. MERCOSUR's negotiations with Chile provide a good example in this respect: concluding a final agreement was not the result of a consistent and collectively well-designed bargaining strategy on MERCOSUR's side, but of the top political priority that one of its members, Argentina, assigned to it. Though an agreement was finally concluded, the end result was quite meagre from MERCOSUR's point of view. Instead, a strong political commitment by regional leaders, a clear mandate and a collective action plan could probably have made a better agreement feasible.

Getting organised

The main lesson from developing countries that have embarked on preferential trade agreements, including with the EU, is that there is no single model of organisation for the successful conduct of negotiations. Historical, cultural, institutional, political and developmental considerations have to be taken into account and each case must be judged on its own merit. However, useful insights are offered by the experiences of other countries.

Within governments and regional entities, it is crucial that roles are clearly distributed and power delegated to the relevant actors. Ever since trade negotiations went beyond discussing tariff preferences for industrial goods, preparatory work at the national level has concerned (or at least affected) government bodies outside the usual trade and finance ministries. Effectively involving and co-ordinating all these bodies for the very broad EPA negotiations will be a major challenge for the ACP countries (a non-exhaustive list is provided in Table 1).

Ways of conducting external trade negotiations can differ enormously between countries. Whereas in some, both nominal and real authority lie with one department (e.g. the foreign, trade or finance ministry), in many others, authority is dispersed over several factions within the government. Whoever is in charge, a clear intra-governmental co-ordination structure and a well-defined allocation of competences and tasks among ministries are key ingredients to a coherent preparation and conduct to the negotiations. Except for providing the necessary input into the negotiations, such a co-ordination mechanism is key in the sense that ensures that substantial awareness with respect to implementation issues is generated among the relevant government actors. Further, the issues of competences and lead role among ministries must be sorted out before the negotiations begin, and should be arbitrated at the highest political level. The responsibilities and policy fields of ministries differ, and so can their perspective on the negotiations. Setting in place a co-ordination mechanism without assigning competencies may not be sufficient to harmonise positions among government departments.

The South African experience provides an interesting example of a balanced and inclusive structure and institutional setup for the preparation and conduct of the TDCA negotiations with the EU. The overall political guidance was directly provided by President Nelson Mandela, which signalled the high priority of these negotiations for South Africa. For policy orientation, strategic decisions and political arbitrage, a cabinet committee was formed, comprising the main ministries involved in the negotiations. Other ministries were consulted when necessary. The central role of the South Africa Department of Trade and Industry in the preparation of the negotiations was officially recognised by all other departments. This greatly facilitated inter-ministerial co-ordination. Each ministry was responsible for the preparation of its own chapters of the negotiations, after consultation with the other relevant departments. This political co-ordination structure was mimicked at the technical level, where inter-ministerial working groups (at the level of directors and when necessary experts) were formed. The negotiation process was not exempt from clashes and conflict of interest between departments. But the ministerial and cabinet meeting oversight, led by the minister for trade

Table 2. EPA negotiations: A case for inter-departmental co-ordination

Ministry/department	Possible relation to EPA negotiations
Trade and Industry (Economic Affairs) & Foreign Affairs	strategy, co-ordination, delegation, negotiations process
Customs	trade facilitation, rules of origin
Finance	fiscal reform
Agriculture & Trade and Industry	export capacity, import competition, transitional periods, SPS, TBTs, other standards
Employment	trade and labour protection, trade and labour standards, flanking measures
Transport & Communications	trade in services, export capacity
Law (Justice)	TRIPS, competition policy, investment, dispute settlement
Health	health standards
Environment	environmental standards
Foreign Affairs & Finance	development co-operation
Tourism	trade in services

and industry, ensured the necessary cohesion during the negotiations.

As illustrated by Box 3, Argentina provides a useful example of a failed co-operation attempt. The lack of co-ordination between and delegation within the government resulted in serious problems for conducting external negotiations. In an effort to co-ordinate its trade policymaking, the Inter-ministerial Commission for International Trade (CICI) was created in 2000. However, ongoing divisions among ministries, combined with lack of both leadership and authority of its chairman, resulted in the failure of the initiative. At the regional level, Argentina's problems negatively affected both MERCOSUR's integration and the external negotiation agenda. Obviously, when interests are not clearly defined at the national level, divisions are likely to be transferred to the regional level, weakening the credibility and bargaining power of the entire region.

However, creating new trade institutions overnight might prove counterproductive. There exists no ideal structure for trade policymaking. If entirely new structures are created in haste to ensure input for the negotiations in the short run, they could well work counter-productively. One central co-ordination organ, for example, might seem ideal to overcome old barriers between ministries and solve any ambiguities over the distribution of power within the decision-making process. In practice, however, this is often not the case. In a sample of 12 Latin American case studies, Jordana and Ramió (2002) observe that where, overnight, entirely new structures where put in place with respect to the management of external trade policy, the desired results were not achieved. Similarly to Argentina's CICI – which was supposed to co-ordinate international trade policy – in 1992 Paraguay's creation of an Integration Ministry to deal with regional integration issues failed to produce any significant results, leading to its dissolution in 1998. One explanation for the failure of these fast reforms is that institutions often keep behaving according to the 'old rules' (decoupling). Despite new structures and hierarchies, the relevant actors cannot make appropriate policies because there remained a clear division between nominal and real authority.[12] In other cases, a change in government or personal leadership means a *de facto* reshuffle of roles, jeopardising the reform and setting off new turf wars within the public sector. Hence, institutions are unlikely to change overnight and caution with respect to big bang reforms seems warranted. Arguably, more important than establishing one (new) centralised agency that is responsible for trade negotiations, it seems that the establishment of an effective inter-agency co-ordination mechanism that spans all relevant public

Box 3. Argentina and the maze of public actors in trade policy

The Argentinean process of trade policymaking is one of the most intriguing in Latin America. It serves as an excellent case study into the effect that institutional fragmentation can have on the process and quality of policymaking. Well before the economic crisis definitely took hold of the country in 2001, deficiencies in its organisational structure were such that the international bargaining capacity of Argentina was considerably lessened.

The model of Argentina's trade policy process is truly mind-boggling. From the executive branch of the government, responsibilities are delegated the ministries of both foreign affairs and economics. There is no clear delegation of authority between the executive and the ministries or between the ministries themselves. Which of two leads the process in external negotiations has varied throughout the 1990s and depends on particular circumstances, leadership and personalities. For policy design and implementation as well as for the generation of information, both ministries rely on their own supporting departments, advisory committees, investment banks and public–private institutions. This fragmentation continues up to the provincial level. The overlap of responsibilities has led to a duplication of work, the withholding of information and inter-agency competition between various departments.

Compounding these problems is the fact that the private sector is not well organised either. After Argentina moved away from its import-substitution industrialisation strategy in the 1990s, the protectionist and selective ties between the public and the private sector were never replaced by new institutions, let alone ones that aimed at horizontal and transparent consultation. Because of the fragmentation of public policy, clientelistic practices were able to persist. Vested business interests have a stake in retaining the *status quo* because the returns on lobbying are greater than systematic long-term involvement in a diffuse policymaking process. Hence, no broad and inclusive representation of the private sector is likely to occur as long as clear delegation and restructuring has not taken place. The severity of these problems is confirmed by the fact that even an Inter-Ministerial Foreign Trade Commission, established in 2000 and chaired by the President, was unable to provide leadership and initiate reform. Obviously, such inefficiencies have impacted on Argentina's ability to defend its interest in its most important regional and multilateral fora, MERCOSUR and the WTO.

Sources: IADB (2002) and Bouzas (2004)

sector agencies works, and makes use of existing capacities within those agencies.

Beyond a government affair

National governments cannot prepare for trade negotiations on their own. As the subject areas within international trade negotiations are constantly expanding and the details become increasingly elaborate and technical, negotiations cannot be managed by an isolated public sector. A functioning public–private consultation mechanism is indispensable for a variety of reasons.

First, such a mechanism should inform stakeholders about trade negotiations and discuss their implications. Both trade liberalisation and broader policy reforms can have a huge impact on individual households, firms and the government itself. Certain economic sectors and geographic regions are likely to be more affected than others and the benefits and costs are unlikely to be born equally by all actors. Being informed about the opportunities that trade reform can bring (in terms of more employment, lower prices, less bureaucracy, increased profits or more investments) as well as its potential costs (the loss of jobs and industries; fiscal contraction), stakeholders can optimise those benefits and mitigate those costs by taking pre-emptive action. This goes for government agencies as much as for entrepreneurs, farmers and workers. Informing and involving these stakeholders in trade policy, and in trade negotiations in particular, is likely to yield a higher degree of legitimacy for that policy. For any

government that strives for its decisions to be understood, if not recognised, by its citizens, this must be an important point.

Second, a functioning public–private dialogue can greatly enhance the quality of the preparatory process. It can serve as a vehicle for 'tapping ideas', extracting valuable information from parties to feed into the actual negotiations. In this respect, involving business sectors that were 'traditionally' not involved in trade negotiations will be a key challenge for the public sector. On the one hand, this concerns actors that have few resources such as small farmers' organisations, small and medium-sized enterprises (SMEs), and unions. On the other, this also concerns larger business sectors that used to fall outside the realm of international trade negotiations, but are now increasingly affected by their ever-expanding agenda. Admittedly, consultations that become too broad could impede the effectiveness of the dialogue. Hence, it can be prudent for the government to organise consultations at various levels, with representatives of civil society and business sectors finally reporting to the government. In any case, small business elites should be prevented from monopolising contacts with government officials and biasing trade policy in favour of their own but against the general interest. Though informal, *ad hoc* consultation can sometimes help to quickly fill information gaps and ensure effective communication lines, a formalised platform has the advantage that it is more transparent and more open to contributions from a broad array of stakeholders.

In previous case studies on trade policy processes in Latin American countries,[13] the occurrence of legitimacy as a reason in itself for engaging a broad array of stakeholders has clearly come about. In this region, the wider processes of democratization and increased transparency in government decision-making mechanisms have set off important changes in the area of trade policymaking as well, albeit to quite different degrees in the various countries. Whereas in the 1980s protectionism and a concentration of opaque public–private relationships co-determined external trade policy, in the 1990s, more liberal trade policies were followed by broader private-sector participation, movements towards more transparency, improved parliamentary awareness, and a better informed civil society.

In South Africa, the National Economic Development and Labour Council (NEDLAC), a body involving industry, trade unions, organised community actors and the government seems to have had a significant input into the TDCA negotiations. This has been valued by all actors, not the least the South African government itself. NEDLAC played a central role in the formulation of negotiation strategies and positions for the TDCA. It offered an institutional platform for a tripartite dialogue, to which the government was most attentive. The business community provided most detailed information to the South African negotiators on how they will be affected by a reciprocal opening of the EU and South African markets. Combined with trade unions' inputs, this information helped the South African government to identify where trade liberalisation will have the largest impact, how it will affect its main sectors, and which sectors should be considered as sensitive. The government had to resist protectionist tendencies. Differences of views, among the various actors and within the government, were common. Yet, by sharing with non-state actors its main objectives and strategies for the negotiations and by remaining open to propositions and inputs from both private-sector and social actors, the government contributed to establishing a co-operative and constructive dialogue with non-state actors.

The case of the Caribbean also demonstrates that present-day trade negotiations make certain forms of public–private dialogue a mandatory exercise. Interestingly, the origins of Barbados's Social Partnership and the Jamaica Trade and Adjustment Team (JTAT) were quite different. The Social partnership was born out of the urgent need of government and non-state actors to confront an economic crisis jointly. The case shows that when a government faces tough decisions that will strongly affect its citizens, the legitimacy rationale for establishing a broad dialogue is not mere democratic window-dressing, but a process without which many painful but necessary measures would simply be impossible. In the Jamaican case, JTAT was the initiative of a trade minister who strongly believed that consultation with non-state actors would be a necessary component in Jamaica's trade policy. Jamaica had

spent much time and resources determining both its trade and overall development strategy: it was quite clear that without consultation platform these strategies would have a far lesser chance of success.

Yet, the same cases also underline how difficult it can be to establish and maintain a fruitful dialogue. Many enterprises are still barely aware of the stakes involved in international trade agreements. Consequently, they are ill- or not at all prepared for providing the government with the necessary inputs. Also, a lack of trust between the public and the private sector plays a role. Henceforth, there is a clear danger that formal consultation mechanisms degrade into talking shops and that subsequently the large players (big businesses and government ministries) will revert to informal co-ordination behind closed doors. This means that, in effect, the consultation process will be heavily biased towards a select group of enterprises that lean on traditional ties with the public sector. Where this may favour the specific interests of those firms, it is most likely to work well against the general interest. Hence, governments should be aware that a selective consultation process can have serious adverse effects.

Discussing this problem for Latin America, Jordana and Ramió (2002) identify four principles that can help to prevent the trade policy agenda from being captured by specific interests. They argue that: information on trade negotiations should be widely available; consultation mechanisms should be as horizontal as possible (reflecting the wide array of business interests); private-sector actors should not be allowed to sit directly at the negotiating table; and the involvement of non-traditional export sectors should be actively encouraged. This last point is particularly worth noting. The ever-expanding content of international trade agreements increasingly touches upon sectors or groups that were previously unaffected. To genuinely reflect the diverse interests within a country, these groups should be involved in the process as well.

On the other hand, it remains difficult to involve those groups traditionally not involved in trade negotiations. Many interviewees in the Caribbean cases noted the need for governments to increase funding for informed as well as broad private-sector participation. Except for the inevitable resource constraints, however, there are also more fundamental issues at work that can hamper the process. Often, discontent and a lack of confidence characterises private-sector relationships with government authorities – and visa versa.[14] For a successful consultation mechanism both parties need to learn how to do business with each other; parties need to recognise the value-added that each side brings to the table, and create mutual trust.[15] Undeniably, such a process takes time. However, various experiences show that when the enabling condition of political leadership is in place, it is possible to initiate, maintain and improve useful dialogue. Except for the South African and the Caribbean examples of consultation platforms, there are other instructive cases such as Mexico's *Coordinadora de Organismos Empresariales de Comercio Exterior* and Mauritius's *Joint Economic Council*.[16]

The regional dimension

While the broad EPA agenda is already complex in itself, the challenge of negotiations with the EU is further compounded by the regional dimension. Though the Cotonou Agreement does not rule out single-country EPAs, it appears most likely that most countries willing to enter EPA negotiations will do so together with their regional partners. Aside from difficult configuration issues, this poses another considerable challenge in terms of institutional set-up, pooling of resources, delegation of power and preparatory work at the political, strategic and technical levels of the negotiations.

While there is no precedent to negotiating bi-regional agreements such as EPAs, the case studies on the Caribbean and MERCOSUR provide useful insights into two very different types of regional mechanisms, and the way they go about extra-regional trade negotiations. Whereas MERCOSUR leans predominantly on its member states for both the preparations and actual negotiations, CARICOM members – who are all relatively small and face more pressing resource constraints – have recently expanded the mandate of their regional institutions so far that now a separate body exists for extra-regional trade negotiations.

Regional negotiations can serve as a catalyst for institutional change if backed by political leadership and an appropriate policymaking structure. The early experience of MERCOSUR shows that the mere political decision to start negotiations can already improve policymaking procedures and participatory mechanisms in the individual member countries. A dense intra-regional agenda makes national trade bureaucracies (as well as other agencies) subject to the routine of structured interaction in various policy areas, raising demand for expertise and co-ordination. This can be to the benefit of the weaker or smaller member states of regional groupings as their officials engage with better equipped counterparts. However, once either intra- or extra-regional negotiations go beyond a certain level, the catalytic role of trade negotiations as such needs to be strengthened by developing clear regional policymaking structures and by devoting sufficient political capital and resources to create genuine regional institutions (in the public and private spheres) in support of this process.

The establishment of the CRNM in the Caribbean provides an interesting example of how the pressing demands resulting from the international negotiation agenda can foster co-operation and the pooling of resources within a region. The CRNM was created following the acknowledgement by some Caribbean leaders that a separate regional institution could help to tackle the heavy agenda of extra-regional negotiations (in particular the FTAA). Endorsed by the Conference of Heads of Government of CARICOM in 1997, the CRNM initially received strong political backing. This support was vital to ensure an effective role for the organisation in the conduct of the post-Lomé agreement and the FTAA negotiations, as well as the preparation for the WTO negotiations. By agreeing to pull resources together and develop collective expertise, the CARICOM and in fact CARIFORUM countries aimed to increase their influence and control on these negotiations.

Rather than accumulated interests, a common agenda (possibly facilitated by a regional body) is an important precondition for successful extra-regional negotiations. A common agenda for the negotiations cannot be shaped by aggregating individual contributions or merely relying on intuition. It is the joint effort to identify common and complementary interests that should guide the preparations. To move regional interests forward, objectives have to be clearly defined and priorities have to be set. A too broad agenda can stall the process and will usually translate into a defensive rather than an offensive negotiation strategy. A third party at the regional level that is created to provide inputs that go beyond the narrow perspectives of national actors can be of considerable value in this respect. After the main issues have been hammered out at this level, the common agenda needs to be politically nurtured in order to be of strategic value in the negotiations.

For MERCOSUR, one of its major drawbacks is that is has no regional body that is empowered to represent the four member states. The MERCOSUR Secretariat has a facilitating role but cannot stimulate the internal integration process or be engaged in extra-regional negotiations. Arguably, this has contributed to a weakening of the integration process because every subsequent step has so far depended on the initiative of a member state.

Only a regional body that has a clear mandate and maintains a functional co-ordination mechanism with national actors can successfully negotiate on behalf of the region. Simply establishing or strengthening existing regional entities at the regional level is unlikely to deliver the desired results. Once an adequate structure to engage in extra-regional trade negotiations has been established, it is vital to agree on the extent of authority that is delegated to the regional level. Obviously, this is one of the most sensitive aspects of extra-regional negotiations. Even in the EU, where external trade negotiations have belonged to the competency of the Commission for many years, member states have always insisted on short communication lines and a considerable degree of consultation prior to and even during the negotiations.[17] However, delegating no authority at all will leave the negotiation process unmanageable as each and every detail would have to be agreed by the explicit consensus of all regional members. It is key, therefore, to determine beforehand in what areas a more flexible mandate should be given and where negotiators should work more

closely with national ministers and officials in the member states. While trade negotiations, in particular in their final stages, demand both flexibility and rapid decision-making, the degree to which national actors actually want to retain their influence should not be underestimated. In the end, a regional process can only be as strong and as fast as its members want to go. A clear mandate in combination with an effective co-ordination mechanism between national and regional levels can prevent turf wars between national and regional levels from arising.

With the CRNM, the Caribbean also provides an interesting illustration of the potential tensions that may exist among regional partners, as well as how their resolution (or failure to do so) may affect the capacity of the region to actively participate in international negotiations. After its establishment in 1997, the CRNM has to some extent been the victim of its own success. Strong leadership within the organisation reduced the perceived role of some national leaders in the Caribbean, who became increasingly sceptical towards a regional body whose power and influence was becoming too dominant. As a result of political and strategic disagreements, the CRNM was significantly reformed, some of its charismatic leaders leaving the institution.[18] Beyond the internal bickering at the regional level, which is of little relevance outside the Caribbean, problems between the CRNM and the member states illustrate an interesting feature: the tension that exists between a regional entity in charge of preparing or conducting negotiations, which requires at least a partial (if only implicit) delegation of authority by the member states, and the natural desire by member governments to fully control the destiny of their economies and hence the trade negotiation process.

Extra-regional negotiations will inevitably be frustrated without sufficient progress on the internal integration agenda. With regard to EPAs, a region that faces many setbacks and delays with regard to its internal integration agenda basically faces two problems. First, if in one or more countries substantial trade reforms toward regional partners prove too costly or implementation is long overdue, it seems politically unfeasible that similar reforms will be genuinely undertaken towards a regional outsider such as the EU. Second, if an entire region is characterised by considerable setbacks in the implementation of its integration agenda, it will be a much less conceivable negotiation partner for the EU. In order to genuinely pursue trade reforms, the extra-regional negotiation agenda should be coherent, with an internal integration agenda that is feasible in both its time path and implementation.

CARICOM's inability to draft offers for market access in services in the FTAA negotiations is a good example of how extra-regional negotiations are affected once the regional integration process stalls. If there is no clear agreement on the scope and extent of integration within the region, it seems impossible to conclude an extra-regional agreement that is in the interest of its members. In addition to fracturing the internal cohesion of the region – as concessions to third parties would go beyond internal concessions – it would also make the region appear an inconceivable negotiation partner. (This applies to the Caribbean, but also MERCOSUR).

Even where economic interests are aligned, good preparatory work at the regional level is ultimately in vain if no adequate capacity is developed at the national levels. Today, the negotiation of trade agreements as well as their implementation is more complex than ever before. Pooling resources at the regional level can help to better deal with capacity constraints. Nevertheless, key information in preparation for the negotiations needs to be generated at the national level; final provisions of a trade agreement need to be approved by national ministers; and their implementation needs to be executed by national ministries. Building the necessary capacity at the regional level is a necessary but not a sufficient condition for concluding a trade agreement in the interest of that region.

Without a strong political commitment to conclude a balanced agreement, diverging economic interests within a region can easily stall, protract and fracture the extra-regional negotiation process. When concluding a trade agreement winners and losers will inevitably arise. Within a regional grouping, however, the benefits and costs are unlikely to be equally distributed amongst the member countries. Consequently, those members that perceive their interests to be threatened most are likely to frustrate or delay the negotiation process. If no ade-

quate compensation mechanism is in place within the region, it is all the more important that the regional negotiating body as well as those who potentially gain from an agreement account for the concerns of the most vulnerable parties throughout the negotiations. This again requires substantial information exchange between the various parties, a transparent co-ordination mechanism and above all, mutual trust.

The role of donors

As mentioned earlier, international funding for trade capacity-building support has increased markedly over the last years. However, the question remains open if and to what extent such support, besides stimulating more broad objectives, directly strengthens recipient countries' capacity for trade negotiations. Self-evidently, many of the conditions that enable countries to be better prepared for trade negotiations can only be created by the countries themselves. Ultimately, building capacity for trade policymaking is an endogenous process. Yet, donors can further stimulate this process.

Towards donors, a concerted approach is required with respect to trade capacity-building support. It appears that support for trade capacity-building is for both donors and recipients a more difficult issue than 'regular' assistance. The impact of trade capacity-building programmes still needs to be established, funds can be subject to donor bias, and there is an undeniably difficult trade-off between the pressing needs generated by current negotiations, and the imperative to build sustainable trade policymaking capacities for the future. In any case, recipient countries as well as regional bodies should critically assess their needs and the ways in which donors can be involved in meeting them. Donors, on the other hand, would misperceive the complexity of regional integration if they assume that support to regional entities will suffice to ensure that extra-regional negotiations can effectively take place. Support at the national levels is indispensable in order to stimulate the regional dynamics and build the necessary capacity to deal with trade policy in the future.

The Caribbean region offered the most interesting case study as regards the role of the donor community. Only established in 1997, many observers positively assess the CRNM; some even view it as a role model for other regions. Undeniably, donors can claim part of the credit here. Though the CRNM is now pressed to draw more direct funding from its members, international institutions and bilateral donors still provide the main stack of core funds.

Caution needs to be in place as regards external support. Experience shows that it is extremely difficult to design donor programmes in such a way that they directly assist trade negotiation preparations. Therefore, it seems ill-advised for developing countries to fully rely on external assistance programmes. Aside from donor bias, which can seriously jeopardise the effect of external assistance, other factors can substantially reduce the usefulness of external support for trade negotiation preparations. In practice, donor procedures can extract more resources than they yield, assistance is often supply driven and ill-targeted, and external programmes tend to ignore existing local structures. Where external assistance is used, it should be aimed directly at those people close to the negotiating line, and it should be demand driven and involve the permanent bureaucracy rather than temporary and external expertise.

In contrast to the Caribbean, MERCOSUR has not particularly benefited from external assistance to its regional or national institutions. Part of the explanation arguably lies in the fact that the internal organisation of some of the member states' public sector agencies, such as those in Argentina, was overly fragmented, and inter-agency co-ordination has been very poor. Further, assistance to the region often targeted external experts rather than the permanent bureaucracy and programmes were stopped once external funding was not provided anymore.

Challenges for the ACP in negotiating a regional EPA: Concluding remarks

The capacity to develop a coherent trade policy and initiate the accompanying institutions cannot be build over night. The training of civil servants within ministries and delegations abroad, the strengthening and building of institutions, and the

process of involving relevant stakeholders, all require a long-term strategy.

As a result, developing countries are often seen as being weak, if not marginal, participants to international negotiations, whether on trade or other issues. Indeed, if one assume that economic and political power are the sole determinants of the outcome of negotiations, the prospects for developing countries to effectively pursue their interests seems very bleak. Moreover, a lack of experience, knowledge and resources only adds to developing countries' disadvantages compared to their developed counterparts. Still, power is not the only determinant of outcomes and some gaps can be bridged. Developing countries, including the smaller ones, have increasingly shown that effective participation is possible. As Sheila Page notes in reviewing the last 15 years of multilateral negotiations, 'developing countries have proved first that they can modify the outcome, then that they can block a settlement, and finally that they can initiate their own issues' (Page, 2003).

The experience of developing countries in participating in negotiations on preferential trade agreements, notably with industrial entities such as the EU, indicate that some key elements might be adopted to increase the effectiveness of the preparation and conduct of such negotiations.

The problem facing the ACP – one typical for developing countries in general – is that negotiations are conducted while their preparation is just underway, putting the ACP under considerable time pressure. Moreover, they are required to negotiate as a group, at the regional level, which requires additional regional co-ordination. Finally, their negotiating partner is the EU (represented by the European Commission), which possesses a most sophisticated institutional framework, extensive resources and capacity, as well as significant experience in conducting such negotiations, for which it has mainly set the agenda.

Overall, the conditions under which EPA negotiations are taking place are not favourable to the negotiating position of the ACP countries. In that respect, it is all the more necessary for each country to prepare optimally for the negotiations, whether at the all-ACP, regional or national levels. In view of their particular vulnerability in terms of negotiation capacity, and the implicit danger of aid-dependency steering the negotiations, the need to properly identify their own trade interests and develop their own positions in the negotiations is all the more essential.

The additional challenge for the ACP is to develop such capacities not only at the national level, but also to be able to co-ordinate their strategies, position and preparation at the regional level.

The experience of MERCOSUR indicates that the development of a coherent and co-ordinated position at the regional level is no easy task. One factor of success is political will, as exemplified by the FTAA negotiations for which MERCOSUR has so far been better able to initiate a common approach. But the lack of common stable regional institutional settings to develop and co-ordinate a co-operative approach to the negotiations weakens the regional dimension of the negotiations. A permanent regional co-ordination and support body may facilitate this process, as suggested by the RNM experience. Yet, the history of the RNM also points to the fragility of co-operation mechanisms put in place at the regional level in the absence of strong and sustained collective political leadership.

The regional dimension of EPA negotiations poses major challenges in terms of regional institutional set-up, pooling of resources, delegation of authority, and preparatory work at the political, strategic and technical levels of the negotiations.

Simply establishing or re-vitalising existing regional organisations at the regional level is unlikely to deliver the desired results. Several issues need to be given careful attention, including:

- a clear commitment to delegate authority with control and accountability from the national level to the regions;
- effective co-ordination mechanisms between national and regional levels; and
- major investments in institutional strengthening and capacity building of regional policymaking structures so as to play a lead role in EPA negotiations.

Equally important for the ACP is to clearly define

the role and value added of the global ACP institutions in a context where ACP regional organisations and continental groupings (e.g. African Union) will increasingly play a key role in the trade negotiations. Based on the principle of *subsidiarity* the ACP institutions could possibly redefine their roles in terms of:

- grouping and exchanging information on the various ACP ongoing negotiating processes;
- identifying and pooling relevant technical expertise in the various regions; and
- ensuring ACP solidarity and cohesion on common trade-related issues.

In conclusion, it clearly appears that negotiations are won on the basis of a combination of factors including visionary leadership, solid arguments and analysis, a thorough understanding of country interests, strong co-ordination mechanisms both within government and with a multitude of actors and stakeholders, lobby capacities, etc. Countries and regions that were able to work simultaneously and integrate these lessons into their trade policies and negotiations, in general have done quite well. However, it would be too simplistic to copy these lessons and apply them in contexts that are fundamentally different from the ones that were covered by the case studies. Major questions remain: How can we prepare, for example, politically fragile or failed states for trade negotiations? What type of trade capacity support will be required in these types of countries?

Experience also suggests that a number of critical factors can play a determining role in the outcome of any negotiating process. First, there is the element of risk taking that will always play a role in any negotiating process. In spite of huge investments in capacity, impact studies, participatory mechanisms, etc. the effects of certain measures will have a high degree of uncertainty. This risk element is an essential part of any negotiation. There is nothing wrong with it as long as it does not become a kind of 'fuzzy gambling'. Second, the final stages of a negotiation require extreme prudence and caution to guarantee the best possible outcome. 'Horse trading' may be the order of the day and concessions agreed too quickly could lead to a situation where the fruits of a year-long preparatory process and negotiation can quickly get lost. Finally, several countries or regions tend to forget that only with the conclusion of a trade deal does the real work begin. The implementation of what has been agreed remains the most important task. Unfortunately officials and negotiators who have been playing key roles in the negotiating process tend to accept new (sometimes more rewarding) functions within or outside the public sector. Systematically rebuilding these capacities will be a major 'Sisyphian' task.

Drawing lessons from these experiences, it is urgent for each ACP country and region to further develop its own mechanisms for the effective preparation of the negotiations and their successful conclusion.

Endnotes

1. For a discussion on this dimension, see for instance, Bilal and Szepesi (2004).
2. See Bilal (2003), Bilal and Laporte (2004), Bouzas (2004) and Dunlop et al. (2004).
3. The largest cross-institutional initiatives in this respect are the Joint Integrated Technical Assistance Program (JITAP) by the International Trade Commission (ITC), UNCTAD and the WTO; and the Integrated Framework for Trade-Related Technical Assistance for Least Developed Countries (IF) by the IMF, ITC, UNCTAD, UNDP, World Bank and the WTO. In the Doha Round Ministerial Declaration, paragraphs 2, 16, 20–21, 23, 24, 26–27, 33, 38–40, 42 and 43 include provisions for technical co-operation, capacity building or both. A subsequent pledging conference of WTO members in March 2002 resulted in a US$17.5 million Doha Development Trust Fund, twice as much as was originally targeted by the WTO Secretariat.
4. See OECD (2001) and DFID (2001) for broader work on trade capacity-building, and Solignac Lecomte (2000a/b, 2001, 2003), who also provides country case studies and specific contributions on EU–ACP relations.
5. For a review of the emergence of the term *trade capacity-building*, see Kostecki (2001).
6. In many ways, the recent debate on how developing countries can be best supported in bilateral and multilateral trade negotiations reflects the 'classical' debate on humanitarian aid (e.g. food aid or post-disaster aid) versus sustainable development: the two are not necessarily incompatible but if the former is supplied without taking stock of the local circumstances, the latter will be compromised.
7. See Solignac Lecomte (2001) on the risk of biased aid in bilateral assistance programmes. Powell (2002) criticises the World Bank's dominance in multilateral trade capacity-building programmes as these would bring clear 'ideological and institutional baggage' to the trade policy agenda, forcing an intellectual straightjacket upon the policymakers engaged in those programmes. In this respect, the sudden popularity of trade-related capacity building and technical assistance with donors would only be derived from the latter's concern over the implementa-

tion gap developing countries face with respect to their multilateral or bilateral commitments.

8. See for instance the highly critical evaluation of Rajapathirana et al. (2000) on the IF Programme. Case studies on technical assistance and capacity development in general (rather than for trade-related matters alone) can provide most useful insights into the debate in the trade domain (see for example Godfrey et al., 2002).
9. As one interviewed developing country official explains in a survey by Kostecki (2001: p. 21): '... assistance is needed in certain areas and never satisfied. In other areas the needs are inflated because the provider is pushing for such events to take place. The recipient country agrees because there is no cost involved and at times because the local participants and organisers may get more per diem or may travel to attractive places for regional meetings'.
10. See http://tcbdb.wto.org.
11. The present section does not draw solely on the three case studies conducted for this project (the studies can found at www.ecdpm.org), but also incorporates some of the useful insights from two publications by the Inter-American development Bank (IADB, 2002; and Jordana and Ramiro, 2002).
12. See also Oyejide (2000).
13. IADB (2002), and Jordana and Ramió (2002).
14. See Szepesi (2003), Hess (2000) and documentation from the Caribbean Export Development Agency (CEDA, 2002).
15. See Land (2002).
16. For Mexico, see IADB (2002) and Jordana and Ramió (2002); for Mauritius, see Solignac Lecomte (2001).
17. In fact, present-day trade negotiations are an area of mixed competency due to the inclusion of subjects such as services, investment, and intellectual property rights. Annex 1 describes the EU's preparatory process for trade negotiations.
18. For a detailed and most interesting account of the history of the CRNM and its evolving political support, see Grant (2000).

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