

ECONOMIC PARTNERSHIP AGREEMENTS: THE IMPACT OF TRADE LIBERALISATION

The WTO rules of non-discrimination require a redefinition of the existing trade agreements between the European Union and the ACP countries. If they wish to retain preferential access to the European market, these countries and the EU will have to come to a reciprocal free trade agreement (EPAs) covering most of the bilateral trade. But uneven development creates a high degree of asymmetry between the two negotiating parties, accentuated by the current levels of protection which strongly concentrate the effort necessary to accomplish the liberalisation reform on ACP countries. In this article we evaluate the commercial and budgetary impact for each of the six ACP regions with whom the EU has been negotiating. For some countries, the transition will be difficult and will require sustained European support.

Since 1975, the European Union's relations with the 79 countries of Africa, the Caribbean and the Pacific (ACP) have been formalised in a series of conventions – the Yaoundé and then Lomé conventions – which granted unilateral preferences to ACP countries on the EU market. These preferences, which are more favorable than those granted to the other developing countries, contravene the WTO rules of non-discrimination.

The Cotonou Agreement, signed in 2000, has opened the way to a new trade regime. The ultimate aim is to replace the current non-reciprocal preferences with reciprocal preferences, hence setting up free trade for most of the bilateral trade, in compliance with article XXIV of the GATT. In 2001, on this basis, the WTO authorised the maintaining of the existing agreements until 2008 to allow the EU to negotiate new ones with ACP countries – the economic partnership agreements (EPA). The negotiations took place between the EU and the 6 regions grouping the 77 ACP¹ countries on the basis of the existing regional institutions: West Africa (CEDEAO), Central Africa (CEMAC), East Africa (COMESA), Southern Africa (SADC except South Africa), the Caribbean and the Pacific, with a country or a region able to sign an EPA.

At the end of 2007 seven interim agreements and an EPA with the Caribbean had been concluded. They involved 35 ACP countries, 9 of which were least developed countries (LDCs). Amongst the 42 countries rejecting the interim agreements, 32 are LDCs which benefit from free access to the European market under the "Everything But Arms" scheme (EBA); the others are, for the most part, oil-exporting countries (Nigeria, Congo, Gabon). Negotiations to replace the interim agreements with EPAs will continue in 2008.

■ The end of discriminatory preferences

If it is clear that legal constraints impose the necessity to define a new stage in trade policy towards ACP countries, the EPA have raised many criticisms, expressed by ACP countries and by the European civil society. ACP countries fear that giving preferential access to EU products would put their producers at risk of increased competition in numerous sectors. Moreover they claim that cutting customs duties for EU products will deprive their public finances of an important source of revenue. Besides, the expected gains in ACP exports would be potentially weak because of the already generous level of preferences granted by the EU for more than 30 years. Moreover, the value of the preferences that may be secured would rapidly decline: multilateral liberalisation (Doha Round), regional EU agreements (with the Mediterranean countries, ASEAN, India, Mercosur, Central America, etc.) and the spontaneous or enforced unilateral European reforms (in particular concerning sugar and bananas, key products for the ACP countries) reduce the level of EU protection and thus the preferential margin offered by the EPAs. Finally, though consumers and some producers in the ACP countries may benefit from a tariff reduction, economists point out that the EPAs will result in a dual tariff structure (zero tariff on the majority of products imported from the EU and high tariffs on the others), which exacerbates the welfare losses of protection, and maximizes the risks of trade diversion.

Despite these arguments the European Commission defends EPAs. They argue that reciprocity is not the only objective of EPAs. The Cotonou Agreement also includes ambitious objectives

1. Cuba, non-signatory of the Cotonou agreement, and South Africa, which already has a free trade agreement with the EU, are not taking part in these negotiations.

such as poverty eradication, sustainable development and gradual integration of ACP countries into the world economy. In this sense the extent to which EPAs will contain support for deep integration and development assistance will provide an indication of the European commitment. Moreover, according to the Commission, EPAs are the only means of preserving the preferential access enjoyed by ACP countries. The only current alternative to EPAs would be that the non-LDC ACP countries avail of their access to the General System of Preferences (GSP), under which they would not need to reciprocate.² This solution, fully WTO compatible (justified under the Enabling Clause) provides for a less favourable treatment than current preferences. At the same time ACP countries would face competition from more productive Asian and South American countries, also covered by the scheme.³ Concerning EPA ACP countries, which benefit from the EBA arrangement, they might also gain from signing EPAs. Indeed, beyond the full elimination of duties to enter the European market (which operates in the two cases), other “variables” need to be taken into account. For instance EPAs may yield less restrictive rules of origin than those required to export under the EBA scheme.⁴

■ Highly asymmetrical relations

To better understand the debate about EPAs, we need to emphasise the asymmetry between the two parties. Firstly, the economic asymmetry between one of the richest regions of the world and a group of poor or low income countries having limited capacities for negotiation, production and adaptation. Secondly the asymmetry in trade relations, which means that what is at stake in the negotiations is much more crucial for ACP countries than for the EU.

Despite the preferences accorded by the EU during their longstanding partnership, less than 2.5% of EU imports come from the ACP region, with West Africa accounting for half of this. On the other hand, ACP countries are very dependent on trade relations with the EU (30% of their exports go to the EU, 28% of their imports come from there), even if the trend shows that the weight of the EU is tending to diminish at the profit of the new trade partners, particularly China (giving rise to the idea that, with EPAs the EU is trying first and foremost to curb its declined market share in African countries).

Moreover ACP countries are often very specialised. On the export side, one single product (out of the 5,000 products in the HS6 classification) accounts for more than 50% of total exports in one country over two, and more than 70% in one country over three.

The products are often non-agricultural raw materials: oil (90% of Nigerian exports, 81% of Angolan exports or those from Equatorial Guinea, 70% of exports from Chad), gold and diamonds (Botswana 96%, Lesotho 69%), uranium and radioactive products (Niger 68%); or agricultural: coffee (Burundi 67%), cotton (Burkina Faso 83%, Mali 56%). This concentration makes such countries particularly sensitive to changes in the world market for one or more of these products; in agriculture, other non economic factors such as weather or disease also affect the market, making prices very volatile and increasing their capacities to diversify their economies. It is clear that, to reduce the vulnerability of the ACP economies, a more efficient use of their resources is not enough; it is their capacity to diversify that has to be supported. This is one important reason why broad market access is vital to supporting economic growth.

Finally, the actual structure of protection magnifies the asymmetry of the effort required to achieve free trade. New market opportunities for ACP countries are limited due to the current generous preferences granted by the European Union (the Cotonou agreement gives free access to all industrial products and numerous agricultural products, while all LDC products are duty and quota free on the EU market); the complete openness will benefit only a small number of countries specialising in the few agricultural and fishery products which are still highly protected by the EU⁵ against ACP exports.

By contrast, ACP countries apply customs duties which are relatively high on European products. Central Africa, Eastern Africa and the Pacific region are the most protected against EU exports (average rates between 12% and 13.5%), while Southern Africa and Western Africa are the least (7% and 8% respectively). However those high rates do not hide any discriminatory treatment against the EU. On the contrary, due to their specialisation, intra-ACP trade is, on average, more taxed. The Cotonou agreement encourages intra-regional integration which could, in each of the groups of countries, bring substantial gains (except Central Africa and the Caribbean which are already quite integrated). The EPAs which will be agreed should make this regional dimension a reality; otherwise the already weak South-South trade could be seriously damaged by the completion of a free trade agreement with the EU.

Finally, EPAs mean a substantial, but not total, opening up of ACP countries to the EU. The European Commission considers that liberalisation “of substantially all the trade”, required by article XXIV of the WTO is achieved when 90% of bilateral trade and tariff lines are completely liberalised. If the EU opens its market completely (100%), this means, in the case of equilibrium

2. A variant of this option would be, for some of the countries, the GSP+ which provides an improved market access to “vulnerable” economies having ratified and adopted a series of international conventions. Mauritius, for example, could benefit from a more favourable treatment in the textile sector under the GSP+ provision.

3. For a discussion of the impact and limits of the GSP and alternative solutions, see A. Bouët, D. Laborde & S. Mevel (2007), “Accords de partenariat économique entre l’EU et les ACP : quelles options ?”, International Food Policy Research Institute, Research note 10, December.

4. We should note here that if, within the same region, some developing countries sign an EPA but the LDC don’t, regional integration will be severely hampered since the different sets of rules of origin will forbid ACP countries to take advantage of the vertical integration of their production systems.

5. European imports of sugar will still be controlled and protected by safeguard measures in order to preserve the European reforms in progress.

of the trade balance, that ACP countries can exclude from liberalisation 20% of their imports from the EU (leaving room for selecting sensitive products).

■ The impact of EPAs

We have evaluated the impact of trade liberalisation with a partial equilibrium model,⁶ specially built for this exercise. It focuses on the demand side and it aims at giving a very detailed assessment (HS6 level) of the impact on trade and public budgets of EPAs.⁷

Two scenarios were simulated which differed in the choice of “sensitive products”: the 20% which will not be liberalised by the ACP countries.⁸ In the central scenario H1, the purpose is to protect agricultural products. In scenario H2, the objective is to minimise the losses in fiscal revenue at the regional level. In both cases, we assume that the complete implementation of the EPAs by ACP countries will be staggered over 15 years. From 2008 to 2015, a cut of 20% is applied to customs duty on the non-sensitive products imported from the EU; complete elimination of the duty on these products is achieved in 2022.⁹ We also assume that reciprocal liberalisation within each ACP group, to respond to the objective of regional integration, takes place in 2015. As for the EU, it gives free access to all ACP products in 2008.

The trade and budgetary impact of EPAs is presented as a deviation from a reference situation. The latter is not a status quo as such, this is legally no longer possible, but rather the only current legal “alternative trade arrangements” to EPAs: GSP for ACP non-LDCs and EBA for ACP LDCs. This reference situation means a loss of preferences which in 2008 would involve an average fall of 4.8% in exports from ACP countries to the EU. The reduction would be greater for Eastern Africa (-12%), Caribbean and Pacific. The losses are concentrated in products associated with specific protocols.

The trade impact

Starting from this reference situation,¹⁰ in the central scenario EPAs would lead to a 10.7% increase in the volume of exports from ACP countries to the EU in 2022 (table 1). In percentage terms, the largest gains would be concentrated in the livestock sector (+140%). Exports of vegetable and textile products would also forecast to increase significantly (+40%).

Table 1 – Impact of trade liberalisation on ACP-EU trade in the H1 scenario, deviations in 2022 relative to the reference situation (%)

	ACP exports vs the EU	ACP Imports from the EU
ACP	10.7	17.7
ECOWAS	4.0	15.1
CEMAC	7.3	17.2
COMESA	25.5	20.7
SADC	6.6	10.6
Caribbean	25.2	27.1
Pacific	37.1	-0.2

Source: CEPII, simulations results.

Imports from the EU would increase 7% by 2015 and 17.7% by 2022, the end of the liberalisation process, the biggest rise being in the Caribbean (+27%), the smallest being Southern Africa (+11%). Such imports would essentially be industrial products (textile); the increase in agricultural imports would be negligible. In this respect, the selection of sensitive products is critical. Hence the rise in the imports of textile products would be five times lower in scenario H2 than in scenario H1; whereas imports of vegetables, livestock and food products would increase twice as much.

The budgetary impact

The elimination of customs duty on the principal imports from the EU reduces the customs revenue of ACP countries. Two main effects can be disentangled:¹¹

♦ *The direct effect:* the reduction in customs duty on European products diminishes revenue, but the increase in the volume of imports (caused by the fall in their price until liberalisation is complete) increases it. We observe that the direct effect is negative: the impact of the fall in duty is always larger than that of the increase in volumes.

♦ *The diversion effect:* imports (untaxed) from the EU will replace currently (taxed) imports from the rest of the world. Overall, in the central scenario H1, the loss of customs duty revenue on imports from the EU are 28% in 2015 and 71% in 2022. The lowest losses are foreseen in the Southern Africa region (-58%), while the region most heavily affected is forecast to be Western Africa, for which the diversion effect would be particularly detrimental (losses of 700 million euros per year, that is 82% of tariff revenue in 2022). The impact of EPAs on customs duty revenue depends on the country’s share of imports from the EU, as well as the choice of non-liberalised sensitive products (graph 1). In Western Africa, for example,

6. A general equilibrium model is better adapted to the measurement of the global impact on trade and welfare. But in the case of ACP countries, there are no social accounting matrices which are sufficiently reliable. It is therefore preferable to revert to partial equilibrium models which also allow us to work at a detailed level (HS6 level) which is appropriate for countries specialised in just a few products.

7. For a detailed presentation of the results, see L. Fontagné, D. Laborde & C. Mitaritonna (2008), “An Impact Study of the EU-ACP Economic Partnership Agreements in the Six ACP Regions”, *CEPII Working paper*, no. 2008-04.

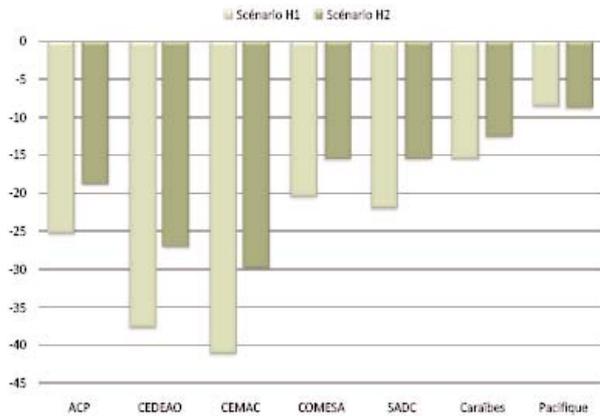
8. A discrete choice model has been built to submit the selection of products to two constraints: the share of trade concerned must not exceed 10% of the bilateral trade and the number of sensitive products must not exceed 20% of the tariff lines.

9. This approach has not been used in the interim agreements. Several successive phases of liberalisation will take place for the various categories of products.

10. The reference selected is obviously essential. Relative to the situation in 2007 (Cotonou trade regime), the EPAs would have a moderate impact, even none at all, on the exports of the ACP countries.

11. We also take into account a “domestic effect”: the VAT receipts increase because the informal internal transactions, exempt from taxation, are replaced by imported products subject to VAT.

Graph 1 – Losses of customs revenue according to the choice of products excluded from the liberalisation - Deviations in 2022 relative to the reference situation (%)

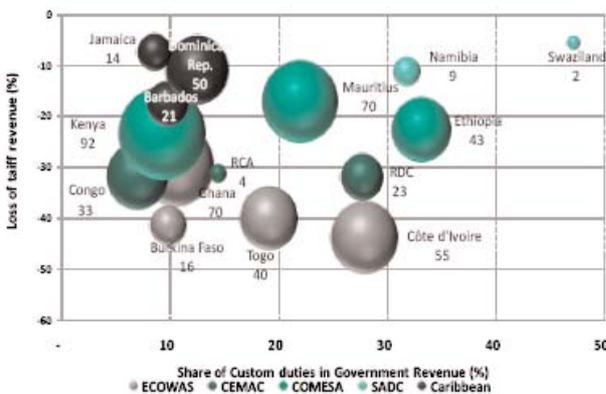


Source: CEPII, simulations results.

the total customs receipts will have diminished by “only” 38% in 2022. For the ACP countries as a whole, these losses amount to 26% (19% in the scenario H2).

Finally, the ultimate impact on each ACP economy depends on the importance of tariffs in the government revenue. It seems that the countries with a budget which depends most on customs duty are, fortunately, those who would suffer the smallest losses. Swaziland for example, where 47% of public revenue comes from customs duty, would lose only 5.7% of its customs revenue (graph 2). At the other extreme, a country like the Congo, where the customs duty

Graph 2 – Losses of customs revenue and budgetary dependency Scenario H1, 2022



Note: the bubbles represent the amounts of customs revenue loss, the figures give this in millions of euros.
Source: CEPII, simulations results of the; IMF.

losses are forecast to be high, almost a third, depends relatively little on this source of revenue (7% in the case of the Congo). However, several West African countries, like Ghana and to a greater extent, the Ivory Coast, which are heavily dependent for their budget on this revenue, may go through difficult transition phases due to the heavy predicted losses in customs receipts. It therefore seems to be important for the negotiators to concentrate on these latter types of countries. LDCs are likely to benefit the most from an adjustment package allowing them to move gradually from a taxation system based on imports to a more stable, domestic focused, system. The transition towards other forms of taxation will be particularly difficult in post-conflict countries where the central government is weak and the whole administration system is still in a phase of “rebirth” (e.g. Central African Republic). Graph 2 shows the absolute values of customs revenue losses, giving a clear picture of the financial requirements for the implementation of such a programme.

The interim agreements made at the end of 2007 have paved the way for an agreement on the market access dimension with the majority of the ACP countries. However, to secure these agreements and complete full EPAs, with commitments in terms of direct investment and services, essential areas for the European Union, negotiations are still going on. The development and capacity building package is still to be defined in detail. The first step would be to reach an agreement on the financial support that should allow ACP countries to deal with the reduction in customs revenue. The definition of the “net fiscal impact” of the agreements and the way it may be compensated is a tricky question. Though tariff revenues are lost by the government, this is not the case for the country as a whole. Private agents, in particular consumers, will benefit from price reductions. For this reason, improving the domestic tax system is the only viable long-term solution. The real question is therefore to see how the EU can support ACP countries to perform domestic reforms at their own speed.

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