Economic Partnership Agreements
between the EU and Africa:

Opportunities, Controversies, and

Open Questions

Larry Hinkle, Lead International Economist,
Africa Region, June 25, 2005
Outline of Presentation

I. An Overview of EPAs

II. The Limitations of Unilateral Preferences

III. The EU’s Implicit Conceptual Model for EPAs

IV. Open Questions: Six Major Design Issues Posed by EPAs

V. Conclusion: Can EPAs be Made to Work Successfully?
I. An Overview of EPAs

A. Importance of EU SSA Trade
B. Objectives of EPAs
C. Three Key Features of EPAs
D. Regional EPA Groupings
A. Importance of Trade between the EU and SSA

- The EU is SSA’s largest trading partner
  -- 31% of SSA exports
  -- 40% of SSA imports

- Since the 1970s, EU has provided SSA unilateral preferential access to its market under the Lomé Conventions, Cotonou Agreement, and Everything-but-Arms Initiative (EBA).

- The EU is willing to further improve its trade policies vis-à-vis Africa through EPAs.

- The EU is also one of the largest aid donors to Africa and can provide substantial “aid for trade”.
B. Objectives of EPAs: Development and Regional Integration

- EPAs are intended primarily to be instruments of development.

- They are also supposed to encourage outward oriented regional integration among the ACP countries.

- Despite these objectives, some features of the EPAs have become quite controversial.

- This presentation looks at EPAs from a development perspective and discusses how to maximize their development and regional integration benefits for SSA.
C. Three Central Features of EPAs

1. *Reciprocal* free trade agreements between the EU and SSA
   -- to replace unilateral Lome-Cotonou preferences.
   -- to bring EU-SSA trade relations into line with WTO rules.

*Controversies:*

   -- Should EPAs provide for reciprocal market opening or just continued unilateral preferences?
   -- Should EPAs comply with WTO rules or should the rules be revised?
C. Three Central Features of EPAs  
(continued)

2. *Comprehensive* trade and investment agreements
   -- covering merchandise trade, services, trade facilitation, investment, and competition.
   -- allowing long implementation periods of 12-20 years for capacity building and adjustment.

*Controversy:* Is a comprehensive approach essential for addressing supply-side issues? Or simply an EU quest for commercial advantage?
C. Three Central Features of EPAs  
(continued)

3. Aid for Trade

-- EPAs and the EU’s aid program are supposed to provide both trade adjustment assistance and financing for trade-related projects.

Controversy: Will EPAs provide additional resources for trade or just re-focus the EU’s current aid programs?
D. Regional EPA Groupings

1. *Four Regional EPA Negotiating Groups* have been agreed upon:

   - ECOWAS + Mauritania
   - CEMAC + Sao Tome
   - ESA: 16 countries supported by the COMESA Secretariat.
   - SADC: SACU (with South Africa as an observer) plus Angola, Mozambique, and Tanzania.

2. The first year of negotiations is focusing on *regional integration*.

3. The EPA process has given a useful, but controversial, *dynamic impetus* to rationalization of overlapping regional trade arrangements and is accelerating discussions of outward oriented regional trade arrangements.
D. Regional EPA Groupings
(continued)

4. Unresolved Geographic Configuration Issues:
   -- Tanzania and EAC
   -- Nigeria and ECOWAS
   -- South Africa, SACU, and SADC
II. The Limitations of Unilateral Preferences:
   A. SSA’s *Loss of EU Market Share*

- Despite the unilateral Lome-Cotonou tariff preferences, SSA’s share of the EU import market has declined steadily over time. And

- There has been very little diversification of SSA’s exports to the EU.
SSA Exports to EU as a Share of total EU Imports

Between 1985 and 2003:
- EPA countries' share of world exports to the EU fell from 3.0% to 0.9% despite preferential market access.
II. The Limitations of Preferences:

B. The 33 LDCs and EBA

The 33 LDCs in SSA

--have had complete tariff-free, quota-free access to EU under the EU’s Everything-but-Arms (EBA) initiative since 2001.

--but EBA by itself is not yet leading to export diversification or acceleration, and there is little reason to suppose that it will.
II. The Limitations of Unilateral Preferences:  
C. The 13 Non-LDCs

For the 13 non-LDCs in SSA, the immediate impact of moving from Cotonou preferences to EBA would be worth

-- only 3% to 8% of the value of current exports to the EU in 4 non-LDCs (Botswana, Cameroon, Cote d’Ivoire, and Namibia)

-- and less than 1% of the value of current exports to the EU in the other 9 non-LDCs.
II. The Limitations of Unilateral Preferences:

D. *Preferences alone Tend to Discourage Reforms*

Ozden and Reinhart (2003) using data from the US GSP find that:

1. Access to preferences, by itself, makes developing countries less likely to liberalize their trade policies.
2. Countries that have lost their GSP preferences have subsequently liberalized their own trade policies.

*Hypothesis:* Export sectors with access to foreign markets provided by preferences have less incentive to oppose protectionist measures at home than they do when access must be obtained through reciprocal concessions.
II. Limitations of Unilateral Preferences:
E. *The Development Challenge for EPAs*

- So even complete tariff-free, quota-free access to the EU market *alone* will not lead to a substantial improvement in SSA’s export performance in the medium term.
- Other serious obstacles to expanding and diversifying merchandise trade are:
  - in EU: Restrictive rules of origin
  - in SSA: Competitiveness and supply problems
- *The development challenge*: Can EPAs effectively address competitiveness and supply-side problems and successfully reverse the decline in SSA’s market share?
III. The EU’s Conceptual Model for EPAs:  
A. Harnessing EPAs for Development

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

-- EU Trade Commissioner Mandelson
III. The EU’s Conceptual Model for EPAs:
B. A Comprehensive Pro-development Trade and Investment Treaty

• **Conceptual Model:** Those north-south trade and investment agreements that have been used to leverage and lock-in *broad programs of trade and investment climate reforms.*

• Examples—
  -- The accession agreements between the EU and Central and Eastern Europe.
  -- EU-Mexico FTA and NAFTA.
  -- Chile’s FTAs with the EU and US.
III. The EU’s Implicit Conceptual Model for EPAs

C. Conclusion

• Competitiveness and supply problems are severe constraints to export diversification and expansion in SSA.
  -- SSA countries rank at the bottom of most investment climate surveys in almost all categories.

• EPAs provide an opportunity
  -- to address trade and supply constraints in a comprehensive way with the support of a major trading partner and donor; and
  -- to accelerate regional and global integration in SSA.

• But a number of difficult design issues will need to be resolved.
III. Open Questions: *Six Major Design Issues Posed by EPAs*

A. Incentives for Reform  
B. High MFN Tariffs  
C. Potential Revenue Losses  
D. Barriers to Regional Integration  
E. Investment Climate Reforms  
F. Diverse Country and Sub-regional Conditions
Design Issue #1: *Incentives for Reform*

*Strong incentives are needed for stimulating reforms:*

-- Where trade and investment agreements have been used to leverage broad reform programs, policy makers have viewed these as very attractive economically and politically.

-- Conditions in a number of SSA countries are not conducive to reform, and tariff preferences alone will not be a large incentive in many cases.

-- *Additional aid for trade* is likely to be a key incentive since most SSA countries already have preferential access to the EU market.

-- Can the EU provide attractive enough trade and aid package under EPAs to help accelerate the reform process?
Design Issue #2: Reducing High MFN Tariffs to Minimize Trade Diversion and Monopoly Pricing Effects of a FTA with the EU

Second, because of Africa’s high MFN tariffs, a free trade agreement with the EU is likely to lead to significant costly trade diversion and monopoly pricing by EU suppliers
Design Issue #2: Reducing High MFN Tariffs to Minimize Trade Diversion and Monopoly Pricing Effects of a FTA with the EU (continued)

• Because of concerns about these problems, other developing countries such as Chile, Mexico, and Bolivia have cut their maximum MFN tariffs to about 10% when implementing free trade arrangements with the EU and US.
  -- African countries would also need to reduce their current MFN tariffs and eliminate other forms of trade protection.

• But the required changes can be phased in gradually over the 12-20 year implementation period.
Design Issue #3: *Offsetting Potential Revenue Losses*

Third, *potential losses of 10-20% of government revenues* from reducing tariffs on imports from the EU will need to be offset by:

-- replacing forgone tariff revenues with VAT and excises levied at equal rates on domestic and imported products.
-- improving tax administration
-- maintaining a low uniform revenue tariff of 5-10% on *all* imports from the EU during the transition period when needed.

The 12-20 year implementation period allows ample time for capacity building and offsetting revenue measures.
Design Issue #4: *Removing Barriers to Regional Integration in SSA*

Fourth, *intra-regional barriers to trade within and between the RECs in SSA need to be reduced*:

-- intra-regional trade is very low: on average 7% of SSA imports and 12% of SSA exports;

-- of all of the RECs in SSA, only SACU has reasonably free intra-regional trade;

-- intra-regional trade in other RECs is constrained by *restrictive rules of origin* and other barriers.

-- intra-SSA trade between RECs is limited by their members’ high MFN tariffs.
Design Issue #5: Investment Climate Reforms

Fifth, in addition to trade liberalization, many other investment-climate reforms are needed:

-- Some investment climate reforms could be addressed under EPAs by including development-friendly treatment of trade in services, investment, competition, and trade facilitation issues.

-- But other reforms will have to be tackled independently by the governments concerned.

-- Not much analytical work has yet been done on designing pro-development approaches to this issues.

-- Work on investment climate reforms needs to be started soon if they are to be included in EPAs.
Design Issue #6: **Differences in Country and Regional Conditions**

Sixth, *enough flexibility is needed in the design of EPAs to accommodate diverse regional and country conditions*, in particular:

-- Differing configurations of customs unions and FTAs in the four EPA regional groupings;
-- Phasing and sequencing of a demanding list of EPA and *independent* investment-climate reforms in countries and sub-regions that are in very different phases of the reform process.
V. Conclusion: *Can EPAs be Made to Work Successfully?*

Can EPAs be made to work as partnerships to promote trade and investment reforms leading to accelerated global and regional integration broadly along the lines envisaged by the EU?
V. Conclusion: *Can EPAs be Made to Work Successfully?* (continued)

*Maybe…* Key Determinants of Success or Failure will be:

- For the EU -- *maintaining the focus of EPAs on development* in the face of mercantilist negotiating traditions and commercial pressures from special interests.
- For SSA -- *seizing the opportunity* and using the EPAs to accelerate trade and investment-climate reforms.

In any case, a more *voluntary, selective, phased* approach to EPAs will probably be needed.