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Economic Partnership Agreements: Does Preferential Access of Non-LDC African Countries Increase?

Negotiations on Economic Partnership Agreements (EPAs) between the European Union and the African, Caribbean, and Pacific (ACP) states were started in 2000 and aim at establishing reciprocal free trade agreements (FTAs) to be World Trade Organisation (WTO) consistent. While negotiations have advanced to the third phase in most of the regions, progress has been glacial and no agreements as of this writing have been signed. Several contentious points complicate the negotiations, including the internal organization in each of the six regions that are negotiating with the EU, agreement on special and differential treatment, and the highly debated issue of whether related aid-for trade should be included legally binding in the EPAs.

One key issue for non-Least Developed Countries (non-LDCs) is the impact that alternatives to an EPA would have on market access and preferences in the EU. This is not an issue for LDCs because they will continue to benefit from quota- and duty-free access to the EU market under the Everything but Arms (EBA) initiative. It is unclear, however, what the alternative to an EPA could be for the non-LDCs. To maintain pressure to come to agreement, the European Union has not put forward any alternative offers even though the Cotonou Agreement states that those countries opting against signing an EPA should end up no worse than under the current trade preferences.

While the exact legal interpretation of that clause is debated, the alternative to an EPA will lie between the two extremes of an EPA with 100% product coverage and (presumably) liberal rules of origin, and preferences being granted under the Generalised System of preferences (GSP). For a preferential trade agreement to conform to WTO norms, it will have to cover “substantially all trade” which is usually understood as covering at least 90% of the total current trade flows. During the Doha Round, the EU put forward the offer to grant quota- and duty-free access to its market for all LDCs for 97% of products. It is unclear if an EPA would cover all imports into the EU or replicate Cotonou-type

coverage. In early April, the EU offered quota and duty free access to the European market for all products except sugar and rice to EPA signatories. The transition period for rice would be brief while full quota and duty free access for sugar would be phased in until 2015. South African exports of a range of "globally competitive" products are exempted from this market access offer. The proposal, however, has been criticized by France and some other European states, as threatening the compromise found on the reform in the sugar and banana sector and as weakening the EU's position before the WTO with regard to the banana dispute. In any case, an EPA would also require a phased market opening for EU products into the ACP countries, even though the phasing could last several years.

Current EU trade preferences for non-LDCs in Africa amounted to 3.9 percent of their exports to the EU or EUR 782 million in 2005. Assuming that Cotonou preferences expire and no new preferences will be in place by that time, 2008, it is possible that these countries would only have access to preferences under the GSP. Other things equal, this would reduce the value of their preferences to 0.5 percent of their exports or EUR 103 million, a loss of EUR 679.[1]

Alternatively, if EPAs with Cotonou-type rules of origin were to be in place by 2008, the value of preferences could increase to 4.5 percent of exports, a notional gain of EUR 107 million. If EPAs were concluded with simple rules of origin, however, preferences could be much higher because this could make several export products competitive in the European market. For example, less restrictive rules of origin for apparel products in the US under AGOA have led to an increase in clothing exports from about USD 250 million in 2000 to more than USD 800 million in 2004.

The value of preferences is the amount of import duties that exporters did not have to pay because of preferential tariff rates available to them. Its calculation is based on actually observed trade flows.

Two caveats are in order. First, this calculation omits the fact that some of these trade flows might only take place because of the preferences. In that case, the whole export value would be additional value that is transferred to the exporter because preferences are granted. This tends to bias downward the calculated value of the preference.

Second, it is impossible to identify from the data those who actually benefits from the preferential rates. The issue is that tariffs create a wedge between the producer price in the exporting country, including transport costs to the export market, and the consumer price in the importing country. In this note, we assume that the exporter actually benefits as he continues to sell the goods in the destination market for the higher consumer price but does not have to pay the import duties. He hence receives a net transfer of the value of preferences. Depending on the market power of the importer, the exporter, or an intermediary, it could be also be the

[1] Another possibility that has been discussed would be to include the non-LDCs as GSP+ beneficiaries. This would increase the eligibility for preferences of their exports and could be temporarily justified under the "vulnerability" criterion as happened in the case of the Andean countries.

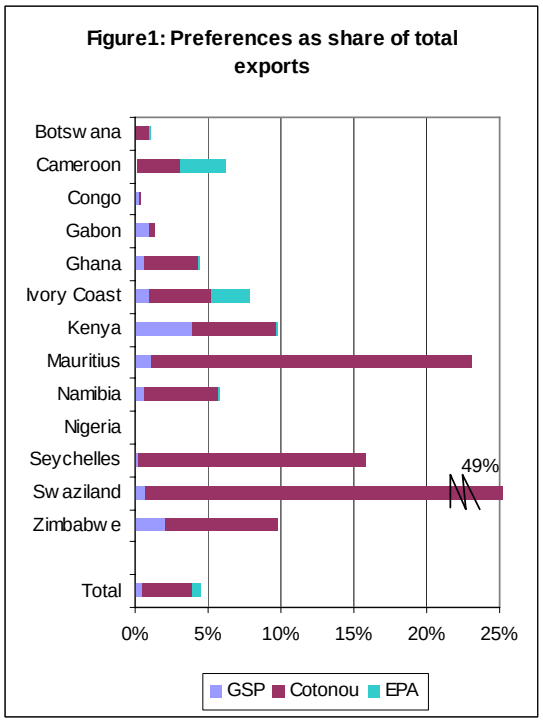
importer or the intermediary who benefit from the reduction in tariff rates. If market power of the importer is high, he can continue to pay the producer price to the exporter (keeping his income constant as compared to the situation without trade preferences) but sell at the higher consumer price in the importing country, keeping the difference in price as a profit. Similarly, the intermediary could benefit from the lower tariff rate by buying from the producer at producer prices and selling to the final reseller at consumer prices. In this situation, the intermediaries income increases while both income for the exporter and final importer stay constant (as compared to the situation without tariff preferences). This tends to bias upward the 'value of preferences' because the calculated gain may overstate the actual transfer to the exporting country (Olarreaga and Özden, 2005).

Using a new dataset the EU has recently made available,[2] we have calculated the value of preferences for each of the 13 sub-Saharan non-LDC countries, taking into account its current preference utilization.[3] This allows us to correct for that proportion of products that currently do not claim preferences because of problems with rules of origin, lack of knowledge of the available preferences, or other reasons.[4] Ad-valorem equivalents (AVEs) for specific tariffs are estimated at a flow basis (i.e. by exporter, product, and preference status). We calculate the difference between duties that would have been paid if all imports entered under MFN and duties that would have been paid if exporters could chose the best preferential rate (in a small number of cases, GSP rates are lower than Cotonou rates). This difference is reported as value of actually claimed tariff preferences. In a second step, we calculate the value of preferences if only GSP preferences were accessible. For comparison, we also present the hypothetical value of preferences if EPAs with duty- and quota-free access and Cotonou-type rules of origin were to be concluded (i.e. setting all EU tariffs to zero and keeping utilization rates constant).

[2] While an earlier version of preferential data for 2002 distinguished between different preferential schemes that were used by the importers (Brenton and Ikezuki, 2005), this is no longer the case in the current dataset. It is likely that this results from the fact that many products are eligible for preferences under various preferential schemes. When analyzing utilization rates for the different schemes, trade flows were often counted more than once in the denominator while they could only be allocated to the numerator of one of the utilization rates. This possibly led to non-representative low take-up rates for some schemes and it is likely that the EU tries to avoid this problem in the new dataset. This new dataset only contains five different kinds of import categories: Imports entering under MFN with zero rates, imports entering under MFN with non-zero rates, preferential imports facing zero duties, preferential imports facing positive (but reduced) duties, and imports whose status is unknown.

[3] We treat trade flows in the unknown category as not receiving preferences.

[4] The costs of the documentation requirements to proof that the rules of origin are satisfied is often estimated at three percent of the goods' value, casting doubt on the economic value of such small preference margins.



note: all values in EUR1000, calculation of preferences takes current utilization rates into account

Source: EU preference data, TRAINS, Bank staff calculations

Overall, actually claimed preferences for all 13 sub-Saharan non-LDCs[5] represent 3.9 percent of their exports to the EU. If only GSP preferences were available, this value would fall to 0.5 percent of total exports. The fall would be substantial for all countries but particularly high in the case of Mauritius, the Seychelles, and Swaziland where the value of preferences would fall from about 23, 16, and 50 percent respectively to nearly zero. For Kenya, a shift to GSP preferences would reduce preferences from 9.7 to 3.9 percent.[6]

If EPA negotiations were to be successful and quota- and duty- free access were to become available to non-LDCs, preferences would amount to 4.5 percent of total exports. Compared to current Cotonou preferences, EPAs would provide only a marginal increase, because only few products are omitted by the generous access Cotonou offers.[7]

The actual value of preferences under an EPA, however, would depend on the rules of origin that were to be agreed. While the 4.5 percent figure assumes identical utilization rates as under the current regime, inclusion of non-restrictive rules of origin in EPAs could increase that value to 5.2 percent assuming constant trade flows. The World Bank has advocated non-restrictive rules of origin—such as the 10% value-added rule proposed by the Blair commission and/or a simple change of tariff heading rule—that could open a range of new export opportunities for beneficiary countries, thereby increasing the value of preferences. It is very difficult to estimate the potential value of these changes in competitiveness, however, but they could potentially be very large.

[5] South Africa is not included in the analysis as it is only an ACP country since 1998 and is not a signatory to the commercial provisions of the Cotonou Agreement, which foresees the negotiation of EPAs. While South Africa has signed an FTA with the EU in 1999, its partners in the customs union (SACU) are supposed to sign an EPA. Both arrangements are likely to create barriers within SACU. South Africa has expressed interest to join the SADC EPA but this has been rejected by the EU.

[6] While a recent paper by the ODI (ODI, 2007) only does a number count of tariff lines that would see increases in tariff rates if Cotonou preferences were withdrawn, the numbers presented in this paper support the relative importance of preferential access for various exporting countries.

[7] The value of preferences under the EBA initiative would be similar, showing the limited additional coverage that EBA preferences offer over Cotonou preferences

It is also important to note that the importance of preferences strongly differs by country. This is mainly due to differences in the composition of exports to the EU. For example, the ratio of actually claimed preferences to exports ranges from 0.1 percent for Nigeria, which mainly exports oil to the EU, to 49.5 percent for Swaziland that mainly exports sugar to the EU which benefits from large preferences (see table 1).

While the importance of preferences as a share of exports varies between countries, more detailed analysis shows that in each case, two or three products account for the bulk of claimed preferences (table A.2).Even though these products differ by exporting country, among the most important ones are frequently fish, edible vegetables, meat preparations, sugar, and cocoa (preparations). This is also true at the aggregate level. *Taking all export flows together, 6 products account for 78 percent of the total value of preferences.* The most important ones are sugar (36 percent of preference value), edible fruits and nuts (12 percent), and preparations of meat, fish or crustaceans (12 percent).

Conclusion

The total value of EU preferences claimed by African non-LDCs, expressed as a share of exports, is small—3.9%—but could potentially be important if that margin (which is quite substantial for some countries) is a necessary condition for these countries' exports to successfully compete in the European market. Preferences amount to a substantial share of total exports for three countries (Mauritius, the Seychelles, and Swaziland) and exceed five percent of exports for another four countries. Nonetheless, while it is unclear who actually benefits from the preferences, the value of preferences for non-LDCs would fall to 0.5 percent, a notional loss of EUR 679 million, if no new trading arrangements were in place in 2008, when Cotonou preferences expire. Alternatively, if EPAs with Cotonou-type rules of origin were to be in place by 2008, the value of preferences could increase to 4.5 percent of exports, a notional gain of EUR 107 million.

There still exists the possibility that the EU will continue to grant these preferences even in violation of WTO laws, but that might politically difficult – and reportedly several states stand ready to challenge any unilateral arrangements under WTO rules. What happens strongly depends on whether any kind of trading agreement can be reached and implemented within the next 12 months.

EPAs are not only about preferences, however. More importantly, the negotiations offer the opportunity to strengthen regional integration and foster economic growth. A larger internal market and harmonized policies will increase the efficiency of resource allocation and investment incentives. ACP countries could also use the negotiations to address domestic constraints to growth that inhibit resources to flow from low-productivity sectors to high-productivity sectors. Necessary reforms could possibly be supported by additional aid-for-trade that should be used to address supply-side constraints.

On the other hand, signing EPAs would also mean that companies in the EU would gain preferential market access to ACP markets. Under these agreements, however, liberalization of the ACP countries vis-à-vis the EU would be phased in over a long time horizon. While liberalization would provide new competitive pressures on certain companies in ACP countries, it would also discipline prices, drive productivity improvements, and lead to increased efficiency and growth. This would contribute to making ACP countries more competitive in the global market.

If no agreement came into place in 2008, the direct costs to exporting non-LDCs in terms of foregone preferences were generally manageable while there are small but non-trivial gains in the value of preferences to be obtained from signing EPAs. However, the implementation of a 'bad' EPA—an EPA that does not address domestic policy constraints—or the non-implementation of an agreement would remove the leverage for domestic policy reforms that the European Union still holds and would impose much higher long-term costs on ACP countries because of another missed opportunity for structural reforms. This would be the real drama of unsuccessful EPA negotiations.

References:

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Annex:

Table A.1: Comparison of Cotonou, GSP, and EBA Preferences for 13 African Non-LDCs in 2005

	Exports used for calculation	Potential preferences under EPA	Preferences if only GSP used	Actually claimed preferences* (GSP&ACP)	Potential prefs under EPA (as % of exports)	Preferences if only GSP used (as % of exports)	Actually claimed preferences* (as % of exports)	COMEXT TOTAL	percent missing	note
Botswana**	2,383,430	25,219	319	23,556	1.1%	0.0%	1.0%	2,383,947	0.0%	
Cameroon	1,958,817	121,241	2,718	59,647	6.2%	0.1%	3.0%	1,960,381	0.1%	
Congo	293,385	1,206	577	1,206	0.4%	0.2%	0.4%	294,698	0.4%	
Gabon	546,179	6,881	5,315	6,881	1.3%	1.0%	1.3%	547,536	0.2%	
Ghana	958,415	42,441	6,178	41,458	4.4%	0.6%	4.3%	973,995	1.6%	1
Ivory Coast	1,949,361	152,888	17,796	102,491	7.8%	0.9%	5.3%	1,955,971	0.3%	
Kenya	946,670	92,015	36,930	91,706	9.7%	3.9%	9.7%	954,631	0.8%	
Mauritius	1,120,824	259,415	11,652	259,415	23.1%	1.0%	23.1%	1,125,148	0.4%	
Namibia	929,521	54,772	5,349	52,654	5.9%	0.6%	5.7%	950,789	2.2%	2
Nigeria	8,319,340	11,638	7,496	11,637	0.1%	0.1%	0.1%	8,343,282	0.3%	
Seychelles	259,097	41,086	756	41,086	15.9%	0.3%	15.9%	260,745	0.6%	
Swaziland	110,628	54,719	744	54,718	49.5%	0.7%	49.5%	115,792	4.5%	3
Zimbabwe	367,444	35,953	7,560	35,947	9.8%	2.1%	9.8%	390,606	5.9%	4
Total	**20,143,111**	**899,474**	**103,390**	**782,401**	**4.5%**	**0.5%**	**3.9%**	**20,257,523**	**0.6%**	

note: all values in EUR1000, calculation of preferences takes current utilization rates into account, "potential preferences under EPA " assumes Cotonou-type rules of origin

Missing trade in which products and why missing 1) special lines (HS12, 99); 2, 3) annex2 (HS8); 4) annex2 (HS8) and special lines

*Due to the treatment of bananas in the analysis, total preferences claimed are approximately EUR 32m larger in 2005 (Ivory Coast 28m, Cameroon 4m)

** Comparing these values to the 2002 values, one should notice that Botswana's value of preferences as a share of total exports has decreased substantially. This is due to an immense increase in exports of diamonds from EUR 240m in 2002 to EUR 2.3b in 2005

Source: EU preference data, TRAINS, Bank staff calculations

Table A.2: Comparison of Commodity Protocol and Cotonou Tariff Preferences With Basic GSP Preferences for African non-LDCs (2005)

HS-chapter	Description	Prefs under GSP (as % of exports) (a)	Prefs under GSP&ACP (as % of exports) (b)	change (a)-(b)
	Botswana			
2	Meat and edible meat offal	0.0%	1.0%	-1.0%
61	Art of apparel & clothing access	0.0%	0.0%	0.0%
85	Electrical machinery and equipment	0.0%	0.0%	0.0%
	top3	0.0%	1.0%	-1.0%
	Total	0.0%	1.0%	-1.0%
	Cameroon			
8	Edible fruit and nuts; peel of citrus	0.0%	2.5%	-2.5%
76	Aluminium and articles thereof	0.0%	0.3%	-0.3%
18	Cocoa and cocoa preparations	0.0%	0.1%	-0.1%
	top3	0.0%	2.9%	-2.8%
	Total	0.1%	3.0%	-2.9%
	Congo			
24	Tobacco and manuf. tobacco	0.0%	0.2%	-0.1%
3	Fish & crustacean, mollusc & other	0.1%	0.2%	-0.1%
44	Wood and articles of wood	0.0%	0.0%	0.0%
	top3	0.2%	0.4%	-0.2%
	Total	0.2%	0.4%	-0.2%
	Gabon			
44	Wood and articles of wood	0.7%	0.9%	-0.1%
3	Fish & crustacean, mollusc & other	0.2%	0.4%	-0.1%
39	Plastics and articles thereof	0.0%	0.0%	0.0%
	top3	1.0%	1.3%	-0.3%
	Total	1.0%	1.3%	-0.3%
	Ghana			
16	Prep of meat, fish or crustaceans	0.0%	1.6%	-1.6%
7	Edible vegetables and certain roots	0.0%	1.3%	-1.3%
18	Cocoa and cocoa preparations	0.2%	0.5%	-0.3%
	top3	0.3%	3.5%	-3.2%
	Total	0.6%	4.3%	-3.7%
	Ivory Coast			
8	Edible fruit and nuts; peel of citrus	0.1%	2.2%	-2.1%
18	Cocoa and cocoa preparations	0.6%	1.6%	-0.9%
16	Prep of meat, fish or crustaceans	0.0%	0.8%	-0.8%
	top3	0.7%	4.6%	-3.9%
	Total	0.9%	5.3%	-4.3%
	Kenya			
7	Edible vegetables and certain roots	2.6%	3.8%	-1.2%
6	Live tree & other plant; bulb, root	0.9%	2.8%	-1.9%
20	Prep of vegetable, fruit, nuts or o	0.2%	1.1%	-0.9%
	top3	3.8%	7.7%	-4.0%
	Total	3.9%	9.7%	-5.8%

	Mauritius			
17	Sugars and sugar confectionery	0.0%	17.0%	-17.0%
61	Art of apparel & clothing access	0.7%	3.5%	-2.8%
16	Prep of meat, fish or crustaceans	0.0%	1.6%	-1.6%
	top3	0.7%	22.1%	-21.4%
	Total	1.0%	23.1%	-22.1%
	Namibia			
2	Meat and edible meat offal	0.0%	3.2%	-3.2%
3	Fish & crustacean, mollusc & other	0.6%	2.3%	-1.7%
16	Prep of meat, fish or crustaceans	0.0%	0.1%	-0.1%
	top3	0.6%	5.6%	-5.0%
	Total	0.6%	5.7%	-5.1%
	Nigeria			
3	Fish & crustacean, mollusc & other	0.0%	0.1%	0.0%
18	Cocoa and cocoa preparations	0.0%	0.0%	0.0%
41	Raw hides and skins	0.0%	0.0%	0.0%
	top3	0.1%	0.1%	0.0%
	Total	0.1%	0.1%	0.0%
	Seychelles			
16	Prep of meat, fish or crustaceans	0.0%	12.9%	-12.9%
3	Fish & crustacean, mollusc & other	0.3%	3.0%	-2.7%
40	Rubber and articles thereof	0.0%	0.0%	0.0%
	top3	0.3%	15.9%	-15.6%
	Total	0.3%	15.9%	-15.6%
	Swaziland			
17	Sugars and sugar confectionery	0.0%	46.7%	-46.7%
20	Prep of vegetable, fruit, nuts or	0.5%	2.4%	-1.8%
7	Edible vegetables and certain roots	0.0%	0.1%	-0.1%
	top3	0.6%	49.2%	-48.6%
	Total	0.7%	49.5%	-48.8%
	Zimbabwe			
17	Sugars and sugar confectionery	0.0%	6.0%	-6.0%
24	Tobacco and manuf. Tobacco	0.6%	1.3%	-0.7%
6	Live tree & other plant; bulb, root	0.3%	0.8%	-0.6%
	top3	0.9%	8.1%	-7.3%
	Total	2.1%	9.8%	-7.7%

Source: EU preference data, TRAINS, Bank staff calculations

Annex 3: Data assumptions

The figures presented in this analysis include most of trade registered in COMEXT, the official trade database of the European Union. Trade flows that are excluded from the analysis are confidential trade and trade in non-confidential tariff lines where the entry-price system is applied. For both we do not know and cannot estimate the applicable tariff rates. Overall, we exclude only 0.5% of exports from African non-LDCs to the EU due to these data constraints (ref. columns 9&10 of table A.1). Trade in tariff lines where the entry-price system is applied takes mainly place in HS chapter 8 (edible fruits and nuts) so the value of preferences for these products is likely to be understated. However, only 7% of HS-chapter-8 imports into the EU from African non-LDCs are excluded.

Some additional caveats to the data apply. With regard to the three specific protocols (sugar, beef, bananas), we had to use the following assumptions:

- **For sugar exports, we assume all export enter under quotas and hence with a zero tariff.** This treatment is applied to raw cane sugar and cane or beet sugar (as we cannot distinguish between cane and beet sugar from the data we reasonably assume that only cane sugar is exported from African non-LDCs to the EU). The EU-market price for sugar will be cut by 36 percent over the next four years which means that income from sugar exports will fall strongly.
- **All beef and veal exports are assumed to fall under the quotas** (substantial exports are only registered from countries that are actually granted quotas (minimal exception of Ivory Coast with 50,000 EUR)) and hence the specific element of the ACP tariff rates are reduced by 92% (see protocol 4 of Annex V of the Cotonou Agreement) if preferences have been claimed.
- **With regard to bananas, we have applied a tariff preference of 300 EUR/ton for 2005** in light of the rapidly changing regulations in the market for bananas. In the year of the analysis, the difference between out of quota MFN and ACP specific tariffs was 300 EUR/ton but also some ACP preferences of 0% tariff existed. Following the market opening and the successful challenge of the regime by some Latin American countries before the WTO, the out of quota MFN tariff (and hence the maximal margin of preference) stood at 176 EUR/t at the beginning of 2007. A substantial amount of the bananas from ACP countries entered with zero duties in 2005 and using a preference margin of 300 EUR/t hence understates the amount of preferences granted in 2005 as the preference margin for bananas entering duty free (as compared to entering out of quota from third countries) would have been much larger (i.e. 680 EUR/t). The reported value, however, has to be used with care as it overstates the potential value of preferences for 2006 and in the future. The preferential margin that is used for its calculation had strongly narrowed.