The Economic Partnership Agreements with Africa: macroeconomic impacts and pro-developmental policy responses

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The Economic Partnership Agreements (EPAs) between the EU and African, Caribbean and Pacific (ACP) countries mark a new era in the economic relations between both sides. Reciprocal tariff liberalization will however result in asymmetric market opening by ACP partners, which will entail negative, though small, macroeconomic effects for these countries in the short to medium term. In order to deliver upon the promised tangible benefits of EPAs in the longer term, the EU should implement strong policy responses in three key areas: (i) coping with adjustment costs, (ii) promoting productive development, and (iii) fostering trade-related institutional capacities in the public sector and civil society, including an effective monitoring process for EPA implementation.[1]

EPAs as the basis for a new era in economic relations between EU and ACP

Since the mid-2000s the European Union (EU) has concluded or currently is in the process of concluding trade and development agreements with the group of African, Caribbean and Pacific (ACP) countries. Representing the economic pillar of the framework Cotonou Agreement, the EPAs mark the beginning of a new era in the economic relations between the EU and the ACP countries. Instead of the unilateral preferential approach prevalent until the Lomé Agreements, the EPAs are bi-regional agreements, which commit both parties to reciprocal tariff liberalization.

Unsurprisingly, by involving an economically highly advanced group of countries on the one hand, and a group of countries, which disposes of rather fragile and structurally dependent economies on the other hand, EPA negotiations have proofed challenging and highly controversial. For the EPA-regions in southern (SADC), western (ECOWAS) and eastern (EAC)[2] Sub-Saharan Africa (SSA), it took ten or more years to conclude negotiations, with ratification of agreements still pending in some countries.

The EPAs and the challenge of their implementation are therefore a highly charged political project. It is well understood that the EPAs must deliver tangible benefits to the ACP partners. Thus, both the market access liberalization and the regulatory reforms triggered by the agreements must support sustainable economic development for the African partner countries, i.e. economic growth that is socially inclusive and respects ecological boundaries. EPAs are therefore primarily to be judged against this yardstick, which bears important implications for the incipient negotiations on the Post-Cotonou agreement.

Expected macroeconomic effects

The key change introduced by the EPAs is the reciprocal tariff liberalization instead of unilateral trade preferences granted by the EU as under the previous Lomé regime. Hence, market opening will be asymmetrical, with ACP partner countries unilaterally reducing their import tariffs, while no changes in tariffs appear on the export side due to the already existing duty-free, quota-free (DFQF) market access to the EU. The African EPA partners will be required to liberalize around 80% of their trade with the EU over an implementation period of 10 years (SADC), 20 years (ECOWAS) and 25 years (EAC), respectively. This will in particular entail substantial tariff reductions for industrial goods and to a lesser extent for agricultural products.

The magnitude of macroeconomic effects of the EPA liberalisation in the specific regions and countries depends on the existing level of tariff protection as well as on the importance of the EU as a trade partner. The removal of import duties results in a decline of the tariff level on imports from the EU from 9.7% to 2.5% in ECOWAS, from 6.7% to 1.7% in the EAC region and from 2.9% to 1.7% in SADC (GTAP 9 data). As the EU is the source for around 30% of imports into these regions, the changes to tariffs have important implications on macroeconomic variables.

Model simulations of this unilateral liberalization performed with the ÖFSE Global Trade Model show that the implementation of the EPAs will lead to losses in terms of output and employment for the African partners (Table 1).[3] The size of the effects depends to a large degree on the importance of the EU as a trading partner, as well as on the degree of existing tariff liberalization and the sectoral structures of the particular countries.

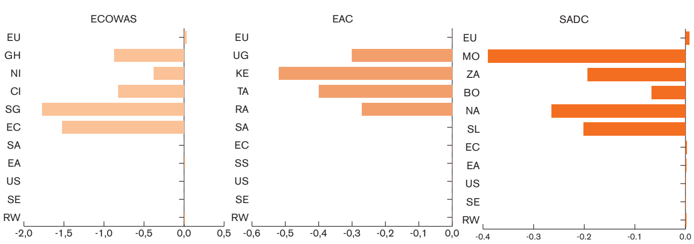
Given their rather intensive trade relations with the EU, ECOWAS countries will be hit hardest, with aggregate losses amounting to roughly 0.61% of regional GDP. Effects for EAC and SADC are smaller, amounting to 0.42% and 0.20%, respectively. The results on a regional level are largely determined by the dominant economies in the bloc (Nigeria, Kenya, and South Africa) and single countries may face changes above or below the regional average, for instance Senegal with losses of 1.77% or Botswana with losses of 0.07% (see Figure 1). Most importantly, all countries participating in an EPA will experience negative effects due to the asymmetric liberalization. These effects are mainly driven by increased imports from the EU, which though beneficial for household consumption and firms' sourcing costs, will negatively affect domestic production because of import competition, with the latter effect prevailing over the former.[4]

Table 1: Summary of macroeconomic EPA effects (in %)

	ECOWAS	EAC	SADC
GDP (regional)	-0.61	-0.42	-0.20
GDP (range)			
largest (country)	-1.77 (SG)	-0.52 (KE)	-0.39 (MO)
smallest (country)	-0.38 (NI)	-0.27 (RW)	-0.07 (BO)
Imports *(from EU)*	8	6	2.2
Exports *(to EU)*	0.1	0.01	0.26
Current account balance *(Exp-Imp)*	-0.55	-0.37	-0.17
Public balance *(Tax-Gov)*	-0.52	-0.34	-0.16
Employment *(range)*	-0.02 to -0.10	-0.1 to -0.3	-0.05 to -0.15

Note: See for country codes footnote 2 and Grumiller et al. 2018a
Source: CGE calculations

Figure 1: GDP changes per country, EPA-Scenario (in %)



Note: See for country codes footnote 2 and Grumiller et al. 2018a
Source: CGE calculations

Beyond changes to bilateral trade flows with the EU (in particular imports), intra-regional trade within the three country groupings will also be affected by the EPAs. Our results hint at small trade diversion effects within EPA regional groupings and between EPA regions as well as with third countries. Hence, trade diversion of intra-regional trade through EU imports reduces the overall export performance of the African partner countries.

On a sectoral level, industrial sectors such as machinery, chemicals and other manufacturing will be hit hardest in comparative terms, with concomitant negative effects on employment. Though the aggregate losses are comparatively small, the percentage changes would be equivalent to 11,000 jobs in SADC, 85,000 jobs in EAC, and up to 210,000 jobs in ECOWAS. For individual countries such as Mozambique, Uganda and Ghana, the related numbers would amount to 7,000, 13,000 and 20,000, respectively. These job losses in manufacturing industries are particularly painful given their relative high wages and the limited industrial capacities of these countries.

Macroeconomic balances, that is the private balance, public balance and current account balance, will also be affected by trade liberalization. Typically, our results point to a deterioration of the current account, i.e. a reduction of net exports driven by increased imports, and of the public balance driven by a loss in tariff revenues.

The effects on the sectoral patterns and overall level of employment and public revenues are related to potential adjustment costs that come along with the implementation of the EPA. In particular, changes to public income due to lower tariff revenues will have repercussions on public budgets, and require suitable policy responses as well as budget support from the EU.

Coping with adjustment costs

It is well-known that tariff revenues are an important source for public budgets in most SSA-countries. This is particularly true for West Africa, where depending on the country, import duties account for 10-30% of public income. Even though the role of tariff revenues varies between the three regions and countries assessed, the countries will have to cope with public sector income declines during the implementation phase of the agreements.

Relating the regional EPA liberalisation schemes to current import values (UN Comtrade Data for the year 2015-16) gives an indication of the magnitude of foregone public income. In the ECOWAS region, lost tariff revenues amount to USD 615 million per year in the first stage of the liberalisation period and increase to USD 1.74 billion, once the full liberalisation is carried out. For individual countries such as Ghana, the respective numbers is a sizable USD 226 million p.a. Under the assumption that the agreement enters into force in 2018, these tariff income losses would however only start to materialize from 2023 onwards and extend until the year 2038. Reflecting the smaller weight of both tariff income for public budgets and EU imports as a share of total imports, for the EAC region, tariff income losses would rise to USD 154 million p.a. at the end of the implementation period. For individual countries like Uganda, the respective number amounts to USD 4 million per year, which appears better manageable than in the case of ECOWAS countries.

Budget support by the EU to compensate for lower public revenues are not yet secured, as tariff income losses would only kick-in after the current programming period of EU development cooperation instruments, which ends in 2020. In current programming schedules, EU budget support seems limited, however. For instance in the case of ECOWAS (PAPED Axis 4) the financial assistance for adjustment costs amounts to EUR 126 million per year. Compared to the potential loss of tariff revenues, it would appear that EU budget support would have to be substantially increased in the period post-2020.

Irrespective of additional direct budget support in the future, discussion on the effects on public balances in EPA countries must not be confined to the compensation of lost tariff income. EPA countries have in addition the need to mobilize additional funds for the effective implementation of regulatory changes associated with the EPAs as well as the promotion of productive capacities of export sectors in order to benefit from the EPAs in the longer run.

Thus, current financial assistance by the EU should be directed towards strengthening the domestic tax base. However, a broadening of the tax base will entail substantial reforms of the national tax collection systems, particularly with respect to levying income taxes on wages and profits. Hence, any eventual political reform process should be expected to be lengthy and burdensome. In our view, increased efforts towards domestic resource mobilization are without alternative, but need increased support from the EU even before EPA implementation formally commences.

Promoting productive development in export sectors

Our analysis so far has important implications for the use of policy tools to overcome negative macroeconomic effects and adjustment costs. It should not be expected that EPA economies will immediately benefit from the EPA agreements, for instance via increasing exports. First, African partner countries already enjoyed DFQF market access to the EU before the EPAs. Even though the EPAs put this market access on a secure and long-term basis, which is of particular importance for non-Least Developed Countries (LDCs), there is no change in tariffs compared to the current market access regulation. Second, increasing exports depends not only on market access – as important as it is – but also on the dynamics of specific Global Value Chains (GVCs), through which the large majority of trade takes place today, as well as on the development of productive capacities in partner countries.

Our analysis of selected sector case studies for important export sectors in a number of EPA countries (see Grumiller et al. 2018a, 2018b) show that the development of competitive export sectors is a major challenge in many African partner countries. Importantly, it requires pro-active industrial policies to support economic upgrading and diversification, and the development of related institutions that drive these policies.[5]

A long-term strategy for the promotion and upgrading of export sectors will necessitate in particular:

i. Support services in the area of finance, skills development and extension services in agricultural and manufacturing sectors in order to foster the development of farmers and local firms. A focus on initiating collaboration and linkages among local actors (farmers and firms) as well as between local and foreign firms can support productivity and learning.

ii. The development of effective public institutions to increase productivity, upgrading and diversification. Public-private dialogue and broad inclusion of civil society is important to ensure effective and sustainable policies and outcomes.

iii. Regional integration on the production as well as end market side to strategically tackle productive constraints and to influence the bargaining power vis-à-vis global buyers. Further, domestic and regional end markets can be an important alternative to high-income country markets particularly for developing further functional upgrading processes in terms of agro-processing and manufactured products.

The EPAs with their guaranteed DFQF market access to the EU are an important factor, but alone will not trigger the development of more locally embedded export sectors. This will require strategic and strong industrial policies at the national and regional level, which will also have to use the existing, though limited in the EPAs flexibilities (e.g. for local content rules, export duties, safeguard mechanisms) in order to increase domestic police space.

Development cooperation in the context of the EPAs could play a crucial role in the promotion of export sectors. EU development cooperation support, particularly via Aid for Trade programs, is required to address challenges of local firms, workers and farmers, build inclusive local institutions that support sector development, upgrading and linkages, and use the potential of regional value chains and markets to benefit from the export-related opportunities of the EPAs. This support should be sought for and used strategically to ensure a consistent portfolio of programs by different development cooperation actors. Hence, development cooperation in the area of productive capacity and capability building will continue to be important in order to support sector-specific policies and projects at the local, national and regional level that will be able to exploit the export-side potential of the EPAs.

Trade policy capacity building and the role of Aid for Trade

Liberalizing trade as well as promoting export diversification put strong demands on state capacities. On the import side, customs authorities will be responsible for processing imports covering thousands of tariff lines with specific tariff rates and/or quotas. On the export side, certificates of origin, certifications with respect to technical standards and SPS regulations will have to be provided by government institutions and other mostly public entities such as Chambers of Commerce as well as testing as well and inspection agencies. In addition, trade ministries will have to monitor the development of imports and exports and produce timely statistics and intelligence, which form the basis for effective trade policy-making, for instance anti-dumping measures or other safeguard measures. In terms of promoting export-oriented policies, government entities are responsible for providing a range of services, e.g. with regard to finance, extension services, and of consultancy services with respect to technical and sanitary standards.

In terms of promoting the participation in value chains and related upgrading strategies, even more demanding planning and industrial policy capacities are required from state agencies. Thus, the swift and effective implementation of the EPAs as well as the timely management of the flexibilities and opportunities for expanded trade built into the agreements will put heavy demands on the technical capacities of the Africa partners. While certainly a challenge for all African partners, our research suggests that the aforementioned exigencies will be particularly difficult to shoulder for LDCs such as Mozambique, given low institutional capacities and severe financial constraints in the face of a multitude of challenges.

EU Aid for Trade funding has so far focused on spending for infrastructure and private sector capacity-building. A key factor both for successful EPA implementation and active management of agreement flexibilities as well as productive development with a focus on upgrading and economic diversification will however be to foster the capacities of governments and public institutions. A substantial increase of funds available for trade policy and regulation as well as trade policy development under EU development cooperation programmes is thus necessary.

Designing an effective monitoring process for EPA implementation

Though the EPAs to varying degrees set up an institutional structure responsible for the implementation and review of the agreements, effective implementation should not be taken for granted. Effectiveness for our purposes entails in particular that the agreements reach their intended goal of fostering sustainable development of the African partner countries. Recent implementation experiences of sustainability chapters in EU FTAs point to a number of severe shortcomings that provide important lessons for EPA implementation. These shortcomings relate in particular to the following issues:

i. A lack of commitment by governments and public officials responsible for implementation. This can have diverse reasons. Government officials might constrain themselves to their narrow agendas only, e.g. trade officials only taking care of specific trade issues. Thus important linkages between the different dimensions remain out of the focus. Similarly, since sustainability chapters are considered the darling of parliaments and civil society, expectations for making progress on these issues are loaded onto civil society.

ii. Operational deficits in terms of supporting the work of civil society mechanisms, including in particular inadequate resourcing, infrequent meetings and insufficient influence. Given that the EU requires a high level of civil society engagement to ensure implementation of e.g. labour clauses and remedies for labour violations, trade unions and civil society actors as a result are confronted with rather high demands in terms of fulfilling this role. Particularly in LDC circumstances, the accomplishment of these tasks cannot be taken for granted, but necessitate strong capacity-building.

iii. Conceptual problems in terms of defining and agreeing upon the precise objectives of the monitoring and review exercises and its operationalization in terms of a suitable methodology. Depending on the specific politico-economic context of the agreement, differing and potentially incompatible objectives promoted by different stakeholders might emerge that severely hamper the work of the civil society mechanisms. In the CARIFORUM agreement, efforts to develop a methodological approach for monitoring the economic and social impacts of the agreement have just begun, i.e. ten years after its signature.

Given the weak institutional structures on a governmental and a civil society level in EPA partners, capacity building with respect to the implementation of the EPAs in terms of their economic, social and environmental dimensions will be of crucial importance. Based on the results of our analysis, it is our strong contention that EPA implementation will necessitate a priority for building institutional capacities at both government and civil society level, in addition to the private sector level. To this end, we propose to define a new budget line for EPA monitoring under Category 1 of EU Aid for Trade-programming, which will support the work of in particular ACP civil society as well as government institutions.

Conclusion

Though ratification is still pending in a number of African partner countries, it seems evident that for good or worse the EPAs will provide the regulatory framework for the economic relations between the ACP countries and the European Union for the medium-term future. Since the political debate on the future relationship between the EU and the ACP group of countries is currently gaining momentum, a key challenge for the Post-Cotonou governance architecture will consist in devising an appropriate implementation mechanism for the EPAs, which allows African partners to reap maximum benefits from the agreements.

Against the backdrop of negative, though small macroeconomic impacts in the short to medium term, for pro-developmental implementation EU policy-makers should prioritize three sets of measures: (i) mitigating adjustment costs on local labour markets and for public budgets via appropriate support mechanisms; (ii) promoting a long-term strategy of productive development, and (iii) fostering trade-related institutional capacities in the public sector and civil society, as well as setting up an effective monitoring process for EPA implementation.

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1 This policy note builds on the results of a comprehensive study (Grumiller et al. 2018a) conducted by the Austrian Foundation for Development Research (ÖFSE). The study focuses on three countries in Sub-Saharan Africa (SSA), which are each part of three regional EPAs – namely Mozambique (SADC-EPA), Ghana (ECOWAS-EPA) and Uganda (EAC-EPA). The economic assessment is based on simulations with the ÖFSE Global Trade Model, a structuralist Computable General Equilibrium model. The qualitative analysis on the agreement and its implementation challenges as well as the sector case studies draw on text and data analysis, a literature review and interviews in Ghana, Mozambique and Uganda.

2 The ECOWAS-EPA includes 16 countries of the Economic Community of West African States ECOWAS: Ghana (GH), Nigeria (NI), Côte d'Ivoire (CI), Senegal (SG), Benin, Burkina Faso, Cape Verde, Gambia, Guinea, Guinea Bissau, Liberia, Mauritania, Mali, Niger, Sierra Leone and Togo as well as Mauritania (combined as EC); (abbreviations in brackets indicates regional aggregation in model simulations).

The EAC-EPA includes all member of the East African Community: Uganda (UG), Kenya (KE), Tanzania (TA) and Rwanda (RA) and Burundi.

The SADC EPA includes only selected members of the Southern African Development Community: Mozambique (MO), South Africa (ZA), Botswana (BO), Namibia (NA) and Swaziland and Lesotho) (SL).

3 The European Union (EU) generally considers that a trade agreement must contain an overall level of trade liberalization equivalent to 90% of trade volume and tariff lines, respectively, in order to be WTO compatible. This outcome may also be the result of full liberalization on the one side (EU) and partial liberalization on the other side (EPA-regions).

4 Specifics on model and simulation design as well as detailed results are provided in Grumiller et al. 2018a.

5 Key policy recommendations on upgrading potentials for the sectors of mango, cocoa, olive-oil and textiles and apparel in specific African countries are also summarized in a series of ÖFSE Policy Notes, see https://www.oefse.at/en/publications/policy-notes/

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