

MAKING THE ECONOMIC PARTNERSHIP AGREEMENTS MORE POVERTY FRIENDLY

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I. INTRODUCTION

This paper explores how the Economic Partnership Agreements (EPAs) between the European Union (EU) and the African Caribbean and Pacific (ACP) States can be made more poverty friendly. EPAs were conceived in the late 1990s as a means of preserving the ACP states' favourable access to the EU market in the face of the opposition of WTO members to unilateral preferences. Given the GATT-inconsistency of unilateral preferences, the EPAs were intended to offer preferential access via GATT's Article 24, which applies to Free Trade Areas and Customs Unions. This requires that the preferences cover substantially all trade between the partners to an agreement, reduce tariffs and other barriers between them to zero and be reciprocal. In addition the EU intended the EPAs to include elements of services trade liberalisation, changes to rules and regulations for trade and commitments about aid. As part of this process the EU hoped to encourage the ACP countries to integrate more closely with their regional neighbours by reducing intra-regional trade barriers and adopting a common policy towards the rest of the world and the EU in particular. That is, their vision was of the EPAs as regional rather than national policies pertaining to relations between the EU and a

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small number of regions with strong intra-regional trade and integration.

The negotiation process was started in 2000 with an agreed end-date of 2007, when the waiver that the EU and ACP states had received for the old unilateral model of preferences expired. By 2008 only one region has initialled a full EPA covering all sectors — the Caribbean — while of the remaining 63 ACP countries, 8 out of 37 Least Developed Countries and 10 out of 26 others have signed interim agreements covering goods liberalisation only. The whole experience has been fraught with controversy and disagreement about the role of trade policy in fostering development, with many countries and NGOs arguing that they imposed too much trade liberalisation on the ACP partners and the EU protesting that it imposed nothing but that WTO rules had to be obeyed if retaliation was to be avoided. The EU rarely made the case that trade liberalisation was a useful part of the policy cocktail to reduce poverty, and never with much conviction.

This paper seeks to redress the rhetorical balance by briefly reviewing the evidence for arguments that trade liberalisation is a useful tool of development, asking how well the EPAs match up against those arguments, and offering a concrete proposal for improving the situation. The latter takes as given the progress so far on the EPAs and seeks to do no violence to their conclusions. It involves:

- Extending the tariff preferences to other suppliers that the ACP countries have had to give EU suppliers;
- A transfer of new money from the EU to the ACP states to cover (temporarily) the revenue losses implied by such extension;
- Similar encouragement to the ACP countries to rationalise the tariff structures that would emerge from such an extension of preferences; and
- The simplification of future negotiations in services and on regulations pertaining to trade.

II. TRADE AND POVERTY

This section discusses the role that trade liberalisation might play in reducing poverty in developing countries. There are both macro and micro dimensions to this¹ and given the macroeconomic nature of the EPAs, I focus mainly on the former. The strong presumption is that economic growth reduces poverty; Kraay (2006), for example, finds that according to the measure of poverty used, growth accounts on average for 60–80% of poverty reduction over 1980s and 1990s. The link from trade policy to growth, however, has been more contentious and so I discuss that in more detail.

Economic theory offers several reasons why increasing a country's engagement with the rest of the world might raise its level of income (stimulate its economic growth, at least for a period), and while there are several routes to such engagement, all eventually require it to liberalise its own international trade:

- Specialising on goods for which world prices exceed those that would be available at home,
- Reaping economies of scale,
- Improving performance in the face of new competition, and
- Benefitting from better inputs and technologies available from abroad.

None of these is guaranteed, though, so ultimately whether trade does stimulate income is an empirical matter. Over the 1990s several highly visible global cross-country studies argued that openness was good for growth/income (e.g. Dollar, 1992; Sachs and Warner, 1995; and Frankel and Romer, 1999). They all suffered severe criticism by Rodriguez and Rodrik (2001), however, who showed that their measures of openness were not appropriate to the theories they propounded, that their results were sensitive to particular but extraneous features of the data, and that the econometric methods they used failed adequately to identify

¹ See Winters, McCulloch and McKay (2004).

causation running from trade liberalisation to growth. Rodriguez and Rodrik also found it hard to replicate some of the results in the literature, raising some concern about their accuracy.²

The difficulty of establishing an empirical link between liberal trade and economic growth arises from at least four sources (Winters, 2004). First, once one comes inside the boundary of near autarchy, it is difficult to measure a country's trade stance: for example, tariffs need to be aggregated across goods, quantitative restrictions assessed and then aggregated, and the levels of predictability and enforcement measured.

Second, causation is difficult to establish. Actual openness, which is usually measured by the ratio of trade to domestic output, is certainly a result of growth as well as a possible cause. But even policy-based measures, such as average tariffs, could face the same problem, because growing countries might be more willing to liberalise. Rodrik (2005) argues that if trade liberalisation is consciously pursued to solve shortcomings in growth but cannot completely overcome the obstacles, we will observe a negative relationship between liberalisation and growth even if, in fact, the latter is beneficial. There are two caveats to this argument, however. First, this effect stacks the cards against finding a positive empirical relationship and so might increase our faith in the effectiveness of liberalisation if we actually do find one. Second, not all liberalisations arise solely from growth objectives and so, in fact, there is some independent variation with which to identify the growth effects.

The third challenge is that anything beyond a short-term effect on growth requires liberalisation to be combined with other good policies and sound institutions. This makes it difficult to isolate the individual effects of trade

² The weight borne by cross-country studies in the literature on economic growth in the 1990s is remarkable, given that so many economists professed to distrust them. After all, why should all countries respond the same way? Nonetheless the attraction of simple rules and generalisations seduced much of the profession into citing their results when giving policy advice. In dismissing Rodriguez and Rodrik's contribution, Srinivasan and Bhagwati (2001) chide the economics profession for ever having taken these studies seriously.

reform, and indeed, it raises the question of whether it is even worth trying to do so if policies always come in packages. The situation becomes even more complex if, fourth, openness causes improvements in other policies and institutions. As examples, countries with simple open trade regimes appear to be less corrupt, and open economies have less inflation.

Since 2001, however, further research and debate has re-established to most economists' satisfaction that openness really does enhance income — at least conditionally. Researchers have worked hard to establish causation by isolating those parts of international trade that are genuinely exogenous to (i.e., not caused by) income and asking if they in turn cause higher incomes: Noguera and Siscart (2005), for example, find that that part of trade that is due to countries' size and location contributes to higher income.

Researchers have also explored the set of appropriate complementary policies if liberalisation is to have strong effects. They include at least a minimal degree of labour market flexibility, firm entry flexibility, financial access and human capital investment (Freund and Bolaky, 2008). Many studies have associated openness with faster accumulation (i.e. investment) (e.g. Levine and Renelt, 1992; Taylor, 1998; Warziarg, 2001) and so a poor investment climate could undermine the benefits of trade reform. For example, if labour regulation is too restrictive, opening up could reduce incomes, whereas under more flexible regimes, it would stimulate them. The problem is that while the negative effects of increased competition on import-competing firms cannot be avoided, so that jobs and investment are lost, a rigid economy cannot effectively shift the resources so released to expanding exporting industries. In short, the economy cannot respond to new incentives.

A strong branch of development theory holds that the primary determinant of economic growth and higher incomes is the quality of institutions, and no observer could deny them at least some role. In a 'horse race', Rodrik, Subramanian and Trebbi (2004) argue that institutions far outperform geography and openness as explanations of real income per capita and,

indeed, that given institutions, openness has an insignificantly negative effect. They find, however, that openness partly explains the quality of institutions and so has a positive indirect effect on incomes. In fact, openness is the only variable in their work that can be manipulated to affect institutions, and hence they rather lend support to trade liberalisation as an income-enhancing policy than the opposite (Winters, 2004).

Recent research has also exploited longer time-series of data and offered a number of statistical case studies. Wacziarg and Welch (forthcoming) find considerable variations in experience across countries and between different periods of time; their cross-country results are suggestive of, and their detailed country studies strongly supportive of, the benign effects of trade liberalisation. Further recent research has provided detailed narrative case studies which have found openness at the heart of development (e.g. Reinikka and Collier, 2001 on Uganda and Edwards and Lederman, 2001 on Chile). And more recently still, the Commission on Growth and Development (2008) has found that exploiting the opportunities provided by world markets (both to sell exports and obtain cheap imports) is one of the few common features of countries which have had successful long-run growth experiences. Indeed, no country has developed since World War II without significantly relying on overseas markets.

Further evidence on the link between openness and income examines possible causal links between openness and growth separately. I have already mentioned investment. A second key link is between openness and productivity. The evidence from country, sectoral and firm level studies suggests very strongly that opening up international trade stimulates productivity. Part of the way in which it does so is by allowing more efficient (exporting) firms to grow faster than less efficient ones, and allowing import competition to pick off weaker domestic firms — adjustment again — but we also see evidence of improvements within firms (e.g. Pavcnik, 2002 and Fernandes 2007). Such rationalisation may harm the workers and owners of failing firms, but equally clearly, long-term progress requires adaptation and adjustment. The key is to allow

firms to fail but to ensure that new opportunities can arise to take their place.

Productivity and productivity growth vary across sectors and so one might ask whether trade policy should be used actively to shift resources into high-productivity sectors or into those sectors promising rapid productivity growth — essentially the virtues of so-called infant industry protection. If trade policy were used for this purpose, one would observe similar patterns of protection across countries (since the sectors concerned tend to be similar across the world) and presumably a good deal of explicit governmental promotion of those sectors. In fact, there is considerable doubt among economists as to whether this is a viable approach to growth. That growth in high productivity sectors matters for growth is not disputed, but it is disputed whether or not the incentives established by protection would actually solve the market failures that lead to such sectors being underdeveloped. Baldwin (1969), in a classic statement, argued convincingly that it would not. Similarly, the recent debate about industrial policy, having started off favourable to industry-specific interventions now seems largely to accept that it is more appropriate to tackle the factors underlying the private sectors' inability to develop new sectors directly than to guide them into particular sectors by means of support (e.g. Rodrik, 2007).

We all recognise that there will be variations across circumstances and no one pretends that trade is the only thing that matters, but overall, the weight of experience and evidence now seems strongly to suggest that openness enhances average incomes. Thus, a key yardstick for the EPAs must be whether they actually foster trade and openness. Another is whether they absorb political and bureaucratic capacity that might have been more profitably spent on other activities. In Winters (2001), I argued that, precisely because other elements of policy mattered so much, a major objective of trade policy should be simplicity, transparency and ease of negotiation.

I turn now very briefly to the microeconomic aspects of trade liberalisation, which are discussed at length in Winters, McCulloch and McKay (2004). If trade reform reduces the price of a particular commodity, it benefits net consumers and penalises net producers. Thus a key dimension of its immediate poverty effects (i.e. before any income effects have occurred) is the net positions of the poor and near-poor in goods whose prices have been changed. A second key issue is the way in which trade liberalisation feeds through into factor rewards. The Stolper-Samuelson Theorem gives one insight into this, although far from the only one, and suggests that a liberalisation fostering the output of unskilled labour intensive goods will raise the wages of the unskilled and thus tend to be poverty-reducing. For small, poor developing countries like the ACP states, this suggests the importance of labour-intensive manufactured exports (clothing, for example). A final dimension to mention here is the effect of liberalisation on tariff revenues. Reducing tariffs to zero will reduce government revenue and while this need not impinge on the poor, we should at least consider the possibility. Certainly, ACP governments have worried a good deal about the revenue effects of the EPAs and so I consider this a little below.

III. THE EPAS IN 2008

This section reviews the current situation over the EPAs and asks whether, in the light of what precedes, they are likely to contribute significantly to poverty reduction. The criteria include whether they look likely to foster growth either according to the macro studies above or by stimulating important sectors of high-productivity activity or productivity growth, whether they encourage efficiency and whether their details might plausibly be designed to affect poverty through microeconomic links we laid out above.³ A good starting point is the European Commission's own statement at the outset of EPA process that:

³ It is clear that general rules will give us only a rough idea of the degree of growth or poverty friendliness that the EPAs involve and that detailed country study would be required to go

“The European Union’s primary concern must be the integration of the poor into economic and social life and the integration of the ACP countries into the world economy (European Commission, 1997), which is well aligned with our criteria if slightly narrower”.

It is important to recall, however, that the EPAs did not start from a blank page. They arose from the inconsistency with WTO rules of the EU’s earlier trade policy for ACP states — the Lome convention — which granted ACP exports non-reciprocal preferential access to the EU market, i.e., without their having to offer corresponding preferences to the EU. Except for the UN category of Least Developed Countries (LDCs), WTO obligations require members to treat all developing countries equally and so the only way of preferring a subset of them (the ACP countries) is within an Article 24-consistent free trade area or customs union. There is room for debate whether this requirement could have been avoided by seeking a permanent waiver for ACP-preferences at the WTO, but in the event the EU and ACP states applied only for a temporary waiver, which expired at the end of 2007.⁴

Thus, the EPAs were constrained to be reciprocal and to meet the requirements of the GATT’s Article 24 and the GATS’s Article 5 if they included services. There were also a member of other *de facto* constraints such as the limited governmental and productive capacity of most ACP agreements, the declining faith in markets in general and trade liberalisation specifically in developing countries, and the reinforcement of such attitudes by many developed country NGOs. One constraint ostensibly absent (and mercifully so if that true) is EU mercantilist interests. The ACP states are small and poor; the EU has

any further. However, from the dynamics of the negotiation, the impression is strong that no such analysis has actually influenced the form of the EPAs.

⁴ The argument is essentially about what the EU would have had to offer by way of market access concessions to non-ACP developing countries to have persuaded them to permit preferences for the ACP countries. Some policy-makers have argued that the peace would not have been very great.

sought to assure them that it has no 'offensive' interests in their markets, and thus that within the defined parameters for the overall degree of liberalisation, it has no views about their tariff structures— see, for example, European Commission (2007).

The original blueprint for the EPAs was that regional blocks of ACP countries would first negotiate regional free trade between themselves, and then collectively negotiate an EPA with the EU. The principal incentive for non-LDC countries to sign an EPA was to preserve their existing favourable access to the EU after 2007 rather than having to fall back on the EU's less favourable GSP preferences. But this does not apply to LDC members of the group because they already have nearly unfettered access to the EU market via the EBA ('Everything but Arms') programme. And neither *de facto* did it apply to countries such as Nigeria that primarily exported oil to the EU. It was also intended that these EPAs would go well beyond just goods trade policies. In fact, this has all proved too ambitious and the result is that only one full EPA has been initialled so far — with the Caribbean Forum (CARIFORUM) — and several interim agreements dealing only with goods trade. The EPA regions are not precisely those originally envisaged, nor are they coterminous with existing regional trading agreements among the ACP countries. Moreover, in most regions, not all countries have signed EPAs and those that have, have often signed different ones.

These complex variations make it difficult not to conclude that the EPAs have complicated trading arrangements within the ACP regions rather than the opposite. Because they have different tariffs for the EU, ACP partners will have to introduce rules of origin (RoO) for their mutual trade, with all the opportunities for muddle, protection and corruption that entails. A stated objective of the EPAs was to foster regional integration within each EPA region in order to promote competition and economies of scale, the absence of which are major handicaps for such

tiny economies as the ACP states. In this regard they have arguably set the clock back, at least at present.⁵

The parties have agreed 'rendezvous clauses' to carry on negotiating to complete the EPAs — ostensibly by the end of 2008. This would aim to iron out the intercountry inconsistencies in tariffs and to add services and areas of deep integration such as intellectual property, procurement, environment and trade facilitation (which are included will vary by EPA). It is not clear what has changed to make this suddenly feasible, however, except perhaps that the regional blocs are now determined, and so one must expect further delays and significant expenditures of bureaucratic and political energy. Such negotiation-intensity is potentially a major drain on the resources of poor and small countries and will detract from other areas of policy and administration. It is true that negotiating in regional blocs could offer large efficiency gains compared to individual negotiations, but only if it is based on trust and genuine cooperation. There will be no gains if every regional decision and position has to be negotiated in detail and then monitored by the various national capitals.

As noted above the key 'carrot' in the EPA process was to head off the threatened erosion of preferences for non-LDC ACP countries in the EU. With the waiver expiring in 2008, the EU made it clear that it would switch these countries to the much less favourable GSP regime if they did not sign EPAs. Thus for these countries, the 'win' from the EPA access was basically 'no change' in market access.⁶ No developed country has previously reduced access for a large group of developing countries.⁷ And for the ACP countries the prospect of suddenly being taxed on some of their exports to the EU was very alarming. Thus, on both sides of the table there was

⁵ Valuable as it is, there is little to suggest that regional integration is worth promoting at the expense of integration with the rest of the world. Rather the ideal is to have sufficiently low barriers to trade to permit both regional and global integration and to allow firms and consumers to choose between them.

⁶ The EU has also relaxed a few rules of origin for EPA countries, but these are minor concessions relative to the main threat.

⁷ Individual countries have been graduated from the GSP and have lost access in specific goods as they become too competitive.

undoubtedly great pressure to preserve the preferential access. This should not blind us, however, to the fact that, to date, preferences of this kind have generally had — and been predicted to have — very minor effects. The ACP share of EU imports has fallen inexorably over the last four decades; the EU reserves the right to impose safeguard measures against ACP exports; the RoOs continue to be burdensome and in some cases seriously restrictive; the margins of preference are frequently small, and the EU is negotiating to erode them both multilaterally (in the Doha round) and bilaterally (in the other FTA negotiations, e.g. with India). Moreover, to the extent that they are exploited, EU preferences transmit to the ACP countries the EU's price distortions (i.e., allowing prices and costs above world levels) and encourage short-termism, because they are not guaranteed and are likely to be eroded.⁸

Thus overall the ACP countries' preferential market access has not contributed much to development and poverty reduction so far, and is hardly set to improve anyway. Thus, if the EPAs are to be integrating and poverty-friendly, we need to find the mechanism elsewhere. The biggest change they entail is the reciprocal preferences that ACP countries are obliged to offer imports from the EU. Maybe these will reduce prices and increase real income or open up the ACP market sufficiently to stimulate their growth. Unfortunately, there is reason to doubt that.

First, there is the simple point that by reducing tariffs only on EU goods, the ACP partners open themselves up to trade diversion — private agents buying from the EU because it faces no tax (tariff) but the country as a whole paying more for imports because part of what was previously paid to the government as tariff is now paid to EU producers. The extent of the

⁸ The success of the USA's African Growth Opportunities Act (AGOA) when its RoOs were relaxed is something of counter-example to these strictures, but it has been restricted to a few countries and a relatively small proportion of trade Frazer and Van Biesebroeck (2007) Thus on the whole I maintain my caution about the value of preferences. The AGOA experience, however, certainly re-inforces the case for making RoOs liberal so that ACP countries can source the inputs into their exports as widely as is necessary to minimise costs.

problem depends on how much higher the EU's prices are than the previous suppliers' and on how much trade is diverted. Some argue that because the EU is a large, fairly open, economy its prices must be close to world prices and that the loss will consequently be small. On the other hand, the lack of competitiveness in its own markets is a constant EU worry. More important, the ACP economies are so small that they are frequently, one suspects, served by only one or two foreign suppliers (The fixed costs of trade make the entry of further suppliers unviable). These suppliers have great market power and will have selected their prices according to what the market will bear; when offered a reduction in tariff they may have no need to reduce their prices to consumers and so will put the whole benefit into their own bottom lines. In other words, in the extreme, the whole of what was previously tariff revenue will be transferred to EU suppliers. For sure, this is not the only possibility, but all the European Commission's initial studies of EPAs (then called REPAs, with the inevitable vulnerability to jokes about the grim reaper) predicted losses from trade diversion.

If trade diversion is a worry, however, there may be comfort in the fact that the ACP countries were not required to liberalise all their trade with the EU and had considerable flexibility in the liberalisation that they undertook. But to the extent that they avoided meaningful liberalisation, the ACP countries could have no new gains from trade and we should anticipate little poverty reduction. So what exactly is the situation of the ACP countries' tariff schedules? It is difficult to summarise the situation precisely because every EPA is different — the EU was genuine in allowing the ACP states to determine the details of their tariff liberalisations. However a few regularities are evident.

The GATT's Article 24 calls for 'substantially all trade' to be freed between partners in a FTA, but members have never succeeded in defining 'substantially all'. Over a couple of decades, the EU has advanced the view that it means 90% of mutual trade and in the last decade has refined this to include asymmetric liberalisations in which the EU frees 100% of its imports from a partner and the partner frees 80% of

its import from the EU.⁹ This is the model that the EPAs apply. Some small countries have made exclusions worth less than 20% of their base period trade with the EU (e.g. Seychelles, 2.5%; Lesotho, 9.9%), but equally some have claimed well over 20%, especially if one treats the tariff headings that are not mentioned in their schedules as excluded (e.g. Mozambique, 37.8%; Burundi, 48%).

Defining the exclusion class with reference to the value of imports from the EU in the base period potentially preserves all the most restrictive elements of the ACP countries' tariff structure, for the tighter were the restrictions were in the base year, the lower were base year imports.¹⁰ In the limit, the tariff on any product that the ACP country does not import from the EU in the base period may be added to the exclusion class 'for free.'

The excluded sectors vary across EPAs, but two common features seem fairly evident: many countries exclude a good deal of agriculture from liberalisation and most refer (along with EU sources) to the need to protect infant industries. In agriculture presumably the motivation is at least partly to protect local producers against subsidised exports from the EU.¹¹ Clearly, details of the poverty effects of such exclusions are very case-specific, but it is worth noting that Hertel et al (forthcoming) find that reducing agricultural prices through trade liberalisation would tend to reduce poverty in their sample of 15 developing countries. That is, in their sample countries the poorest tended to be net consumers of importable foods, not net producers.

⁹ These interpretations have not been challenged by other WTO members; this might imply that they have been tacitly accepted, but it equally means that if a challenge were to be made it might be upheld in the WTO's Appellate Body.

¹⁰ Suppose that three-quarters of the product lines had tariff of 5% and the other quarter 35%. Treating them all systematically, if the elasticity of demand for imports were 2, the restricted quarter of headings would account for less than 20% of the value of imports, and so could, on the '20% rule', remain entirely untouched by the EPA.

¹¹ The tariff has to be kept in the schedule because ACP countries may not be able to apply safeguards measures effectively.

The argument about infant industry protection is among the oldest in economics and still continues to generate controversy today. Baldwin's (1969) classic treatment suggests that even if there are market failures that lead to insufficient innovation in the product space, tariffs are as likely to worsen them as to cure them. Hausmann and Rodrik's (2003) recent advocacy of the need for self-discovery makes exactly the point and promotes policies of a quite different nature from simple tariff protection. When one looks at the tariffs actually excluded from liberalisation in the EPAs, it is difficult to see much evidence of a conscious attempt to cure critical market failures in innovation (although I readily concede that one cannot be definitive at this distance). Thus, for example, the Seychelles (population 84,000) will continue to protect motor vehicles and Mozambique will exclude motor vehicles, organic chemicals and iron and steel!

Every EPA from continental Africa has significant exclusions for cotton. This may reflect fears about subsidised cotton from the USA, but it seems an extraordinary way of stimulating a nascent clothing sector, which is often the first manufacturing sector in a country to export. Some countries will also continue to protect clothing, which may preserve or help to establish capacity for the local market, but is similarly unlikely to boost exports.

Setting aside the ultimate degree of trade liberalisation, there is also a question of timing. The Uruguay Round understanding on Article 24 suggested that a transitional period of 10 years is a reasonable norm, but the EPAs generally take longer on the ACP side. They all have at least two phases of liberalisation and in some cases the first involves no reductions in applied tariffs at all. For example, the East African Community's EPA calls for the liberalisation of headings accounting for 64% of imports from the EU by 2010, a further 16% by 2023 and the last 2% by 2033. (The remaining 18% need never be liberalised.) Currently 64% of imports from the EU — guess which — are duty free!

It is difficult to summarise the degree of liberalisation entailed in the EPAs because the schedules are not available to me, even in provisional form. However, Stevens et al (2008) provide some telling statistics. The first three columns of Table 1 summarise a few of these from the African EPAs, reporting the average tariffs of the goods liberalised in the first tranche of liberalisation — whenever that happens to occur — and, by contrast, the average tariff for the goods excluded from liberalisation. For the latter we offer two versions — a trade-weighted average and, recognising that higher tariffs tend to receive too low a weight in such averages because they cut imports disproportionately, a simple average. In every case the excluded commodities face considerably higher tariffs than the first tranche. It is true that in most cases the later tranches of liberalisation include headings with higher tariffs (inducing a worry about the degree of trade diversion they will entail), but these data suggest strongly that liberalisation, even for imports from the EU, will be slow and that the higher tariffs will remain even after the EPAs conclude. Such statistics are hardly the stuff of rapid integration into world commerce.

Table 1. Average Tariffs in Selected EPAs

	Average Tariffs			Tariff Revenue Losses
	Trade-weighted		Simple	
	First tranche	Excluded	Excluded	
	%	%	%	
Cameroon	8.1	22.0	25.4	
Cote d'Ivoire	6.0	13.6	15.6	24.0
Ghana	6.6	16.0	16.0	17.6
Kenya (a)	0.0	26.6	24.5	8.6
Madagascar	10.4	17.7	18.5	10.9
Mauritius	1.8	23.4	23.1	6.3
Sechelles	104.1	79.3	116.4	
Zimbabwe	12.0	42.4	23.7	
BLNS	1.2	12.4	22.0	0.0
Mozambique	6.8	13.5	13.1	

Source: Stevens et al (2008)

Notes: (a) the tariff data are representative of all EAC countries, but not the revenue calculation which is higher for Kenya than others.

The removal of lower tariff rates first raises concerns about the tariff structure that will result from the EPAs. One concern is that effective rates of protection (ERPs) may rise as intermediate inputs receive tariff cuts but final goods do not. Depending on the details this might be seen as a helpful stimulus to industrial activity, but experience of the 1960s and 1970s shows that it can easily get out of hand and induce huge inefficiency. A second concern is dispersion among nominal tariffs. For a given mean, nearly every model predicts greater costs of protection the greater the dispersion. I do not have the data, but cutting lower tariffs to zero while keeping higher ones unchanged may well increase dispersion.

A major concern of policy makers, analysts and civil society is that the EPAs might erode tariff revenues and thus government revenue. Baungsgaard and Keen (2005) have suggested that in the past, low income countries have not been good at making up revenues lost through tariff reform. Estimating such losses is a very imprecise art, and one should not take too literally the exact numbers that are generated. The Price Waterhouse (2007) summary of the Sustainability Impacts Assessments suggest a huge range of effects stretching from losses approaching 80% of tariff revenue for some West African EPAs, through 25–80% in East Africa, 10–20% in the Caribbean to 2–4% in the Pacific. Stevens et al offer an alternative lens based on actual schedules for African countries; they reach more modest conclusions, especially for the poorer countries. Estimates are given in column 4 of Table 1, although they are awkward hybrid ones. Stevens et al calculate ‘hypothetical’ revenue by applying the declared tariff rate to the observed base-period trade flow line by line and then summing. These clearly overstate actual collections and hence potential losses, but not having the schedules, we have to compare them with estimates of actual tariff revenue where available (from the World Bank’s *World Development Indicators*).¹² For

¹² Elsewhere experience suggests that actual collections can be half or less of hypothetical collections because of formal exemptions as well as poor administration.

the richer west African countries — heavily dependent on the EU for trade — the losses are significant but elsewhere they are relatively small, especially given the long transition periods in which to find additional revenue sources. Part of the negotiation process has been involved with solving these revenue problems, sometimes through the agency of aid, although the EU has refused to add concrete aid commitments to the EPA itself. I do not wish to debate the revenue effects here, but note that if revenue losses are small, this may indicate that tariff cuts have been concentrated on goods for which the EU is a relatively minor supplier — precisely those in which trade diversion is a serious possibility.

IV. A PROPOSAL

The catalogue of possible problems with EPAs is distressingly long. There is almost no evidence that their microeconomic details have been determined with an eye towards poverty or that they will contribute directly to poverty reduction in any significant way. On the macroeconomic front, they will increase the ACP countries' openness to EU goods but quite possibly at the expense of regional integration and at the certain cost of trade diversion. There is no convincing evidence that preferential agreements increase economic growth and the increasing focus on Europe as a trade partner seems unlikely to induce much dynamism given Europe's own performance relative to America's and Asia's. This last section asks how the EPAs might be made more poverty friendly — as promised in the title of the paper. The criteria are essentially to simplify — to reduce administrative burden — and to eliminate distortions. It is true that by the general theory of second best there is no guarantee that eliminating a subset of distortions will be beneficial, and that I cannot conduct the detailed analysis to prove the benefits case by case. Nonetheless I believe the proposal makes robust good sense overall, at least enough to warrant further study by the people who do have access to the required data.

The elements of the proposal all concern EU positions and behaviours, but they also require the agreement or at least the acquiescence of the ACP

states, and if this is not forthcoming they should not be forced through. It is, however, for the EU to initiate them because improving the EPAs is an EU responsibility. The EU created the preferences for the ACP countries in the first place and has not disavowed its wish to help them. It was the EU that chose to pursue WTO consistency by creating FTAs (a favourite activity of the Commission, in particular) rather than seeking another solution, and the EU that has the capacity to analyse the outcome more fully.

The principles underlying the proposal are that the EU should seek to;

- Assist the ACP countries' global integration,
- Reduce the costs of trade diversion
- Reduce costs of variable tariff structure
- Address the ACP countries' concerns over tariff revenue
- Honour the assertion that the EU has no mercantilist interest in ACP markets,
- Find a constructive use for the Aid-for-Trade funds that have been committed.

The proposal has several parts, but the most pressing is that the EU should support the ACP countries in extending the market access concessions to other countries that they have made to the EU — i.e. in making the EPA concessions MFN. This would be constructive in eliminating the costs of trade diversion and reducing the ACP countries' average tariff rates. The EU should support such an evolution of the trade regime via technical assistance and analytical services, but also with aid. I propose that the EU should replace the revenue lost from this extension of the EPA tariff to others for a period of, say, ten years in order to allow the ACP countries to develop alternative sources of revenue. There may need to be a cap on this replacement flow to reflect the fact that some ACP groups (mainly the richer ones) trade very little with the EU, so that there is perhaps a limit to the responsibility that it should shoulder — say, up to three times the revenue losses estimated from the EPA itself. I would also make the offer of replacement non-negotiable to discourage yet more waste of resources in negotiation. It should cover all trade headings (i.e. permit no exceptions), be

paid six months in arrears and be withdrawn for two years if there is any backsliding, and be open for the ACP countries to agree only for a finite period — say, until the end of 2009. This would not seriously constrain the ACP countries — they have long enough to decide whether to accept the scheme, can always withdraw with no penalty and commit only to treat the EU and other trading partners equally. Thus I am not here adding constraints on the extent to which ACP countries could raise their tariffs, merely saying that if they do so, they do so for everyone.

The cost of the proposal for the EU needs to be worked out. Given the relatively small costs to most of the EPAs as negotiated, it may be that their costs of extending the concessions to other suppliers may be quite high because, as noted above, they may be concentrated in headings where the others are far more important suppliers. The EU will also need to find a credible way of committing that the replacement revenue would be with resources additional to existing aid commitments. This is hard to do practically, because money is short, and harder still to demonstrate, but given the strong case for correcting the distortions of the EPAs it seems to me to be a high priority.

There has been an objection raised that one should not ‘purchase’ trade liberalisation because the latter bears its own reward. I agree in general, even though revenue stresses can be a serious problem for developing countries and the end-point of liberalisation is desirable. But in this case the EU created the problem of discrimination and acquiesced in the peculiar structure of the EPA liberalisation that resulted; thus I believe that this is an EU responsibility, and if in fact, the perverse incentives over the structure of liberalisation mean that the MFN extension (i.e. putting the problem of discrimination right) has bigger revenue effects than did the initial policy, so be it. All this leads me to think that the EPAs are a valid exception to the general rule of not offering revenue compensation. Other objections include that revenue replacement tilts aid flows towards richer and larger countries because they have the larger revenues. This is not necessarily true, but if it were, I would argue again that the circumstances of the case and the

additionality of the funds excuse this feature. It has also been objected that the proposal amounts to using EU money to help the Chinese sell more! It does, but the EU said it was not interested in the ACP markets, and the point is that the money helps the ACP countries to buy goods from more efficient producers and so benefits them directly.

This element of the proposal would not help the dispersion of tariff rates and would still leave a good deal of protection in place. Thus I would wish that the ACP countries continue the liberalisation by reducing their remaining tariffs significantly. Some replacement revenue might also be offered to support this reform, on the grounds that the tariff structure resulting from the 'MFN-ing' of the EPA was not desirable and could not have been anticipated by the ACP countries and thus that it too represented another element of putting the EPA process right. I would, however, make any such replacement revenue scheme much less generous than the previous one, keep it open only for a brief period and make it conditional on significant reductions in some measure of tariff dispersion. Again, almost the most important feature should be that it be simple and transparent and thus not require much negotiation between ACP governments and the EU.

My proposal contains two further elements oriented towards simplicity. The EU should scale back its hopes and ambitions for ACP progress in areas of services and deep integration. To be sure, these things are important, but to force them into the EPAs will actually delay progress both on them and on trade reforms. In services, the EU should, as with goods, express no view about which areas should be included, but be prepared to include whatever areas the ACP countries wish to register in the EPA. Most important, the EU should insist that any liberalisation offered be *prima facie* beneficial and extended on an MFN basis. The last is desirable both to prevent trade diversion and to get this element of the EPA out of the shadow of Article 5 of the GATS. The latter means that there is no worry about adhering to the 'substantially all trade' clause (which takes a more demanding form in the GATS than the GATT), so that the ACP countries can genuinely choose the sectors they want to liberalise.

The last element is on rules and regulations. Here, in order to keep the process manageable, the EU should keep the EPA focussed only on regulatory reforms that improve the climate for international trade — the cost of doing international business. This includes areas such as the ‘soft’ areas of trade facilitation such as customs and finance, and the costs (and feasibility) of meeting standards and related conformity assessments for OECD markets. This is pertinent to the rest of the EPA agenda and seems so obviously important that it is a desirable objective regardless of what else the government might aspire to. The facilitation must be for imports as well as exports, of course.

In both services and business regulation, the EU should offer technical assistance as requested and persuade itself that the proposed measure make sense in the context of the EPA. It should also make some effort to underpin the included reforms by establishing, if requested, a light monitoring and enforcement mechanism which would help to create some credibility for the reforms.

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