Overseas Development Institute

Briefing Paper 6

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The 'Development Dimension': Matching Problems and Solutions

What must Economic Partnership Agreements offer if they are to be 'development agreements'?

Key points

- The Cotonou Partnership Agreement already provides an enabling framework for measures to improve the poverty reducing impact of trade – to contribute to poverty reduction EPAs must result in things happening that would not otherwise occur.
- If EPAs are to be 'developmental', they need to do more than merely increase trade as a share of GDP or promote economic growth.
- EPAs could improve on the Cotonou Partnership Agreement by supporting measures to improve supply capacity and enhancing the poverty reducing effects of increased trade.

Overseas Development Institute

ODI is the UK's leading independent think tank on international development and humanitarian issues.

Economic Partnership Agreements (EPAs) will provide a pragmatic fix for a WTO problem (see *Economic Partnership Agreements: Where We Are,* ODI Briefing Paper 4, June 2006) but their supporters claim much more for them than this: they will be 'development accords' allowing the parties to do things that have not been possible under the broad enabling framework of four Lomé Conventions and the Cotonou Partnership Agreement (CPA) – see Box 1. If EPAs were limited to trade liberalisation, the overall welfare effects would be positive according to the modelling that has been done, but the balance of gains and losses varies between countries and the results need to be treated cautiously both because key features of EPAs are unknown and because of limitations in the models (see *The Potential Effects of Economic Partnership Agreements: What Quantitative Models Say*, ODI Briefing Paper 5, June 2006).

What about the effects of a more ambitious EPA?

This Briefing Paper asks the questions: what are the problems common to the countries in the negotiating regions, and what sort of EPA provision would be appropriate to them? There is no doubt that the 30 year relationship has not produced the effects foreseen by the architects of Lomé 1. But what needs to change? What must EPAs offer if they are to be 'development agreements'? From what is known at present EPAs seem to be offering a solution to a problem that

Rwanda: Preparing marshland to grow oilseed crops.

is faced only by some ACP countries, and not necessarily the ones most likely to join.

ACP Marginalisation

At first sight, the EPA objectives seem relevant. On average, ACP countries have grown more slowly in recent years than other developing countries and have also been less integrated into international trade, as reflected in measures of trade openness such as the export-GDP ratio, or the Sachs and Warner trade policy index.[1]

Their trade pattern provides a stark illustration of the underlying problems. In 1975, when the first Lomé Convention was agreed, the ACP accounted for over six percent of the EU's trade with the rest of the world, and was second only to the Mediterranean as a regional partner from the developing world; three decades later, the

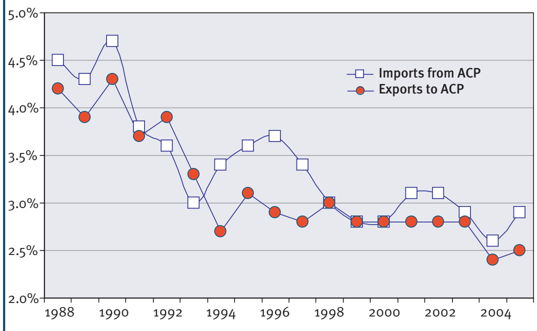
Box 1: What's already possible – without EPAs?

The objective of EPAs is to foster 'the smooth and gradual integration of the ACP States into the world economy...[and] to enable the ACP States to play a full part in international trade...to manage the challenges of globalisation and to adapt progressively to new conditions of international trade thereby facilitating their transition to the liberalised global economy.' (CPA Article 34:1-2) But these are also the objectives of the CPA which will continue to 2020 regardless of what happens with EPAs.

Like its predecessors the CPA already provides an enabling framework for almost everything that could be imagined as developmentally useful; how will an EPA expand upon it other than by requiring ACP liberalisation – 'reciprocity' in the jargon? The CPA sets the objective of economic and trade co-operation as achieving 'rapid and sustainable job-creating economic growth' (Article 20:1a) inter alia by enhancing 'the production, supply and trading capacity' of the ACP and 'their capacity to attract investment' (Article 34:2). Among the ways foreseen in the CPA to achieve these goals are: catalysing and leveraging flows of private savings (Article 21.2a); business development through finance and technical support (Article 21:3); support for agricultural production, and competitive industrial mining and energy sectors and trade development (Article 23).

The European Commission wants EPAs to cover services, investment, and other trade issues. But these are already covered in the CPA: it includes no concrete measures, but provides the framework within which such detail could be negotiated with interested ACP states. Implementation has inevitably fallen short of precept so there are many practical ways in which an EPA might improve upon the past. But without any detail it is not possible to know which opportunities will be grasped. All that is certain is that EPAs will differ from the status quo by incorporating reciprocity. Is this a sufficient – or even a necessary – solution to ACP problems?

Figure 1: EU trade with the ACP as a percentage of total extra-EU trade, 1988–2005



Source: derived from Eurostat data

share is less than half this level. The sharpest fall in the ACP's share of EU trade was in the late 1980s and 1990s; it has since stabilised with a recent upswing probably reflecting the commodity boom (Figure 1).

This fall has coloured the EPA debate. Unfortunately it does not reflect a diversification of ACP trade towards partners other than Europe (which would be a healthy trend): ACP trade with other countries mirrors that with the EU. Africa's share of global trade, for example, has fallen from about five percent in the 1960s to less than two percent now.

Nor has the fall been concentrated on just one or two ACP sub-regions. Once oil and diamonds are taken into account, the changes in regional trade shares are insufficient to support any claim that one region or another has avoided marginalisation between 1988 and 2003. There have been individual countries that have bucked the trend – especially when account is taken of services trade – such as Barbados, Botswana and Mauritius, but not entire regions.

The diversity within the ACP group (which is substantial – see Table 1) is as much within as between regions. To the extent that there are identifiable sub-groups with similar features it is between the least developed (LDC ACP) and the rest (non-LDC ACP). All the EPA regions contain both sub-groups (see *Economic Partnership Agreements: Where We Are,* ODI Briefing Paper 4, June 2006).

Relative performance

A majority of the countries in the LDC category belong to the ACP. It is this that has pulled down the ACP group averages. If we look only at non-LDCs, we see much smaller differences between ACP and non-ACP economic performance (see Table 2 cols 2 and 3). ACP states that are not LDCs have grown at about the same rate as other non-LDCs in recent years (1.5% vs. 1.6% per year). And they are more rather than less integrated into international trade, as reflected in a higher average export-GDP ratio during 2000-2004 (51% vs. 39%), and a higher average score on the Sachs-Warner index during the 1990s (67% vs. 57%). The picture painted is not one for which the EPA objective of 'integration ...into the world economy' is an obvious starting point.

When attention turns to the LDC ACP states the issues raised by the EPA debate on whether the ACP should liberalise (see *Economic Partnership Agreements: Where We Are,* ODI Briefing Paper 4, June 2006) seem more relevant. The ACP LDCs countries have on average grown more slowly than other LDCs, and are less integrated into international trade. But the sample of non-ACP states is very small and will be heavily biased by Bangladesh, which has performed relatively well.

Why distinguish between LDC and non-LDC states when there is, as is usually the case, a wide range within each of the groups (cols 2 and 4)? The answer is because the LDCs are among those least likely to join EPAs if the only change they offer from the status quo is 'reciprocity'. The duty-free treatment of LDC exports to the EU will not come to an end in 2007 because a continuation is provided under the Everything But Arms (EBA) regime (see *Economic Partnership*

Table 1: The ACP: a region of diversity

EPA sub-region	GDP (current $)		Debt (current $)		Foreign direct investment, net inflows (current $)		ODA and official aid (current $)	
	Total ($ million)	Per capita ($)	Total ($ million)	Per capita ($)	Total ($ million)	Per capita ($)	Total ($ million)	Per capita ($)
Caribbean	56,382	2,339	27,756	1,151	2,047	85	553	23
Central Africa	35,259	1,006	20,309	579	2,750	78	787	22
ESA	88,478	302	51,576	176	2,159	7	4,845	17
Pacific	8,194	1,058	3,095	400	141	18	641	83
SADC-minus	54,411	713	14,330	188	2,172	28	3,508	46
West Africa	130,613	502	60,633	233	2,211	9	3,840	15

Source: World Bank, cited by DG Trade (http://europa.eu.int/comm/trade/issues/bilateral/regions/acp/stats.htm)

Agreements: Where We Are, ODI Briefing Paper 4, June 2006) and nor will the non-trade provisions of the CPA. Unless an EPA can offer more, the very countries for which reciprocity may be a necessary part of the way forward may not join. There are ways in which an EPA can be made more attractive than EBA – but most are not automatic; the EU will have to accept innovations to which it has not yet agreed in the negotiations (see Box 2).

Trade and poverty

What EPAs might offer is assistance for laggards to emulate the more successful ACP states: the range of recent ACP growth rates and levels of trade integration is a striking feature of Table 2. What explains this variation – and how could an EPA address it? This is a difficult question to answer as there are likely to be various factors involved. But one thing seems clear: there is no obvious tendency for higher levels of trade integration among ACP countries to be associated with better growth performance (see Figure 2). Just as many countries with low or negative economic growth (measured on the vertical axis) have a high share of exports in GDP as a low one (on the horizontal axis).

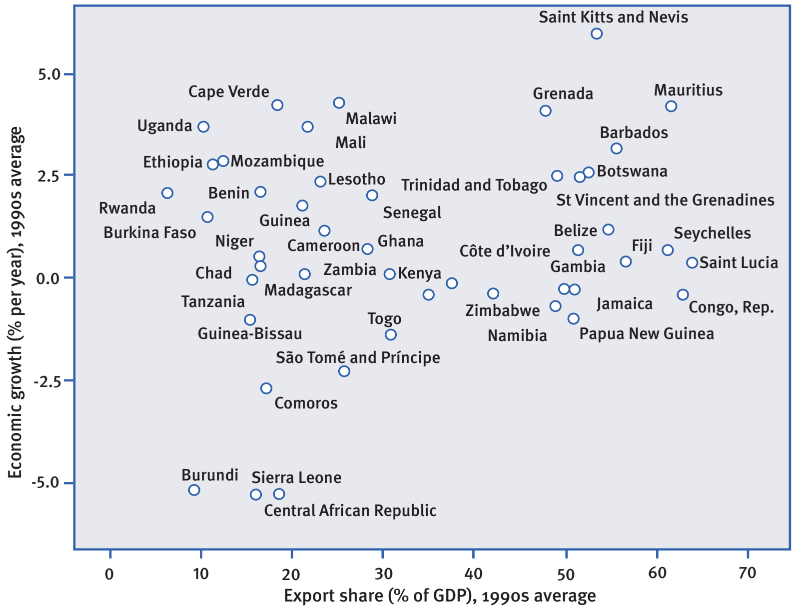
The implication is that 'reciprocity' is not a sufficient cure for ACP ills: if EPAs are to be 'developmental' they need do more than merely increase trade as a share of GDP. They also need to do more than just promote economic growth because there is wide variation among the ACP in the rate at which growth translates into poverty reduction: the so-called 'poverty elasticity of growth'. Most notably, this important parameter tends to be lower in those ACP countries with higher inequality, as evidenced by a lower share of total income received by the poorest 20% than it is in those with less inequality (see Figure 3).

EPAs must pay careful attention to the distribution of benefits from growth. Even the best designed trade reforms create winners and losers[2] but there are complementary measures which can ensure that the aggregate benefits from trade integration are widely and equitably shared. These range from broad-based unemployment insurance schemes, including public-works programmes, to more direct compensatory mechanisms targeted at firms and workers displaced by imports, including relocation assistance, wage subsidies, and training and business development schemes.

The most well-known example of a direct trade-related compensatory scheme is the Trade-Adjustment Assistance Programme (TAAP) in the United States. This programme provides assistance to workers who lose their jobs due to an increase in imports. It was established in 1962 and since then has provided benefits to approximately 2 million former workers in the textiles, electronics, autos and steel sectors (out of a total estimated eligibility of 3 million). Under the programme, workers can receive up to 18 months of financial assistance (in comparison with the standard 6 months of unemployment insurance), and additional financial assistance for training and relocation.[3]

Compensatory programmes such as the TAAP can increase political support for trade reform, with overall benefits for all. The main logistical difficulty with such schemes is determining eligibility, since it is difficult to attribute the source of job loss or firm closure to a specific factor such as trade reform. The alternative is a broad-based unemployment insurance system, a variety of which operate across countries. Contributory schemes are possible in cases where a large proportion of the labour force is engaged in the formal sector. Where a large proportion of the labour force remain in the informal sector, some combination of public works, cash transfers and/or price subsidies is more suitable.

Figure 2: ACP trade integration and recent growth performance



Notes: Sample includes 47 LDC and non-LDC ACP countries for which recent growth and export share data are available, except that Guyana (an obvious outlier) is omitted. Fitting a linear trend to these data yield a positive but statistically insignificant slope coefficient, with a corresponding R-squared figure of 0.03.

Putting a 'development dimension' in EPAs

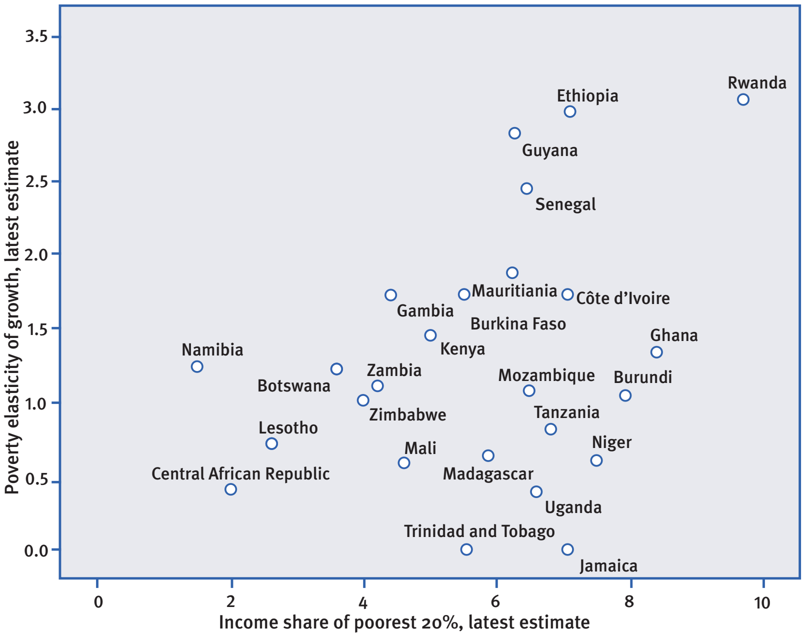
The CPA already provides an enabling framework for measures to improve the poverty reducing impact of trade. To contribute to the task (and not simply

Table 2: Relative performance of non-LDC ACP

	Non-LDC		LDC	
	ACP	*Non-ACP*	*ACP*	*Non-ACP*
Economic growth (% per year), most recent 7-year period				
- mean	1.5	1.6	0.4	1.9
- range	-1.0 – 6.2	-5.1 – 6.8	-5.3 – 4.3	-0.4 – 3.3
- no. of observations (missing values)	22 (3)	54 (21)	26 (13)	3 (6)
Export-GDP ratio (%), 2000-2004				
- mean	51	39	25	38
- range	14 – 94	3 – 118	8 – 77	15 –89
- no. of observations (missing values)	25 (0)	72 (3)	36 (3)	7 (2)
Sachs and Warner trade policy index (%), 1990-98				
- mean	67	57	30	36
- range	0 – 100	0 – 100	0 – 100	0 – 100
- no. of observations (missing values)	14 (11)	56 (19)	26 (13)	4 (5)

Notes: Figures refer to all low and middle-income countries included in the World Bank World Development Indicators database (100 in total). Economic growth is measured as the increase in GDP per capita in real terms (i.e. adjusted for inflation).

Figure 3: ACP poverty elasticity of growth



Notes: Sample includes 25 LDC and non-LDC ACP countries for which recent income distribution data are available. Correlation coefficient = 0.33.

Box 2: Making the development dimension binding

EPAs can offer something that the CPA does not: an increase in the certainty of aid delivery. This could break out of the sterile exchanges in which the ACP ask for more aid, the EU retorts that much past aid remains unspent, the ACP counter that this is because of unreasonable administrative requirements, to which the EU has its own reply – and nothing much happens. As the 'donor', the EU will always have the final say over aid delivery – but the conditionality in EPAs could be used to increase ACP influence.

Conventionally, EU trade agreements provide for specified tranches of liberalisation to occur on set dates, but as development agreements EPAs could go beyond this formula. All parties agree in principle that the ACP will need assistance, for example, to develop new sources of government revenue to replace the tariffs that are removed and to make the productive sector more competitive in order to face off cheaper imports. The timing of ACP liberalisation could be made conditional upon the effective delivery of such support. The EPA schedules could establish, for example, that an ACP state will remove tariffs on specified high revenue-yielding goods 'by 2015 or following the successful implementation of an EU-supported sales tax system whichever is later'. Or it could go even further and pledge the EU to provide compensatory budget support after 2015 if the sales tax system is not yet effective.

sidestep a WTO problem in the least disruptive way), EPAs must result in things happening that would not otherwise occur. 'Reciprocity' (the removal by the ACP of trade barriers on substantially all imports) will not produce such a result. For those ACP that are already relatively open it will have no major effect. For the others, the exclusion of some items and the likely deferral of cuts to other high tariffs until the end of a 12 (or even 20) year transition period means that change in the short to medium-term will be limited.

On this analysis, the 'development dimension' of EPAs is not a rhetorical flourish but the feature that will determine its impact. But given that so much is possible under the CPA, what more could an EPA do? So far the only discussion in the negotiations has been over the volume of aid. An increase may be desirable; but if so, an EPA is not needed to bring it about.

One way an EPA could improve upon the CPA is to increase certainty of implementation for the wide raft of measures needed to improve the supply capacity of the ACP and enhance the poverty reduction effects of any increased trade. Because the CPA allows almost everything (trade and non trade related) it commits the parties to nothing! What is missing is a binding commitment (for which there are several possible and combinable options) to ensure that the ACP receive in a timely fashion the resources they will need in the areas required 'to manage the challenges of globalisation and to adapt progressively to new conditions of international trade' – which is the stated aim of EPAs.

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Sources and Further Information

1. The Sachs and Warner index takes the value 0 if an economy was closed according to any one of the following criteria: it had average tariff rates higher than 40%; its non-tariff barriers covered on average more than 40% of imports; it had a socialist economic system; it had a state monopoly of major exports, and its black market premium exceeded 20% during either the decade of the 1970s or 1980s.
2. Bannister, G. and Thugge, K. (2001). International trade and poverty alleviation. IMF Working Paper 01/54, International Monetary Fund, Washington D.C.
3. Rosen, H. (2005). Trade-related labour market adjustment policies and programs, with special reference to textile and apparel workers. Trade Adjustment Assistance Coalition, www.taacoalition.com. The programme is fairly unique among OECD countries, although towards the end of 2005 the European Commission called for a similar programme to be implemented throughout the European Union, to be called the Globalisation Adjustment Fund.

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