

Briefing Paper

Making EPAs Development Friendly

Negotiations on Economic Partnership Agreements (EPAs) are proving difficult and contentious despite consensus on certain fundamentals such as the potential benefits for developing countries from greater integration into the world economy and the need for increased development assistance. The EPAs are viewed by some as the European Commission (EC) mostly forcing the ACP countries to unfairly open up their markets to EU firms, while the EC states that it wants to make the EPAs “development friendly”. We argue that much of the contention is driven by the EC’s insistence on separating out the issue of market access (trade liberalisation) from the issue of development assistance, and that successful market access requires more than just reductions in formal barriers to trade. For many ACP countries difficulties in accessing EU markets arise from a range of non-tariff impediments to trade, both in the exporting country and in the EU, and resolving these impediments will require development assistance. We suggest the way forward is for the EPAs to include development priorities based on reducing these impediments to trade, and for which trade related development assistance will be provided.

The EU and the African, Caribbean and Pacific (ACP) states are engaged in complex negotiations over a new set of trade agreements —Economic Partnership Agreements (EPAs). The EU has repeatedly affirmed that the EPAs should be “development friendly,” facilitating greater integration of the ACP states into both their respective regional economies and the world economy. However, for many reason, the EPA negotiations are proving very difficult.

Different perspectives on the EPAs...

The impetus for negotiating EPAs arose from the WTO incompatibility of the existing asymmetric relations between the EU and the ACP states. The status quo is not a viable option, and the need for change is being forced upon both parties, putting pressure on the negotiations. The negotiations are between the EU and regional groupings of ACP states, which complicates the process because the countries composing those groupings have different priorities and agendas, with different issues of special and/or differential treatment. Many of the proposed EPA groupings cut across existing formal integration arrangement both within and across the regions, which raises complex issues of compatibility. Finally, many ACP states want to link the trade negotiations with EU commitments regarding development assistance, while the European Commission has repeatedly argued that the two issues should be kept separate.

If the EPA negotiations fail, the ACP states would have access to the EU under existing preferential schemes such as the Generalised System of Preferences (GSP) or Everything but Arms (EBA), which are unilateral but reversible concessions by the EU. Many ACP states appear to have a

preference for a new EPA agreement, since switching to GSP/EBA preferences entails less favourable access to the EU than they currently have, and any changes in the unilateral preference arrangements is uncertain. In certain cases, there is also the hope that signing an EPA is likely to entail more substantial development assistance, even without any formal linkage in the agreement. There is also recognition that liberalising their own trade regimes may be good for development and poverty reduction. The EU also appears keen to complete EPA agreements with the stated motive of improving the prospects for development and poverty reduction in the ACP states.

The objectives are laudable, and clearly in the interests of the developing countries. There is strong evidence and general acceptance that integration in global markets is an important part of the process of successful development. Yet, listening to both sides in the negotiations and to external commentary, the two parties seem to be very far apart. To caricature the differences, the EU is often portrayed as forcing poor developing countries to further liberalise access to their markets so as to benefit EU firms, while doing nothing to improve access to EU markets. On the other hand, the ACP states are characterised as pandering to their domestic constituents and not understanding the benefits from a more open trading environment. Linking increased aid to a trade agreement is seen as simply trying to get more money out of the EU, which is already providing substantial development assistance.

The caricature of the EU position pains the European Commission (EC), which insists that the criticisms are misguided and that an EPA can genuinely help the ACP

states through their integration into EU markets; and that the EU already provides so much development assistance that the budget is typically under-spent. The ACP states, in turn, argue that they do understand the benefits of trade liberalisation, but that the form of liberalisation being insisted upon by the Commission is unsuitable, and that the EPAs will require substantial structural adjustment in their economies, and that therefore additional aid is needed to deal with the process of adjustment.

Wherein lie the difficulties...

While there is a considerable degree of posturing in the above positions, there are significant areas of agreement and also fundamental differences that need to be understood.

There is agreement over the need for development assistance, and that assistance will be granted. There is also agreement that the ACP states are currently at the top of the pyramid in terms of the degree of preferential market access given to them in EU markets, and that continuation of this access in some form is desirable. There is also agreement that greater integration into the world economy is likely to be good for development.

The key disagreements appear to revolve around the degree of flexibility in the EPAs with regard to the timetable(s) for the process of trade liberalisation; the possibility of special and differential treatment across countries; and the insistence by the European Commission on separating the trade aspects of the agreement from development aspects, in particular from development assistance.

What role for trade related development assistance ...

Central to this debate is the issue of under what circumstances does trade liberalisation yield benefits in terms of growth and poverty reduction. Impediments to successful integration in the world economy by developing countries are both internal and external: the former include domestic constraints such as inadequate infrastructure, poor regulatory and financial frameworks, market imperfections, and lack of institutions to facilitate trade; and the latter include constraints such as non-tariff impediments in the EU (e.g., product and process standards, certification procedures, and customs procedures), complex rules of origin, and domestic EU policy distortions such as protection of agriculture. To address these impediments, their presence needs to be explicitly recognised in the EPA and mechanisms to deal with them need to be incorporated into the agreement.

The result of only opening domestic markets to foreign suppliers could well be devastating to domestic producers and workers, without obvious routes to productivity growth and better integration into the world economy. For a successful development-friendly trade agreement, the conditions have to be "right". But what is the best way to create the right conditions?

A fundamental precept underlying the position of the EU is that clarity, commitment and credibility are essential. If one allows a country to start from the position that tariffs will be liberalised only when it is "ready" then the likelihood is that the country will never be ready, and liberalisation will never occur. Credible commitment is important. The presence of a binding commitment, even with a long time lag, is likely to concentrate minds and ensure that countries will engage in the necessary reforms and expenditures to successfully manage the liberalisation process.

From this perspective, development assistance *needs* to be separated from the trade liberalisation process, as linking raises the spectre of countries deciding that they are not ready for liberalisation because of inadequate or ineffective development assistance. This perspective also implies a more limited approach to the idea of special and differential treatment in trade agreements. The Commission is currently insisting that there be no differentiation between country groupings regarding timescale and product categories to be included — the goal is to make the EPAs as uniform as possible. One reason is to simplify the negotiating process — it is difficult for the EC to negotiate separately with over 70 ACP states. In addition, including special and differential treatment introduces significant political economy considerations as countries and groups within countries vie for the special treatment — a process that can muddy the waters of clarity, commitment and credibility.

The Commission also notes that the EU is already providing substantial amounts of trade-related assistance under the current European Development Fund (EDF), the Aid for Trade initiative, and direct support by member states. The Commission argues that a trade agreement is not a development package, and that it would be wrong to integrate development assistance directly into an EPA.

Our view, however, is that the Commission is overlooking a fundamental point. Trade agreements are *de facto* and *de jure* largely concerned with market access. Successful market access for developing countries requires more than just reductions in formal barriers to trade in the EU, such as tariffs. A successful EPA needs to address both the internal and external impediments that ACP countries face in increasing access to EU markets.

The implication is that an EPA agreement in addition to containing market access obligations for the ACP partner should also contain obligations for the EU with respect to:

- a) trade-related assistance to allow the ACP countries to gain from the commitments they have undertaken by supporting structural adjustment for increased imports and expanded export opportunities; and
- b) commitments by the EU to facilitate market access by reducing non-tariff barriers (e.g., onerous and unnecessary inspection regimes) and assisting in meeting legitimate standards and procedures.

These commitments need to be subject to some kind of dispute resolution procedure and not depend solely on good will by either party.

The core of this argument is that a development friendly trade agreement should recognize that market access is not simply about tariffs, and should focus on the full range of impediments to trade with the EU. Expanding access requires elements of both negative integration — removal of barriers; and positive integration — supporting policies that facilitate trade. Where measures to facilitate trade require development assistance — technical or financial — then the agreement should explicitly include such assistance.

Shallow and deep integration...

Dealing with the broad range of trade impediments is difficult because many of these are related to the concept of “deep integration”. Shallow, or negative, integration involves the removal of border barriers to trade, typically tariffs and quotas. Much of the discussion of EPAs appears to have focused asymmetrically on the need by the ACP states to remove their border barriers. As is well known in the trade literature the overall gains from removing border barriers are inherently ambiguous and can even be negative. In the context of the EPAs a number of empirical studies have illustrated that the potential gains for the ACP states from only lowering tariffs would be very small, which raises the fundamental question as to whether it is in their interest to negotiate an EPA that involves only shallow integration.

Deep, or positive, integration involves supporting policies and institutions that facilitate trade by reducing or eliminating regulatory and behind-the-border impediments to trade, whether or not these impediments are intentional (e.g. recognition conformity assessment certification where this meets standards). There are good empirical and theoretical reasons for supposing that the gains from deeper regional integration are potentially much higher than those arising from shallow integration.

At the University of Sussex, we have been working on new approaches to evaluating regional trade agreements (RTAs). We have developed the “Sussex Framework,” a practical tool kit for evaluating RTAs, and have applied our approach to evaluating EU agreements with ACP countries in the Caribbean region and with Egypt; and we are currently considering EU agreements with India, China, and Ethiopia. Our work indicates that an RTA is potentially much more beneficial if it incorporates a deeper approach to market access than removing tariff or other border barriers, focusing as well on the creation and maintenance of trade facilitating measures with respect to standards, technical requirements, and the relationship between domestic markets and exports. Trade agreements that support deeper integration have a potential for generating positive spillovers leading to increased productivity, possible scale economies, and growth. Some, though not all, of these benefits can be generated by the market. For those that cannot, government action is required, and in poorer and smaller developing countries, in particular, that means aid will be needed.

Truly development-friendly EPAs would require both policies and aid to the ACP countries to improve their

capacity to deal with such non-tariff impediments to trade and achieve deeper integration. Or, to put it another way, there is a clear argument for including *trade related* development assistance —where the term assistance includes specific policy actions (e.g. on rules of origin, removal of EU trade barriers), technical assistance (e.g. with regard to standards and certification), institutional and financial support (e.g. with regard to regulatory reform and trade facilitation). Such targeted assistance could logically be included in a trade agreement, linked to facilitating market access for particular commodities.

The particular circumstances and needs of individual countries are likely to vary greatly. There is therefore a need for dialogue at the country level in order to establish country-specific, trade-related development priorities (which are variously referred to in different contexts as “benchmarks” or “milestones”) and the actions required to support them.

To date the Commission is resisting this approach on the grounds that the trade and development aspects of EU policy with regard to the ACP states should be clearly separated. As argued earlier this view is driven by the need for clarity, commitment and credibility in trade agreements. The Commission is, for example, resisting proposals that appear to link protocols on market access to measurements of aid effectiveness, which are difficult to define. In addition, providing a linkage between trade and development aspects of EPAs potentially raises issues of conditionality, which makes some ACP states and external commentators uneasy. The issues of conditionality and linkage need to be carefully thought through.

Conditionality and development priorities

Linking the trade agreement to development assistance could imply conditionality, where the position of the donor (EU) is that: “*We won’t give you assistance x unless you have first reduced barrier y or introduced policy z.*” An alternative approach, from the point of view of the ACP states, is that: “*We will liberalise barrier y or introduce policy z when we have achieved a given well-defined priority, but in order to do so we need development assistance x.*”

This second approach raises the issue of precisely what is meant by a development “priority”, as the term covers a range of possibilities. One definition is to specify certain economic “benchmarks” or “milestones” that need to be fulfilled or reached. For example, specify that exports to the EU rise by x%; or that a given Millennium Development Goal is attained or partially attained. However, such outcome defined benchmarks are inevitably arbitrary and open to considerable dispute. It is important to have broad development targets, but it is not advisable to link implementation of trade agreements to them.

On the other hand, trade agreements can incorporate the need for implementation of specific trade related actions, dealing with, for example, standards, certification, trade facilitation, and/or rules of origin. It is far better to establish benchmarks

in terms of the implementation of certain policies and supporting reforms than to outcomes. These policies need to be specified in terms of the constraints identified with respect to each of these issues (e.g., minimum levels of infrastructure, minimum standard of domestic institutions and regulations, institutions to support trade facilitation), and then in terms of a logical sequence of policy initiatives designed to address these issues. There is not much point in implementing a given policy if the underlying infrastructure, institutional framework, and trained personnel are not there to take advantage of the new market opportunities, or if non-tariff impediments to exports to the EU remain. Hence, the implementation of these policy initiatives is likely to require action on the part of both the EU and the ACP states, but for the ACP states will also require appropriate, trade-related, development assistance.

There are two further significant advantage of this approach. First, it requires the formulation of development priorities and actions, which encourages more ownership of the EPA process for the ACP states than is currently the case under the asymmetric shallow integration approach. Secondly, it provides a well-targeted approach to the issue of special and differential treatment, which is more likely to be successful than an approach that focuses only on differentiating tariff lines or time-scales for liberalisation.

Given that the EPAs need to be signed ready for implementation by the beginning of 2008, agreement on country priorities and necessary actions required is probably infeasible within the time available. However, it is not necessary for the precise priorities to be agreed at the time of signing an EPA. What is needed is a protocol or development chapter accepting the need for agreement on such priorities and actions, providing a timetable for negotiating these with the respective member states, and committing to the provision of financial support for their implementation.

Linking market access to aid effectiveness?

An important question that needs to be addressed is: Does accepting the need for trade related development assistance in an EPA link the protocols on market access to aid effectiveness (or to the realisation of a set of benchmarks)? Does this approach undermine the principles of clarity, commitment and credibility, with countries free to assert that they are not “ready” to undertake trade liberalisation?

There are two approaches one can take to this concern. The first is to include trade for aid, but still require that the tariff liberalisation takes place in accordance with the schedule originally agreed upon irrespective of the success or failure of the program of trade related development assistance. Even this approach would be a significant step forward with regard to the current negotiating position of the EC, which has to date resisted the inclusion of development protocols or chapters. The second approach is to allow for the possibility that the tariff/quota liberalisation will not occur, or be delayed, if either or both parties have not fulfilled the part of the agreement relating to meeting development priorities.

This approach also raises the question of how to determine whether the commitments have been met or not.

The disadvantage of the second approach is that it opens the door to not engaging in the process of trade liberalisation, which clearly is an issue of concern to the Commission. One answer to this concern is to note that failure of the agreement will have much larger negative welfare impact on any given ACP country than on the EU. The importance of the ACP in EU trade is so small, that it is unlikely to have much of an effect on the EU. There is also a case to be made that the possibility of the tariff reduction protocols in the agreement not being implemented could be a powerful spur to the ACP countries precisely to introduce the policies, address the development priorities, and so reap the rewards derived from greater integration in the world economy. That in turn is more likely the more symmetry there is with regard to responsibility and obligations on both sides of the agreement.

On balance, however, our view is that the first approach is more desirable. The second is more difficult to negotiate and implement, with risks that the process of trade liberalisation will be slower and bumpier, introducing increased uncertainty that will hinder investment decisions by the private sector and complicate government planning as well.

For the EPA to be an improvement on GSP, it needs to be a treaty obligation of the EU rather than provide unilateral and hence easily revocable concessions. The EU will have obligations that would include trade facilitation measures as well as targeted trade-related assistance. A dispute settlement procedure should be included that would provide for some form of compensation if conditions are not met, but we would argue that this should not take the form of allowing additional or prolonged trade restrictions on either side.

Conclusions:

In summary, our work suggests that the true development benefits of EPAs are likely to come only from specific actions to successfully facilitate both shallow and deep integration. To be effective, those actions need financial and technical assistance components. The linking of policy changes with trade-related development assistance provisions in the areas we suggest should be fundamental to the EPA negotiation process.

Michael Gasiorek
Peter Holmes
Sherman Robinson