

EU–ACP Economic Partnership Agreements: The Effects of Reciprocity



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Speculation about Economic Partnership Agreements (EPAs) abounds: will they support the regional integration of the African, Caribbean and Pacific (ACP) countries as the EU claims, or lay these economies open to subsidised European exports as some critics allege? This Briefing Paper suggests that both views are uninformed and incorrect.

It is impossible to know exactly what will be in an EPA until one nears completion, which may not be for another two years. But it is possible to make some informed speculations now. As part of a project to support ACP preparations for the detailed phase of EPA negotiations, IDS has undertaken a comprehensive review of the trade and tariff structure of almost all ACP states (see Box 1).¹

Making plausible assumptions about the strategic choices of ACP governments on reciprocity, the research comes to startling conclusions. The claim that EPAs will necessarily result in ACP markets being thrown open to EU imports appears to be overstated, but evidence suggests that they may well cause serious problems for regional integration and for government revenue.

Reciprocity

Whilst EPA preparations are required on a large number of issues, this project has concentrated on one key element, known as reciprocity. Under the trade regimes that have linked them to Europe for three decades, the ACP have not been required to treat imports from the EU differently from those sourced in other industrialised countries. Under EPAs, by contrast, the ACP will be expected to remove tariffs on 'substantially all' imports from the EU during an implementation period. It is this requirement that has led to the assumption that EPAs

Box 1: Support for the EPA negotiations

As part of a project funded by DFID, IDS has developed a methodology and set of databases that 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 aim is to encourage an informed debate both within countries and between members of each regional group.

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.² 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.

Using this methodology and the full set of ACP datasets, IDS has undertaken a **demonstration exercise** showing which items would be excluded from liberalisation on different assumptions – see Box 2. This serves two functions. As part of the Handbook it explains how the methodology can be used, but it also supports some general observations – the subject of this Briefing Paper.

are aimed at opening up ACP economies to subsidised European exports.

In fact, as explained in this project's first Briefing Paper,³ a primary objective of EPAs is to make the EU–ACP trade regime more easily defensible within the WTO. One peg upon which a defence can be hung is Article XXIV, from which the phrase 'substantially all trade' is taken. This allows countries to discriminate in their trade policy in favour of each other, and against other WTO members, if they are creating a free trade area (FTA). One requirement of an FTA is that most – but not all – trade be liberalised.

Because not all trade must be liberalised, the ACP have some room for manoeuvre to maintain their current barriers on some imports from the EU. How much room for manoeuvre, and the use that ACP countries make of it, will be a vital part of the EPA negotiations. Until these factors become clear, it will not be possible definitively to calculate the potential economic impact.

But some informed assumptions can be made to provide early guidance on the potential direction and scale of EPA effects. The fundamental purpose of the IDS project is to empower stakeholders in ACP countries to make their own assumptions. Rather than relying on the polarised and inaccurate debate currently being had about EPAs, the IDS project aims to facilitate national debates that create a consensus on negotiating positions. In addition, IDS has used the database it has created to identify the implications of one plausible set of assumptions, which are outlined in this Briefing Paper (Box 2).

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%.

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, 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 'base-line' 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 Commission official that the proportionate liberalisation of the ACP could vary between regions.⁴ 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 pre-determined 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?

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 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 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 countries⁵ 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 of 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 large high-tariff items absorb a substantial share of the 20%

Table 1. Broad regional picture

Region ^a	Marginal tariff (%) ^b	Range	High outliers ^c
Caribbean	20	15–30	<i>St Kitts</i> , St Lucia, Surinam
Central Africa	30	20–30	None
East and Southern Africa	25	5–100	Burundi, <i>Djibouti</i> , Ethiopia, <i>Seychelles</i>
SADC	5	0–42.5	Angola, <i>Botswana</i> , <i>Mozambique</i> , 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.

excludable imports. For Seychelles it is tuna; if four fish items are ignored, its marginal tariff would be only 25%.⁶ In Botswana it is one category of vehicle; its removal reduces the marginal rate to 0%.⁷ Apart from these two, only a handful of states would have to liberalise tariffs that severely restrict imports at present.⁸

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 countries⁹ would be forced to cut tariffs that are over 10%. And half of these face the problem of 'lumpy' imports noted for 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 all the exclusion lists of all members of any of the groups!¹⁰ And there would be very few that are common even to 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.

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

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.

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 EU² (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 exemptions¹¹), 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 could lose 40% or more of their tariff revenue from the EU, and for over one-third 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%.

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
<i>Note:</i>				
(a) Botswana, Lesotho, Namibia and Swaziland, covered by the SACU revenue formula, are excluded.				

Implications for EPAs

This Briefing Paper began by pointing to the widespread criticism of EPAs that they will force open ACP markets – but for some observers this is a desirable outcome. One of the arguments advanced by the European Commission, many EU member states and liberal trade economists in favour of EPAs is precisely that they will encourage ACP liberalisation.

This is not the place to enter into that debate – only to note that 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.

In the meantime, the more countries that undertake their own calculations of ideal inclusions/exclusions 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 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 liberalisation 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.

Notes

¹ The research was funded by the UK Department for International Development (DFID). The views expressed in this Briefing Paper are those of the authors alone, and do not necessarily reflect those of DFID. Twenty-two of the 77 ACP countries were excluded from analysis because recent data on their applied tariffs were unavailable from the international source used (UNCTAD's Trade Analysis and Information System (TRAINS) database).

² Subject to data availability.

³ Available on the IDS website at <http://www.ids.ac.uk/ids/global/pdfs/CSEPARECBP1.pdf>.

⁴ 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.

⁵ Plus Haiti.

⁶ The fish are 'imports' only in the sense that they are caught on EU vessels. They are then canned in Seychelles and exported. The EPA negotiations will allow Seychelles to identify an alternative way to levy a tax on this trade.

⁷ 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.

⁸ 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.

⁹ For which data are available.

¹⁰ Other than the Pacific group – for which data are available for only two of the 14 members.

¹¹ 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.