Searching for an alternative to Economic Partnership Agreements

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1. Introduction

On January 1st, 2008, Economic Partnerships Agreements (EPAs), currently negotiated between the European Union and nearly eighty African, Caribbean, and Pacific (ACP) countries are expected to replace the Cotonou Agreement signed, in Benin, on June 23rd 2000. The Cotonou agreement has been implemented through a waiver from the World Trade Organization (WTO), which expires on December 31, 2007.

The EPAs cover a broad agenda and are supposed to boost ACP economic growth. They encompass a particularly sensitive trade dimension. Indeed, a key factor that led to a move from the old fashioned Lomé Convention to the EPAs was the need for EU tariff preferences granted to ACP countries to be WTO-compatible. This will entail a quasi reciprocal free trade between the EU and six groups of ACP countries, but market access proposals are still highly contentious and unresolved issues in the negotiations. Practically, under the EPAs, the EU should eliminate all remaining barriers on products coming from ACP countries. In a reciprocal, but asymmetric way, all ACP countries must open their borders to European products. The asymmetry will have two dimensions: up to twenty percent of ACP imports from the EU (sensitive products clause) would be exempt from the agreement and ACP countries will have time (up to 20 years) to implement it. Last, to foster regional integration, the six ACP negotiating groups are expected to evolve into free trade areas or custom unions: Southern Africa (SADC), Eastern and Southern Africa (ESA/COMESA), Western Africa (ECOWAS), Central Africa (CEMAC and a part of the ECCAS), Caribbean (CARIFORUM), and Pacific.[1]

[1] Southern Africa (SADC) negotiating group consists of 7 Southern African Development Community (SADC) countries; Eastern and Southern Africa (ESA/COMESA) consists of 15 Common Market of

While the EPAs are expected to be effective at the beginning of 2008, the debate is growing about the pertinence of such agreements for both parties. A key question in this debate is whether the EPAs represent an option that is beneficial for ACP countries. For the European Commission, the EPAs are seen as the best solution to bring economic growth and modernization in Africa and to replace the previous ineffective EU policies based on the Lomé framework. For many NGOs and African countries, opening vulnerable economies to EU products will cut fiscal resources for governments and will wash away nascent industries. At the same time, potential export gains for ACP countries are weak since the EU has very little to offer due to the current level of preferences that it has already conceded to these countries. The only hope is related to the capacity reinforcement program that will be a part of the aid dimension of the EPAs. Economists add that the EPA market access design will have perverse effects on ACP trade policies since it will increase tariffs dispersion both across partners (consequence of the FTA) and across products (consequence of the sensitive products clause). Moreover, the agreement will have collateral damages since trade diversion, switching from more competitive non-EU suppliers to EU suppliers, will harm many third countries.

Despite these inherent weaknesses, the European Commission argues that the EPAs are the only alternative to preserve ACP market access to the EU. Otherwise, the less generous Generalized System of Preferences (GSP) will replace current preferences. This move would have negative impacts for ACP economies, even for Least Developed Countries (LDCs) that already benefit from a duty-free and quota-free access thanks to the EU's Everything But Arms (EBA) due to more restrictive rules of origin.[2]

The aim of this brief is not to support or oppose the EPA process, but to assess its consequences for the EU, ACP countries, and third countries by focusing on the trade component of the agreement. Moreover, it will hopefully open the discussion on potential

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Eastern and Southern Africa (COMESA) countries; Western Africa consists of 14 Economic Community Of West African States (ECOWAS) countries and Mauritania; Central Africa consists of 6 Economic and Monetary Community of Central Africa (CEMAC) countries, Democratic Republic of Congo, and Sao Tome and Principe; Caribbean is made up of 15 Caribbean Forum (CARIFORUM) countries and Dominican Republic; Pacific group is made up of 14 countries of the Pacific region.

[2] The EBA initiative has been implemented in 2001. However the total liberalization of some products has been delayed: the banana in 2006, the sugar and the rice in 2009.

available alternatives. Indeed, for ACP countries the current debate has been quickly reduced to the proverb: *Of two evils, EPA or GSP, one must choose the lesser.* So, beyond these two solutions, are positive alternatives possible? Could those alternatives be implemented from a WTO point of view? Would they be worthwhile from an economic point of view?

2. The legal dimension of negotiations

The World Trade Organization (WTO) membership is founded on the Most Favored Nation (MFN) principle which prohibits WTO members from discriminating among trade partners. While this general principle rules the world trading system, some provisions are allowed.

The European Union has argued that the only possible alternative to the EPAs which would be compatible with the WTO rules is the GSP regime. In reality, however, different alternatives are possible.

Article XXIV of the General Agreement on Tariffs and Trade (GATT), which serves as a legal basis for Free Trade Areas defines the current framework for the EPAs. Under this Article, discrimination in a WTO member's trade policy due to a FTA or a Custom Union (CU) is allowed provided that it does not entail rising protection against non-members of the FTA (Article XXIV; subparagraphs 5a and 5b) and that "duties and other restrictive regulations of commerce (…) are eliminated with respect to substantially all the trade between the constituent territories in products originating in such territories" (article XXIV, subparagraph 8bi). It is important to note, however, that this condition does not define any clear-cut and operational criterion; instead, it is left open to various interpretations.

The EU interpretation of what is WTO-compatible overlooks certain aspects of the Enabling Clause (1979) and the WTO law. It is well-known that the Enabling Clause (November 28th, 1979) authorizes WTO members to grant preferential treatment to all Developing Countries (DCs) or Least Developed Countries (LDCs). But it should be noted that granting specific market conditions, beyond those provided in the GSP, to developing countries with particular needs was allowed by the Appellate Body Report (paragraph 173), issued on April 7, 2004, on the EC-India Panel on EC-Preferential Tariffs. The ruling in question allowed for differential treatment through preferential tariff schemes as long as such treatment is available to all "similarly-situated" (i.e. countries sharing the same "development, financial, and trade needs") beneficiaries. Therefore, it could well be argued that the Small and Vulnerable Economies (SVE) category meets this requirement.

Finally, preferential treatment incompliant with previous WTO clauses is currently conceded by WTO members to a subset of DCs: this is the case with the African Growth Opportunity Act (AGOA) and the Caribbean Basin Initiative (CBI) granted by the US. In this line, as recently proposed by Patrick Messerlin and Claire Delpeuch (GEM-Sciences Po Paris),[3] ACP countries could offer multilateral market access to ensure that a new waiver will be granted and that no WTO members will raise a veto against it. Alternatively, and following the article XXIV procedure and the incoming EPA, the proposal could be part of the "Interim Agreements". Ultimately, it also implies that the problem of a waiver is not about its legal dimension but its political one.

Contrary to the conventional view that the GSP is the only alternative to the EPA, this shows that there are different options available to address this issue: either the EPAs are concluded, or the specific access conceded by the EU to ACP countries is extended to all Small and Vulnerable Economies based on the idea that they are a subset of DCs that are similarly-situated, or a certain degree of multilateral liberalization is carried out by ACP countries in order to benefit the rest of the world. These are the different options that are studied in this brief.

[3] « EPAs: A Plan 'A+' » by Patrick A. Messerlin and Claire Delpeuch, November 2007, GEM-Sciences Po, Paris.

3. Methodology

The analysis is performed with the MIRAGE model of the world economy[4]. MIRAGE is a multi-sector, multi-region, computable general equilibrium model devoted to trade policy analysis[5]. Standard closure is assumed with underlying optimistic hypothesis concerning the EPA outcome (no constraint on exchange rates flexibility and perfect price transmission to consumers).[6]

The geographical decomposition is aimed to focus on EPAs regions, but also on major WTO actors (China, USA, MERCOSUR countries, Central America).

Five scenarios of trade liberalization are carried out. For each scenario, we compare results for years 2018 and 2035 between a baseline and the trade reform implemented from 2008.

The first scenario corresponds to the EPAs. The "EPA" scenario combines three levels of liberalization. On one hand, exports of ACP countries gain an immediate free access to the EU market in 2008. On the other hand, 80 percent of the EU's exports gain free access to ACP markets according to the specificity of each product. Indeed, products are classified in five categories. Sensitive products are excluded from trade liberalization and must represent 20 percent of the trade flows from EU to ACP countries. Regarding the four other categories of products accounting for the potential impact on ACP imports and loss of tariff revenues, they are liberalized in different time-frame, with liberalization completed in 2029. Finally, FTAs are established within each ACP zone by 2008.

[4] The MIRAGE model was developed at the Centre d'Etudes Prospectives et d'Informations Internationales (CEPII) in Paris. Full description of the model is available at the CEPII Web site (www.cepii.fr).

[5] Macroeconomic data for 2001 come from the latest GTAP 6.2 database, whereas the data on tariffs for 2004 come from the detailed MAcMapsHS6-v2 dataset which includes all regional agreements and preferential schemes prevailing in 2004.

[6] Even if they are a topic of first interests for many countries, the current high level prices in agricultural commodities are not considered in our baseline. However, the baseline reproduces an upward trend in them. Moreover, in our comparative analysis framework, these high prices will have a significant outcome mainly if it brings the ACP countries to cut unilaterally their agricultural tariffs to reduce the cost of food for their population. In this case, trade diversion concerning these products will not take place.

As mentioned earlier, the EU claims that the only alternative to EPAs would be a return to GSP. Hence, we design a "GSP" scenario where from January 2008 exports from ACP countries to EU face GSP duties.

We propose then a scenario taking into account the fact that Small and Vulnerable Economies (SVE) should also be granted the Cotonou advantages by the EU from 2008. It is an objective and a *de facto* WTO category in the Doha Development Agenda (DDA). We call this scenario "SVE". Since these countries are non-ACP and non-LDCs, these countries are few.

The last two scenarios include a certain amount of multilateral liberalization by ACP countries in order to benefit exports of countries outside those involved in the negotiations.

Two alternatives are designed. The first one called "EPAMULTI" combines the EPAs as defined above with a multilateral liberalization in ACP countries as defined by Messerlin and Delpeuch(2007),[7] characterized by Swiss formulae with high coefficient (cuts in tariffs are higher when tariffs are higher, but globally liberalization is limited). This additional liberalization aims at providing market access gains for non-EPA countries, thus, making the scenario acceptable for them. Finally, a "MULTIPLUS" scenario is simulated. This represents multilateral liberalization carried out by ACP countries, such that at the end of the process each ACP country has the same global rate of protection as the one implied by the EPA scenario. Furthermore, ACP countries get full free access to the EU market. This may not be a realistic option, but it should represent the most advantageous option for ACP countries from an economic point of view. In addition, it could lead to a different outcome from the "EPA" scenario in terms of trade diversion as well as help us understand the distortions implied.

[7] Supra note 3

4. Results

Table 1 shows the impact of these various trade scenarios on exports by each zone/ country in 2018 and 2035. As illustrated below, the implementation of EPAs has a boosting impact on EU's exports (an increase of $ 29.4bn in 2035) and a smaller impact on ACP exports—although the SADC exports are hugely augmented (an increase of $ 7.1bn in 2035). This trade agreement is of great concern for countries which are currently not negotiating an EPA with the EU: when EPAs are implemented, export variations of all these countries/zones add up to a loss of $3bn in 2018 and $6.5bn in 2035. In case of multilateral liberalization, this sum is smaller for the non-EPA countries/zones and even positive in case of a "strictly multilateral" ACP liberalization (Scenario MULTIPLUS). For example, in 2035, exports of non-EPA countries decrease only by $4.8bn under the EPAMULTI scenario. On the other hand, they increase for the same countries/zones by $5.5bn under the MULTIPLUS scenario. Conversely, the EU exports less under the various multilateral scenarios than under the EPA.

For ACP countries/zones, except for Senegal (exports of which are only slightly affected) and SADC, the GSP scenario is detrimental to their exports. The impact is particularly negative for the "Caribbean and Pacific" zone which incurs a decrease of exports by $3bn: this zone comprises of several small Pacific countries and some Caribbean islands. For some of these countries (Saint Kitts and Nevis, Fiji, Saint Lucia, and so on) it is clear that the Cotonou regime over such a long period of time has led to a specialization of these economies in products with a high preferential margin; as a result, a return to the GSP regime would be very detrimental.

Table 1. Export variation ($ bn) under various scenarios

Scenario	EPA		GSP		SVE		EPAMULTI		MULTIPLUS	
Region	2018	2035	2018	2035	2018	2035	2018	2035	2018	2035
Bolivia, Uruguay and Paraguay	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central America	-0.1	-0.2	0.0	0.0	0.3	0.5	-0.1	-0.2	0.0	0.0
China	0.1	-0.1	-0.1	-0.4	-0.2	-0.3	0.2	0.2	0.8	2.0
European Union (27)	14.7	29.4	-3.7	-6.1	1.4	2.1	14.5	28.9	8.5	15.6
India	-0.1	-0.3	0.0	-0.1	0.0	0.0	0.0	-0.1	0.3	0.8
Japan	-0.4	-0.6	0.1	0.1	0.0	-0.1	-0.3	-0.4	-0.1	0.0
Rest of developed Asia	-1.0	-1.7	0.2	0.2	-0.1	-0.1	-0.8	-1.5	-0.1	0.0
Rest of developing Asia	0.1	0.0	0.0	-0.1	0.4	0.7	0.1	0.2	0.3	0.8
Rest of North America	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.0	-0.1	0.3	0.5
Rest of South America	0.2	0.2	0.0	0.0	0.7	1.1	0.2	0.3	0.4	0.7
Rest of SVE countries	0.1	0.1	0.0	0.0	0.3	0.4	0.0	0.1	0.1	0.2
Thailand	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2
Unites States	-1.0	-1.6	0.1	0.0	-0.1	-0.2	-1.0	-1.6	0.0	0.3
South Africa	0.2	0.4	0.0	0.0	0.0	-0.1	0.2	0.4	0.5	1.2
Southern African Development Community (SADC)	3.5	7.1	0.1	0.1	0.0	0.0	3.5	7.2	3.5	7.2
Part of Eastern and Southern Africa (ESA)	1.6	3.0	-0.4	-0.7	0.0	0.0	1.7	3.4	1.6	2.9
Angola, Seychelles, Congo D.R.	0.3	0.7	-0.1	-0.2	0.0	0.0	0.3	0.7	0.5	1.0
Nigeria	0.3	0.5	0.0	0.0	0.0	0.0	0.3	0.5	0.3	0.4
Senegal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rest of Western, Eastern and Central Africa (WECA)	2.0	4.8	-0.6	-1.0	0.0	-0.1	2.1	5.1	2.5	5.8
Rest of Africa	-0.1	-0.1	0.0	0.1	-0.1	-0.1	-0.1	-0.1	0.0	-0.1
Caribbean and Pacific	3.2	6.0	-3.0	-5.0	0.0	0.0	3.6	7.1	3.3	6.5
Rest of the world	-1.0	-2.4	0.0	0.1	-0.1	-0.1	-0.9	-2.1	-0.5	-1.2

Source: Authors' calculations based on the MIRAGE model

Note: "Southern African Development Community" includes all SADC countries except Angola (and South Africa which is not negotiating EPAs),

- "Part of Eastern and Southern Africa" is made of Malawi, Mauritius, Zambia, Zimbabwe, Uganda, Madagascar,
- "Angola" belongs to SADC, "Seychelles" to ESA and "Congo D.R." to CEMAC,
- "Rest of Western, Eastern and Central Africa" includes all the rest of countries belongings to, ESA and CEMAC,
- Caribbean and Pacific are made of all countries belonging to CARIFORUM (except Haiti (in Rest of South America) and Belize (in Central America) and Pacific groups.

Since it has been designed to shelter the ACP from any drastic change, the SVE scenario is a conservative option with very limited impact on ACP exports. Only SVEs which are not ACP countries can benefit from this option (see the case of zones "Central America", the "Rest of Developing Asia", "Rest of South America" and "Rest of SVE countries"). In particular, these countries are Bolivia, Cuba, El Salvador, Ecuador, Guatemala, Honduras, Mongolia, Nicaragua, and Paraguay.

Table 2 shows the impact on real income implied by various trade scenarios. The implementation of EPAs has a vastly varying effect on ACP countries. For a first set of countries (SADC and ESA in particular, and to a lesser extent the zone "Caribbean and Pacific") concluding an EPA is beneficial. This can be explained by the fact that exports of meat and sugar towards the EU are still highly protected and the elimination of these trade barriers has a tremendous impact on these countries' exports; however, phytosanitary constraints have not been considered in this study; therefore in reality, they would undoubtedly hinder this movement. As they open their own economies, imports are also augmented but to a lesser extent, which leads to an appreciation of their real exchange rate. Let us note that these countries have a more diversified geographic structure of imports than countries in Western or Central Africa, which mostly import from the EU.

Table 2. Real income variation (%) under the various scenarios

	EPA		GSP		SVE		EPAMULTI		MULTIPLUS	
Region	2018	2035	2018	2035	2018	2035	2018	2035	2018	2035
European Union (27)	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Southern African Development Community (SADC)	4.4	5.1	0.1	0.1	0.0	0.0	4.5	5.2	4.4	5.1
Part of Eastern and Southern Africa (ESA)	2.1	2.3	-0.6	-0.6	0.0	0.0	2.2	2.4	2.1	2.3
Angola, Seychelles, Congo D.R.	-0.1	-0.2	-0.1	-0.2	0.0	0.0	0.0	-0.3	0.1	-0.1
Nigeria	-0.1	-0.2	0.0	-0.1	0.0	0.0	-0.1	-0.2	0.2	0.3
Senegal	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.1
Rest of Western, Eastern and Central Africa (WECA)	-0.1	-0.1	-0.3	-0.3	0.0	0.0	-0.1	-0.1	0.1	0.2
Caribbean and Pacific	0.5	0.5	-0.8	-0.8	0.0	0.0	0.5	0.5	0.6	0.6

Source: Authors' calculations based on the MIRAGE model

For a second set of countries like Senegal, Nigeria, and zones " WECA", and "Angola, Seychelles, Congo D.R.", the implementation of an EPA does not lead to a surge of exports as they already benefit from a very good access to the European market. Conversely, the ACPs open their economies to European products, which entails a substantial rise in their imports. Real exchange rate is depreciated and they incur a significant loss of tariff revenues. In a country like Senegal, for example, imports from Europe of beverage and tobacco products, dairy products, electronic machinery, motor vehicles, and other food products range from 70 percent to 80 percent of total imports (it is even more than 86 percent for wheat and more than 95 percent for sugar). This implies that a liberalization of these imports decreases very substantially tariff revenues. Table 3 highlights these huge potential losses of tariff revenues in case of the implementation of an EPA.

A return to GSP results in a negative shock for almost all ACP countries/zones, except for SADC which draws a slightly positive increase in real income since its LDC exporters benefit from the rise in tariffs faced by other ACP DC's. Table 2 confirms the idea that an extension of the Cotonou preferences to all SVEs is a conservative scenario. However, an introduction of multilateralism in the agreement is positive for all ACP countries. The scenario EPAMULTI does not change significantly the impact of EPA as it was expected since the multilateral tariff reduction is limited. Table 3 shows that compared to the EPA scenario, this kind of agreement could greatly limit the loss of tariff revenues for ACP countries.

The MULTIPLUS scenario entails a substantial multilateral tariff cut by ACP countries which furthermore obtain additional market access to other ACP countries. For Nigeria, Senegal and zones "Angola, Seychelles, Congo D.R.", and "WECA", the gain in market access is lower compared to the level of market access that they concede to foreign exporters. Consequently, the increase in imports is higher than the one in exports and the real exchange rate is depreciated. As the rate of protection of these economies is substantially decreased, these scenarios imply a significant loss of tariff revenues (see Table 3).

Table 3. Variation of tariff revenues (%)

Region	EPA	GSP	SVE	EPAMULTI	MULTIPLUS
Southern African Development Community (SADC)	1.8	0.3	0.0	0.1	2.6
Part of Eastern and Southern Africa (ESA)	-17.1	-2.2	0.0	-24.0	-10.3
Angola, Seychelles, Congo D.R.	-37.8	-1.1	0.0	-40.4	-47.1
Nigeria	-34.4	-0.2	0.0	-35.2	-35.5
Senegal	-45.2	-0.1	0.0	-45.2	-48.1
Rest of Western, Eastern and Central Africa (WECA)	-39.3	-1.2	-0.1	-40.6	-34.9
Caribbean and Pacific	-13.5	-4.1	0.0	-17.1	-8.5

Source: Authors' calculations based on the MIRAGE model

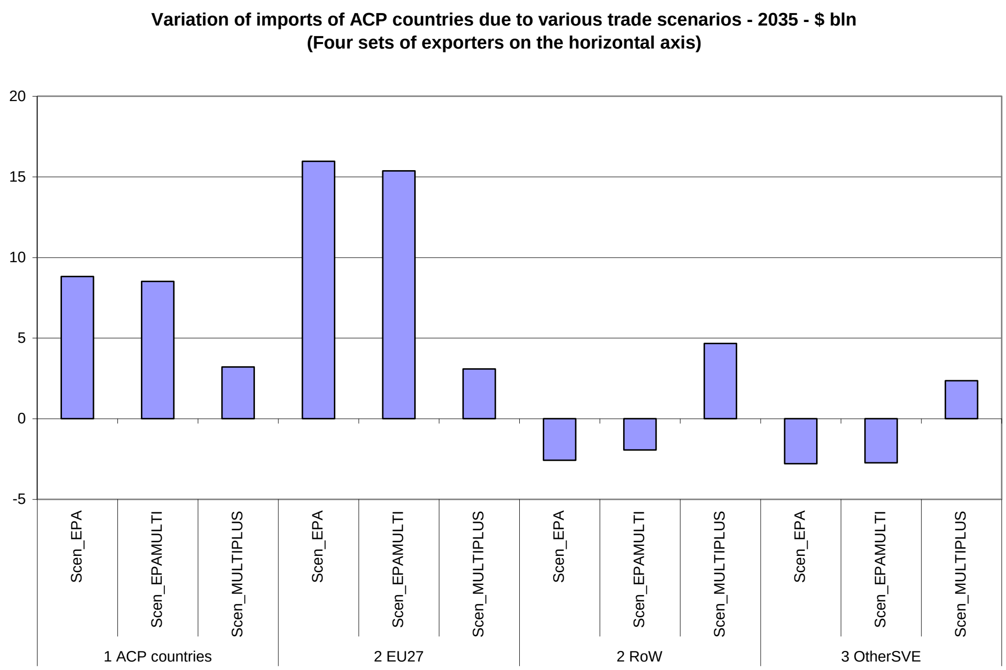
The benefits of multilateral agreements compared to the implementation of an EPA are illustrated in Figure 1, which gives the variation of ACP imports by origin in billions of 2001 constant dollars for 2035. The table describes first, ACP country imports from other ACPs, then from the EU27 countries, the Rest of the World—including all countries in the world except ACPs and the EU27—and the SVEs.

It is noteworthy that an Economic Partnership Agreement with Europe leads to an increase of European exports to ACP countries by $16bn for 2035 and those of ACP countries by $8.8bn, while exports of SVEs and from the Rest of the World to ACP countries are decreased by more than $2bn in each case.

Conversely, the MULTIPLUS agreement, which is strictly multilateral, implies an increase of exports to ACP countries from all zones. The EPAMULTI is intermediate and combines both aspects (multilateral liberalization with preferential access given to the EU), limiting the trade diversion, but this phenomenon still remains.

From figure 1, it clearly appears that the implementation of EPA is a huge obstacle to geographic diversification of imports for ACP countries while any agreement that could include some dose of multilateralism would favor such diversification.

Figure 1. Trade diversion effects



Source: Authors' calculations based on the MIRAGE model

Note: RoW stands for Rest of the World, Other SVE stands for Non ACP Small and Vulnerable Economies

5. Concluding remarks

Although the deadline for completing the EPA negotiations is approaching, there is still much to be said about EPAs. For most of ACP countries, these agreements could introduce new distortions in their trade policy, like tariff dispersion across products and across partners; they could substantially cut their tariff revenues and thereby public receipts, and in addition to all these effects, most ACP countries will not gain new substantial access to foreign markets. In other words, these agreements will potentially result more in diverting rather than creating trade. This study demonstrates that EPAs' trade dimension is neither the best nor the only choice in response to the expiration of the WTO waiver for the Cotonou preferences, which explains the procrastination in negotiating the market access aspect of these agreements.

Furthermore, it shows that there are alternatives to the EPA and GSP which are currently offered as the only options by the EU. First, new preferences can be designed if extended to all non-ACP SVEs, a clear pro-developing strategy for the EU. Second, a dose of multilateralism can be introduced in order to benefit exports from third countries and to reduce trade diversion. By now it is clear that EPAs affect many more countries than those directly involved in the negotiations. Therefore, this brief has contributed in showing that these alternatives exist and they should not be overlooked; instead, they need and can be scrutinized and discussed as a part of the EPA debate.